



Implementation of State Auditor's Recommendations

**Audits Released in January 2005
Through December 2006**

Special Report to

*Senate Budget and Fiscal Review
Subcommittee #1—Education*

February 2007
Report No. 2007-406 S1

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CALIFORNIA STATE AUDITOR

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February 28, 2007

2007-406 S1

The Governor of California
Members of the Legislature
State Capitol
Sacramento, California 95814

Dear Governor and Legislative Leaders:

The Bureau of State Audits presents its special report for the Senate Budget and Fiscal Review Subcommittee No. 1—Education. This report summarizes the audits we issued during the previous two years that are within this subcommittee's purview. This report includes the major findings and recommendations, along with the corrective actions auditees reportedly have taken to implement our recommendations.

This information is also available in a special report that is organized by policy areas that generally correspond to the Assembly and Senate standing committees. This special policy area report includes appendices that summarize recommendations that warrant legislative consideration and monetary benefits that auditees could realize if they implemented our recommendations. This special policy area report is available on our Web site at www.bsa.ca.gov. Finally, we notify auditees of the release of these special reports.

Our audit efforts bring the greatest returns when the auditee acts upon our findings and recommendations. This report is one vehicle to ensure that the State's policy makers and managers are aware of the status of corrective action agencies and departments report they have taken. Further, we believe the State's budget process is a good opportunity for the Legislature to explore these issues and, to the extent necessary, reinforce the need for corrective action.

Respectfully submitted,

ELAINE M. HOWLE
State Auditor

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CONTENTS

Senate Budget and Fiscal Review Subcommittee #1—Education

Introduction 1

Education

Report Number 2005-133, Department of Education:
*Its Mathematics and Reading Professional Development
Program Has Trained Fewer Teachers Than Originally
Expected* 3

Report Number 2005-137, California Public Schools:
*Compliance With Translation Requirements Is
High for Spanish but Significantly Lower for Some
Other Languages* 9

Report Number 2005-104, Department of Education:
*Its Flawed Administration of the California Indian Education
Center Program Prevents It From Effectively Evaluating,
Funding, and Monitoring the Program* 13

**Report Number 2005-116, California K-12 High-Speed
Network:** *The Network Architecture Is Sound, but
Opportunities Exist to Increase Its Use* 19

Report Number 2004-120, Department of Education:
*School Districts' Inconsistent Identification and Redesignation
of English Learners Cause Funding Variances and Make
Comparisons of Performance Outcomes Difficult* 29

Student Aid Commission

**Report Number 2005-120, 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* 39

University of California

Report Number 2006-103, University of California:
*Stricter Oversight and Greater Transparency Are Needed to
Improve Its Compensation Practices* 49

INTRODUCTION

This report summarizes the major findings and recommendations from audit reports we issued from January 2005 through December 2006, that relate to agencies and departments under the purview of the Senate Budget and Fiscal Review Subcommittee No. 1—Education. The purpose of this report is to identify what actions, if any, these auditees have taken in response to our findings and recommendations. We have placed this symbol ☞ in the left-hand margin of the auditee action to identify areas of concern or issues that we believe an auditee has not adequately addressed.

For this report, we have relied upon periodic written responses prepared by auditees to determine whether corrective action has been taken. The Bureau of State Audits' (bureau) policy requests that the auditee provides a written response to the audit findings and recommendations before the audit report is initially issued publicly. As a follow-up, we request the auditee to respond at least three times subsequently: at 60 days, six months, and one year after the public release of the audit report. However, we may request an auditee provide a response beyond one year or initiate a follow-up audit if deemed necessary.

Unless otherwise noted, we have not performed any type of review or validation of the corrective actions reported by the auditees. All corrective actions noted in this report were based on responses received by our office as of January 2007.

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DEPARTMENT OF EDUCATION

Its Mathematics and Reading Professional Development Program Has Trained Fewer Teachers Than Originally Expected

Audit Highlights . . .

Our review of the Mathematics and Reading Professional Development Program (program) revealed that:

- Only a small percentage of mathematics and reading teachers have completed the full 120 hours of training for their current assignments.*
- School districts we surveyed cited several barriers to increased participation in the program, including teacher apathy toward attending training, concerns about funding, and a lack of training providers in close proximity. Nevertheless, school districts in counties with relatively large or small numbers of eligible teachers in various geographic regions throughout the State appear equally capable of accessing program services.*
- The Department of Education (Education) has done little to actively promote the program and currently relies on school districts to navigate its Web site to learn about and apply for the program.*

continued on next page . . .

REPORT NUMBER 2005-133, NOVEMBER 2006

The Department of Education's and State Board of Education's responses as of November 2006

The Joint Legislative Audit Committee (audit committee) requested that the Bureau of State Audits review the Mathematics and Reading Professional Development Program (program). Approved in 2001 (Chapter 737, Statutes of 2001), the program provides incentive grants to local education agencies that choose to send their teachers through standards-based instructional training. Under state law, the State Board of Education (board) adopts educational content standards and is responsible for approving the curriculum of providers wishing to train teachers under the program.

The audit committee asked us to review the board's and the Department of Education's (Education) policies and management practices to determine if they are consistent with the legislative intent of the program. Specifically, the audit committee asked us to assess the method used to track teachers' access to and participation in the program and the extent of any outreach efforts. The audit committee also asked us to identify the number of training providers that offer teacher development services and whether the board's approval process allows for a sufficient pool of training providers. Finally, the audit committee asked us to assess whether Education had adequate internal controls to track program expenditures and to identify any organizational, statutory, or regulatory impediments to the program.

Finding #1: Only a small percentage of teachers have completed the program for their current assignments, while limited data at Education and the school districts makes assessing the program's success difficult.

When the Legislature adopted the program in 2001, it envisioned that 176,000 teachers would receive training on the State's academic content standards over a four-year period. This target represented the majority of the 252,000 teachers statewide who were eligible for program-funded training at that time. Our survey of 100 school districts that participated in the program through fiscal year 2004–05, which represented 46 percent of the State's 398,000 eligible teachers as of January 2006, indicates that data exists at school districts to

- ☑ *Education has not ensured that program compliance audits are conducted in accordance with program statutes.*
- ☑ *Education's July 2005 report to the Legislature was of limited value because it lacked relevant and accurate data for gauging program outcomes.*
- ☑ *Education's ability to adequately track teacher participation in mathematics and reading training is complicated by the multiple funding sources involved and by reduced program-specific funding.*
- ☑ *The State Board of Education relied on the Sacramento County Office of Education to advertise and implement the program.*

substantiate that only 7,230 teachers have been fully trained. This amount represents roughly 3 percent of the 240,987 eligible teachers in school districts that had received program funds through fiscal year 2004–05. Further, 41 school districts from our survey, representing 105,764 teachers, could not readily tell us how many had completed the entire 120 hours of training. More than half of these 41 school districts indicated that they did not have enough information to report specifics about the number of teachers that had completed the training. We acknowledge that some of the teachers in these 41 districts may have completed part or all of the program. We also acknowledge that school districts have not likely been asked to provide complete information about the number of their teachers that have completed the program for their current teaching assignments.

Finally, we noted that Education's July 2005 report to the Legislature was of limited value because it lacks relevant and accurate data regarding the number of trained teachers that are currently using the training in the classroom and provides no correlation between teacher training and student achievement. Education's data collection process resulted in duplicated counts of teachers that had received, but not necessarily completed, program training. As a result, decision makers cannot gauge the progress being made toward accomplishing the program's goals and are ill-prepared to make future funding decisions. Education acknowledged that its report has limitations, stating as much in its report to the Legislature.

Given that only a small percentage of teachers have completed the full 120 hours of program training, and that teacher participation is voluntary, the Legislature should consider redefining its expectations for the program, clearly stating the number of teachers to be fully trained as well as any gains in student achievement expected. Based on how it defines the program's goals, the Legislature should consider making statutory changes to ensure that Education provides meaningful data with which to evaluate program success. Examples of meaningful program data include the following:

- Unduplicated counts of teachers who have completed the training with the aid of program and non-program funding, with a comparison of these figures to the total number of teachers who are eligible to participate in the program.
- Measures of the resulting gains in student achievement for teachers who have completed the program's training, such as higher student scores on standardized tests.

Legislative Action: Unknown.

Finding #2: School districts responding to our surveys cited a variety of reasons for low teacher participation rates.

During the audit we conducted two surveys, each comprised of 100 school districts, that either had or had not received program funding through fiscal year 2004–05. School district responses to both surveys indicated that participant districts and nonparticipant districts alike perceived similar barriers to increased teacher participation in the program. The barriers most frequently cited by school districts were teacher apathy towards the training, concerns about funding, and a lack of training providers nearby. The similarities in these results suggest an opportunity for Education and the board to take steps to improve the program.

We received 169 responses to our surveys of 200 school districts. Responses from 51 of the 169 school districts indicated that a lack of teacher interest was a barrier to greater teacher participation. Some districts indicated that their teachers felt the training program was too long or too closely tied to textbooks, as opposed to a broader focus on understanding state standards. In addition, 42 of the 169 school districts cited funding concerns, primarily related to the timeliness of payment or the amount of funding. Some school districts stressed that they must initially pay for program training with their own funds and then seek program payment from Education, which can take many months. We noted that the program’s payment process can be as long as four to six months for any single year’s first payment. Some of this delay is caused by Education’s need to wait for the board to approve annual certifications from school districts before making program payments.

The remaining barrier cited most frequently by school districts was the lack of training providers in close proximity to the school district. In particular, 33 of the 169 survey respondents cited this as a concern. Some respondents stated that rural school districts are placed at a disadvantage in obtaining training for their teachers because they have more difficulty accessing training providers. However, our review of program payments through fiscal year 2005–06 revealed that counties with relatively large and small numbers of eligible teachers in various geographic regions throughout the State appear equally capable of accessing program services.

To remove a barrier to increased teacher participation in the program, Education should explore opportunities to expedite its payment process to school districts. One such opportunity would be to seek legislation authorizing Education to approve the annual certifications submitted by school districts instead of waiting for board approval, thus removing any payment delay caused by the need to wait for the next board meeting.

Education’s Action: Pending.

Education indicated in its response to the audit report that it will explore the possibility of seeking legislation that would authorize it to approve the annual certifications submitted by school districts.

Finding #3: Education does little to encourage districts to participate in the program.

Education’s role in administering the program has essentially been limited to forwarding school districts’ annual application to the board for approval and to processing program payments. Although not specifically required to do so under the program’s statutes, Education has done little to actively promote the program. This lack of ongoing outreach may contribute to the low percentage of school

districts that have participated in the program, and may explain why nine of the districts that responded to our nonparticipant survey indicated that they were unaware of the program's existence or were confused about the eligibility or funding aspects of the program.

To ensure that school districts are aware of the program and that as many teachers participate in the program as possible, Education should conduct annual outreach activities to all school districts. A component of such an outreach program should include directly informing each school district of the amount of funding for which it is eligible each year.

Education's Action: Pending.

In its response to the audit report, Education indicated that it will continue to update its Internet Web site, including program information pages, frequently asked questions, and lists of eligible teachers and training providers. In addition, Education anticipates working with the board to develop an outreach plan. This plan will include annual letters to districts about the program, changes mandated by new legislation, and the available funding for the fiscal year.

Finding #4: Education has not taken the necessary steps to ensure that program compliance audits occur at school districts.

Education has not ensured that program compliance audits are conducted in accordance with program statute. Specifically, Section 99237 of the Education Code requires that annual financial and compliance audits of school districts include steps to ensure that teachers for whose training districts received program funding were, in fact, trained and that the training met program requirements. In addition, this section requires Education to withhold monthly apportionment payments to school districts to the extent that the results of audits reveal noncompliance with these requirements. Given this responsibility, we would have expected Education to take the necessary steps to ensure that these audits are actually taking place. However, discussion with Education staff revealed that such audits have likely never taken place because the compliance requirements have never been included in audit guides.

According to program statute, the compliance audits are to be performed by licensed local auditors, as opposed to Education's audit division, with the assistance of an audit guide specifying state compliance requirements. The Education Code, Section 14502.1, requires the State Controller's Office (controller), in consultation with the Department of Finance, Education, and representatives of specified organizations to propose the content of the audit guide and submit it to the Education Audit Appeals Panel for review, possible amendment, and eventual adoption. To Education's knowledge, the program's compliance requirements have never been included in the audit guide, and a controller representative confirmed that Education never informed that office of the program and its compliance requirements. As a result, Education has disbursed about \$113 million through fiscal year 2005–06 without ensuring the level of oversight required by statute.

To ensure that required compliance audits are occurring, Education should take steps to ensure that the program's compliance requirements are included in audit guides related to the annual audits of school districts.

Education's Action: Pending.

Education asserted in its response to the audit report that it has drafted the necessary program compliance requirements for consideration by the controller and Education Audit Appeals Panel for inclusion in the audit guide.

Finding #5: The board did not obtain approval from the Department of General Services for program-related contracts with two county offices of education.

Our audit noted that the board relied on two county offices of education for various program functions, including the development of criteria for evaluating training providers and the facilitation of the evaluation of curricula submitted by potential training providers. To provide these services, the board, acting through Education, entered into various contracts with the Sacramento County Office of Education and Orange County Department of Education. According to state law, all contracts entered into by state agencies, except those meeting certain exemptions, are not in effect unless and until approved by the Department of General Services. The board did not obtain the required approvals before the beginning of the contract term for all three program-related contracts and related amendments requiring approval. As a result, the board exposed the State to potential liability for work performed before the contract was approved.

To ensure that it does not expose the State to potential liability for work performed before the contract is approved, the board should ensure that it obtains the Department of General Services' approval of its contracts and amendments before the start of the contract period and before contractors begin work.

Education's Action: Corrective action taken.

In its response to the audit report, the board indicated that Education's procedural revisions to its contracting process, which it had implemented since the time of the program-related contracts referenced in the audit report, has had a profound effect on eliminating late contracts. Specifically, Education's Contracts and Purchasing Unit requires staff to submit contract request forms 60 days prior to the start of the contract. The board also cited an administrative order by the Department of General Services, clarifying the general policy on the timely submission of contracts and the circumstances under which contracts can be approved after the start date.

CALIFORNIA PUBLIC SCHOOLS

Compliance With Translation Requirements Is High for Spanish but Significantly Lower for Some Other Languages

Audit Highlights . . .

Our review of the California Department of Education's (department) and California public schools' compliance with California Education Code, Section 48985 (state translation requirements) revealed the following:

- Compliance with the state translation requirements is high for Spanish, but significantly lower for some other languages.*
 - Some schools are unaware of this state law or may use incorrect methods to identify languages that require translations. In addition, some schools believe there is little demand for translated notices.*
 - Although the department has a process that may assist schools in meeting these requirements, recently enacted legislation requires it to take a larger role in ensuring that schools comply with the state translation requirements.*
 - The department created an electronic clearinghouse for multilingual documents, but it has not achieved much participation from school districts.*
-

REPORT NUMBER 2005-137, OCTOBER 2006

California Department of Education's response as of January 2007

The Joint Legislative Audit Committee (audit committee) requested that the Bureau of State Audits determine whether the California Department of Education (department) and California public schools are in compliance with California Education Code, Section 48985 (state translation requirements). This code section requires that when 15 percent or more of students enrolled in a public school speak a single primary language other than English, all materials sent to the parent by the school or school district must be provided in that language as well as in English. Specifically, the audit committee requested that we identify and evaluate the department's role, if any, in informing local education agencies of the state translation requirements and in monitoring and ensuring their compliance with these requirements. The audit committee also asked us, to the extent possible, to determine how pending legislation would affect the department's distribution of information and oversight of local education agencies' compliance with state translation requirements. Finally, the audit committee asked that we select a sample of districts or schools and identify and evaluate measures taken to include parents in their children's education, the process through which schools meet the state translation requirements, and the extent to which schools comply with these requirements. We found that:

Finding #1: Some districts do not perceive a demand for translations and the home language survey may overstate the need for translations.

About half of California's 10,100 public schools had at least one primary language that required translations in fiscal year 2004-05, and we found that compliance for fiscal year 2005-06 was high for Spanish. Specifically, a survey requesting information about certain notices schools send to parents that we sent to 359 schools, to which 292 schools responded, indicated that schools are providing required Spanish translations for 4,136 of 4,534, or 91 percent of the notices for which we received responses, while for 1,134 notices we did not receive a response. However, compliance rates drop significantly for some of the languages other than Spanish. For example, our survey indicates

that schools are providing Mandarin and Hmong translations for only 54 percent and 48 percent, respectively, of the notices for which we received a response. We did not receive responses regarding the translations of 36 and 18 notices in Mandarin and Hmong, respectively. We found a variety of reasons for these lower compliance rates. For example, 16 percent of the survey respondents were not aware of the state translation requirements. In addition, some schools may not be meeting state translation requirements because their districts may use incorrect methods to identify the languages requiring translations.

As indicated by the results of our site visits, some school districts do not comply with state translation requirements because they believe there is little demand for translated notices. For example, San Diego Unified School District (San Diego) asserted that the main reason it stopped translating documents into Tagalog was a lack of requests for Tagalog translations from schools. Furthermore, although Tagalog was the primary language spoken at home by nearly 40 percent of the students enrolled at San Diego's Mary McLeod Bethune Elementary School during fiscal year 2004–05, a survey initiated by the principal in June 2006 resulted in only 5.6 percent of parents requesting that notices be sent home in Tagalog. Similarly, Cupertino Union Elementary School District generally does not provide Mandarin translations, even though this primary language is spoken by at least 15 percent of the students at several of its schools, because it perceives little demand for these translations. Finally, two districts indicated that in addition to low demand, some parents actually resented receiving translated documents. For example, both San Diego and Fountain Valley School District recalled instances in which parents had called the district to complain that they did not want to be sent translated documents in Tagalog and Vietnamese, respectively.

School districts should use a home language survey developed by the department to determine each student's primary language. Specifically, when parents enroll their children in a new school, the school district should administer the home language survey, which contains a series of questions to assist the school district in identifying the primary language spoken at home. However, the home language survey may overstate the need for translations because it does not account for parents who are fluent in English. The survey was designed to identify the primary language that a student speaks at home and to determine whether the district must assess the student's English proficiency using the California English Language Development Test. It was not designed to identify those parents who are bilingual. Consequently, this tool may overstate the need for translations for those parents whose primary language is not English but who are also fluent in English. Nevertheless, it is inappropriate for districts to assume that there are no parents who need documents translated into the languages that meet the 15 percent threshold under state law. Without asking parents whether they require translations, districts and schools have no way of knowing what the actual demand is and therefore cannot justify sending documents home in English only.

To ensure that translated notices are sent only to parents who need them, the department should modify the home language survey to include a question asking parents to indicate the language in which they would like to receive correspondence. To ensure that this modification does not conflict with current law, the department should seek legislation to amend state law to allow parents to waive the requirement that they receive translated materials in their primary language when they do not need such translations.

Department's Action: Partial corrective action taken.

The department reports that its program offices that oversee or provide input to the home language survey are coordinating efforts to modify the survey to include a question asking parents to indicate the language in which they would like to receive correspondence and whether they elect to waive the receipt of translated materials. If deemed necessary, the department will seek legislation to amend state law to modify the requirements pertaining to the home language survey. The department expects to implement this recommendation by May 2007.

Finding #2: Although not extensively utilized, the clearinghouse for multilingual documents could become a useful tool.

Pursuant to state law, the department created an Internet-based electronic clearinghouse for multilingual documents (clearinghouse) on which local education agencies and the department can post links to translated parental notices. The purpose of the clearinghouse is to provide increased access to translated documents, to assist local education agencies in meeting legal requirements for parental notification, and to reduce redundancy in document translation work. Launched in September 2005, the clearinghouse is an online resource designed to help local education agencies locate, access, and share parental notification documents that have been translated into languages other than English. Through the clearinghouse, local education agencies voluntarily provide information regarding translations they have made and are willing to make available to others. The department hosts the clearinghouse on its Web site.

Despite the department's efforts to promote the clearinghouse, it has not achieved much participation from school districts. Specifically, 12 school districts and the department had posted links to translated notices on the clearinghouse as of mid-September 2006. In addition, 80 percent of the 230 translated documents available through the clearinghouse were available only in Spanish as of mid-September 2006. The value of the clearinghouse as a resource cannot truly be achieved without greater participation from school districts.

To increase the value of the clearinghouse as a resource for translated parental notices, the department should encourage school districts to form coalitions for the purpose of leveraging their combined resources to translate standard parental notices into the languages they have in common. In addition, the department should consider using its available funding to encourage districts to upload links to their translated documents, especially in languages that are currently underrepresented in the clearinghouse.

Department's Action: Partial corrective action taken.

The department reports that it plans to send letters to school districts that will include information about forming translation consortia. In addition, the department plans to inform school districts about new reports that contain data by language group that will help them identify other districts with common translation needs. The department will make these new reports available on its Web site. Finally, the department states that it will consider using available clearinghouse funding to encourage school districts to participate in the clearinghouse. As part of this effort, the department will determine whether clearinghouse funds can be spent in this manner in light of existing provisional language contained in the budget act.

DEPARTMENT OF EDUCATION

Its Flawed Administration of the California Indian Education Center Program Prevents It From Effectively Evaluating, Funding, and Monitoring the Program

REPORT NUMBER 2005-104, FEBRUARY 2006

Audit Highlights . . .

Our review of the management of the California Indian Education Center program (program) by the Department of Education (department) found that:

- Because the department has largely ignored the existing guidance for administering the program, it cannot ensure that the program is successfully meeting the established goals or the needs of the communities it serves.*
- The department did not ensure that California Indian Education Centers (centers) reported all the annual data required by law to measure performance.*
- The department has no record of the centers' assessments of needs called for by the guidelines adopted by the State Board of Education and thus has no way of knowing whether the services the centers assert they provide are those most needed by the populations they serve.*

continued on next page . . .

Department of Education's response as of October 2006

The Joint Legislative Audit Committee (audit committee) requested that the Bureau of State Audits review the Department of Education's (department) administration of the California Indian Education Center program (program), how it determines funding for the California Indian Education Centers (centers), and how it evaluates them. Specifically, the audit committee asked us to determine the department's roles and responsibilities related to the centers and to review and evaluate the department's existing policies, procedures, and practices for administering the program and monitoring the centers. The audit committee was also interested in any written procedures the department has developed to guide program administration. In addition, it asked us to review the department's funding structure for the program and how it appropriates funds to administer the program.

Further, the audit committee requested that we assess the reasonableness of the department's uses of program funds; determine whether it has directed sufficient resources to the program in general and sufficient management attention to completing the program evaluation report that was due to the Legislature on January 1, 2006; and review the department's document retention policies and practices. Finally, the audit committee asked us to review and evaluate the department's process for allocating and disbursing funds to the centers. We found that, despite established guidance, the department has not adequately administered the program and consequently cannot ensure that the program is successfully meeting the goals established in law or the needs of the communities it serves.

Finding #1: The department does not know how the program is performing.

Despite established guidance, the department has not adequately administered the program and consequently cannot ensure that the program is successfully meeting the goals established in law or the needs of the communities it serves. To address the challenges facing

- ☑ *Though submitted to the Legislature on time, the department's evaluation of the program lacks sufficient analysis to adequately support its recommendations to improve the program.*
 - ☑ *The department is unable to justify its basis either for selecting centers to receive funding or for determining the annual amount of funding it grants each center.*
 - ☑ *The department has not always promptly disbursed funds to the centers.*
 - ☑ *The department lacks a monitoring process to ensure that centers spend funds appropriately, pursue program goals, and report accurate data.*
-

American Indian students enrolled in California's public schools—low academic achievement at all grade levels, high dropout rates, and few students continuing their education beyond high school—the Legislature established the program in 1974. The legislation indicated that the centers should serve as educational resources for American Indian students, their parents, and the public schools. In addition, to guide the operation of the centers, the Legislature established a set of goals, such as improving the academic achievement, self-concept, and employment opportunities of American Indian students and adults. From its initial 10 centers funded by a total of \$400,000 in grants, the program has grown to comprise 30 centers that annually receive more than \$4.4 million in total funding as of fiscal year 2005–06. If not reauthorized, the program is set to end on January 1, 2007.

The department is required by state law to administer and oversee the program and receives guidance from legislation as well as internal policies. For instance, state law requires the department to collect data annually to measure the academic performance of the students the centers serve and how well the centers are meeting the goals established by law. Additionally, although no regulations govern the program, state law requires the State Board of Education (board) to adopt guidelines for selecting and administering the centers. The guidelines the board adopted in 1975 require, among other things, that centers design their programs after assessing the needs of their respective communities. Internal guidance comes from the department's 2001 Grant Administration Handbook (handbook), which guides the administration of programs funded by grants similar to those used in this program. The handbook stipulates that the department establish a competitive process to objectively select grant recipients, a monitoring plan to ensure that grant recipients appropriately implement the program, and a document retention and filing process to effect stable program administration and clear communication between the department and the centers.

However, the department has largely ignored the existing guidance for administering the program and therefore has little means of determining program effectiveness. For example, until 2005 the department did not ensure that centers reported the annual academic performance data of their students.

Another indication of the department's flawed administration of the program is its inability to fully justify its basis either for initially selecting centers to receive funding or for determining the annual amount of funding it grants each center. According to the handbook, it should select grant recipients following a competitive process, which

includes an objective scoring methodology and independent raters. However, the department could not demonstrate that it used a competitive process to select the most recent centers currently funded. Further, although program staff state that the department's sole basis for computing the amount that each center receives is the amount granted in the previous fiscal year, it has not consistently followed that method.

Further, the department has not always promptly disbursed funds to the centers. Despite the department's informal policy that it would issue the first of three annual installment payments to centers with approved applications an estimated six to 10 weeks after the governor signs the state budget, in fiscal year 2003–04 the centers did not receive their first grant allocations until December—18 weeks after the budget was approved.

Finally, the department lacks a monitoring process to ensure that centers spend funds appropriately, pursue program goals, and report accurate data to the department. Without operating policies and procedures outlining how staff should consistently administer the program, the department may create confusion among the centers. The department indicates that it is attempting to improve its administration of the program by proposing more detailed legislation to reauthorize the program and by developing a plan for monitoring the centers, but these efforts are too preliminary for us to assess.

To ensure that it administers the program clearly, consistently, and effectively, we recommended that the department develop operating policies and procedures specific to the program and train staff in their application. The policies and procedures should include the following:

- A description of the data that centers must annually report to measure program performance and a standardized format for reporting to allow the department to effectively aggregate and consolidate the data for reports to the Legislature and other interested parties. Further, the department should outline the consequences for failing to submit the data.
- An equitable process to select centers to receive grant awards and determine their respective funding amounts.
- A set time frame that it adheres to for disbursing payments to the centers once their applications are received and approved. The time frame for the first payment can be expressed as a set number of weeks after enactment of the state budget for centers with approved applications.
- A centralized filing system that contains all documents pertinent to the grant program, including documentation of the technical assistance provided to the centers.
- A monitoring process and plan to ensure that reported fiscal and program information is accurate and complete, including a process for corrective action and departmental follow-up for noncompliance.
- A set schedule indicating how long program records are to be kept.

Department's Action: Partial corrective action taken.

According to the department, there is legislation (SB 1710) that, when enacted on January 1, 2007, will change the program's application and reporting requirements beginning in fiscal year 2007–08. In the interim, the department adopted certain operational policies and procedures that included:

- Developing the fiscal year 2006–07 application packets that instruct the centers on what they are required to report. Training on the application process was provided to center directors in January and May 2006.
- Revising the end-of-year report to address all statutory reporting requirements after receiving input from the center directors. The report was designed so that the information could be aggregated and consolidated, and clear consequences were communicated for failure of the centers to report the information required.
- When SB 1710 is enacted, the department stated it would follow policies and procedures in accordance with the new statute for selecting centers to receive grant awards and determine funding amounts.
- The department indicated that it had included set time frames within which it would make periodic payments to the centers in a letter to the centers' directors. However, the letter to which the department refers does not contain this information.
- Establishing a centralized filing system for the center grant program.
- Scheduling 10 centers for monitoring visits during fiscal year 2006–07. The department was silent concerning a process to ensure corrective actions are taken when needed and followed-up for compliance.
- Approving a record retention schedule that indicates how long various records will be retained.

Finding #2: With staff unaware of guidelines requiring needs assessments, the department does not know if centers have designed their programs to meet community needs.

The department has no record of the centers' needs assessments on file and thus has no way of knowing whether the services the centers assert they are providing are the services most needed by the populations they serve.

To ensure that centers use program funds effectively, we recommended that the department ensure that they periodically conduct needs assessments as required by the guidelines adopted by the board.

If the Legislature decides to reauthorize the program, we recommended that it consider requiring annual or biannual reports from the department to monitor the progress of the program and supplement the report the department submitted to the Legislature by the due date of January 1, 2006. Alternatively, the Legislature might want to extend the life of the program in one- or two-year increments to augment the data available for evaluation.

Department's Action: Pending.

When SB 1710 is enacted, the centers will be required to conduct and submit the results of a needs assessment as part of the 2007 through 2012 application cycle.

Legislative Action: None.

The Legislature did not choose to implement our suggestions regarding our recommendation for considering requiring the department to submit annual or biannual reports monitoring the progress of the program or, alternatively, extending the program in one- or two-year increments.

CALIFORNIA K-12 HIGH-SPEED NETWORK

The Network Architecture Is Sound, but Opportunities Exist to Increase Its Use

REPORT NUMBER 2005-116, JANUARY 2006

The Department of Education's response as of January 2007

Audit Highlights . . .

Our review of the California K-12 High-Speed Network (High-Speed Network) found that:

- The State most likely spent less on the building and operation of the High-Speed Network by expanding the existing infrastructure used by the University of California and other higher education institutions than it would have spent for a separate network with comparable services.*
- A study conducted by our technical consultant in 2005 found that the High-Speed Network has adequate bandwidth for potential growth but is not overbuilt. Furthermore, our technical consultant found no compelling technical or financial reason to abandon the existing High-Speed Network.*
- Because of the lack of specific performance measures in state law and because the Imperial County Office of Education (ICOE), which currently administers the project, is in the early stages of developing a suitable plan for measuring the success of the High-Speed Network, it is difficult to determine whether the network accomplishes the Legislature's goals.*

continued on next page . . .

The California K-12 High-Speed Network (High-Speed Network) connects the vast majority of kindergarten through 12th grade (K-12) schools, school districts, and county offices of education statewide to each other, to California's universities and community colleges, and to various Internet service providers that provide access to the commodity Internet. The Joint Legislative Audit Committee (audit committee) requested the Bureau of State Audits (bureau) to determine whether the State is efficiently using its resources by supporting the maintenance of the High-Speed Network. Specifically, the audit committee asked the bureau to determine the roles and responsibilities of the various entities involved since the inception of the High-Speed Network project, to identify the network's funding sources and determine whether there are any limitations or restrictions on the use of this funding or on the disposition of unused funds, and to review the methods used to allocate the costs of the High-Speed Network to determine if they are reasonable. In addition, the audit committee instructed the bureau to review the cost, usage, and, to the extent possible, benefits of the High-Speed Network and to determine whether these costs and benefits are comparable to those of other Internet service providers. The audit committee also directed the bureau to examine any information the State, consortium, or other entity has used to determine whether the benefits of the network outweigh its costs. Further, the bureau was asked to evaluate the reasonableness of any options or plans the State or consortium of county offices of education considered to maximize the use of the High-Speed Network. Moreover, the audit committee requested that the bureau determine the ownership rights to purchases made or services related to the High-Speed Network, including but not limited to intellectual property rights and how the State may exercise those rights. Finally, the bureau was asked to review and evaluate the laws, rules, and regulations significant to the objectives stated above.

Finding #1: From the beginning, state law has provided limited guidance and oversight for the High-Speed Network project.

Between fiscal years 2000–01 and 2003–04, the budget control language that appropriated more than \$93 million to the University of California (UC) for the High-Speed Network stated only that the purpose of the funding was for “expanding the Internet connectivity and network infrastructure

☑ *As of June 30, 2005, the Corporation for Education Network Initiatives in California (CENIC), the nonprofit that built and currently operates the network, held \$13.6 million in High-Speed Network funds and it expects to receive an additional \$3.6 million related to telecommunication discounts in fiscal year 2005–06. These funds are being used to keep the network operating in fiscal year 2005–06 or are held for future equipment replacement.*

☑ *Opportunities exist for ICOE to strengthen its agreements with CENIC to better protect the State's interests. Specifically, its agreements lack detailed service-level agreements, do not ensure that it retains ownership of tangible nonshared assets, and do not ensure that interest earned on advance payments made to CENIC or funds held by CENIC on its behalf accrue to the benefit of the High-Speed Network.*

for K-12.” This budget control language did not impose any more specific requirements or controls on the expenditure of these funds, nor did the Legislature enact legislation to further define the parameters of this project or what was meant by “Internet connectivity and network infrastructure for K-12.” Therefore, it is difficult to determine if the Legislature got what it sought in appropriating the funds.

In the Budget Act of 2004, the Legislature effectively transferred the responsibility for managing the Internet connectivity and infrastructure for K-12 educational institutions from UC to the California Department of Education (Education). Although the Legislature shifted control of this project from UC to Education and ultimately to the Imperial County Office of Education (ICOE), it still has not enacted legislation that clearly prescribes the goals to be accomplished using these funds. Until legislation is enacted, Education cannot be certain that the design and use of the High-Speed Network are achieving the Legislature’s desired outcomes.

We recommended that to ensure that the High-Speed Network meets its expectations, the Legislature should consider enacting legislation that prescribes the specific goals and outcomes it wants from the High-Speed Network project.

Legislative Action: Legislation enacted.

Legislation (Assembly Bill 1228) was enacted on September 28, 2006, that requires the Superintendent of Public Instruction (Superintendent) to, among other things, establish a High-Speed Network advisory board. The legislation requires the advisory board to meet quarterly and to recommend policy direction and broad operational guidance to the Superintendent and the Lead Education Agency responsible for administering the High-Speed Network on behalf of the Superintendent. The advisory board, in consultation with the Lead Education Agency, shall develop recommendations for measuring the success of the network, improving network oversight and monitoring, strengthening accountability, and optimizing the use of the High-Speed Network and its ability to improve education. The advisory board shall report its recommendations to the Legislature, the governor, the Department of Finance, the Legislative Analyst’s Office, and the Office of the Secretary for Education by March 1, 2007. It is the Legislature’s intent that the report identifies and recommends specific annual performance measures that should be established to assess the effectiveness of the network.

Finding #2: The current agreement between ICOE and the Corporation for Education Network Initiatives in California (CENIC) could be strengthened to better protect the State's interests.

UC contracted with CENIC to carry out the High-Speed Network project. After its selection as the lead agency in 2004, ICOE entered into agreements with CENIC under terms that were substantially similar to UC's agreement. The first was executed December 1, 2004, and the second was executed June 24, 2005, and became effective July 1, 2005, after the first agreement expired. Both agreements continue to lack service-level agreements. A service-level agreement describes the specific level of service a vendor is required to provide and typically provides a penalty if that level is not provided. The lack of a service-level agreement makes it difficult to monitor CENIC's performance. Additionally, the agreements fail to contain provisions that fully address the issue of the State's ownership of assets and that require CENIC to limit the use of interest earned on advance payments it receives related to the High-Speed Network.

We recommended that to ensure that the High-Speed Network is appropriately managed, Education should ensure that ICOE does the following:

- Develops a comprehensive and extensive set of service-level agreements based upon applications to be delivered via the High-Speed Network project.
- Requests that CENIC provide a master service-level agreement for its review.
- Includes the appropriate service-level agreements in its ongoing contracts with CENIC and other service providers for the High-Speed Network, using industry standards.

To ensure adequate protection of the State's interest in tangible, nonshared assets, we also recommended that Education should direct ICOE to transfer ownership of those types of assets to the State, to the extent that ICOE is able to bargain for the provision.

Finally, we recommended that to ensure that the interest earned on advance payments made to CENIC are used to benefit the High-Speed Network, Education should direct ICOE to amend its agreement with CENIC to stipulate the allowable use of the interest earned.

Education's Action: Corrective action taken.

Legislation (Assembly Bill 1228) was enacted on September 28, 2006, that requires the Lead Education Agency to enter into appropriate contracts for the provision of high-speed, high-bandwidth Internet connectivity, provided such contracts secure the necessary terms and conditions to adequately protect the interests of the State. The terms and conditions are to include, but are not limited to, all of the following:

- (a) Development of comprehensive service level agreements.
- (b) Protection of any ownership rights of intellectual property of the State that result due to its participation in the High-Speed Network.
- (c) Appropriate protection of state assets acquired due to its participation in the High-Speed Network.
- (d) Assurance that appropriate fee structures are in place.
- (e) Assurance that any interest earned on funds of the State for this purpose are used solely to the benefit of the project.

Education stated that ICOE has not entered into any agreements with service providers, and that, if and when it does, those agreements will include the appropriate service-level agreement terms. Education also stated that ICOE and CENIC have reached agreement on both a master-service level agreement and a service-level agreement for the services CENIC delivers to the High-Speed Network. Our review of the first amendment to the master agreement executed by ICOE and CENIC on January 30, 2007, found that the amendment does contain these provisions. Additionally, the amendment contains language that will require CENIC to transfer ownership of tangible non-shared assets to the State if CENIC ceases to serve K-12 entities. Finally, Education reported that fiscal year 2006–07 budget control language requires “any interest earned on state monies is used for operating the CalREN serving the UC, CSU, CCC, and K-12 segments. Any segment-specific cash reserves held by CENIC for an individual segment shall be held separately and accrue interest to that segment.” The amended agreement between ICOE and CENIC stipulates that interest earned be used in accordance with this budget control language.

Finding #3: CENIC’s charges for commodity Internet use could have been lower.

CENIC provides connections to Internet service providers, enabling High-Speed Network users to access the commodity Internet. Although the annual fees it charges for this access are lower than state negotiated pricing, it could further reduce the amount it charges users by consistently using funds left over from prior-year fees to offset the next year’s cost of providing the service.

CENIC’s commodity Internet service, which became effective during fiscal year 2002–03, has generated a surplus each year; as of June 30, 2005, this surplus was \$2.1 million. The commodity Internet service model approved by its board in June 2001 specifically states that the fixed rate charged per unit of commodity Internet usage should be set to enable CENIC to recover the entire cost of providing the services, should be reviewed semiannually, and should be adjusted downward if cost recovery is projected to be excessive. CENIC did use a portion of its fiscal year 2002–03 surplus revenues to reduce its per-unit rate in fiscal year 2003–04 by 38 percent. For fiscal year 2004–05, however, although CENIC reduced its per-unit rate by a further 25 percent compared to its fiscal year 2003–04 per-unit rate, it did not use the surplus revenues to do so. It achieved its reduction by reducing its estimated annual costs and increasing the minimum usage commitments for commodity Internet service for certain users. We believe that further reductions would have been possible if CENIC had also used a portion of the surplus.

We recommended that to ensure that CENIC’s per-unit rate for access to the commodity Internet is closer to its actual cost to provide the service, Education should require ICOE to amend its agreement with CENIC to stipulate that to the extent possible, CENIC should use its surplus Internet service program revenues from each year to offset the per-unit rate that it sets the following year. ICOE should also stipulate in its agreement that if CENIC is unable to apply the surplus revenue due to a change in its financial position, that CENIC should provide ICOE with documentation to support its inability to do so.

Education’s Action: Corrective action taken.

Education reported that ICOE is currently a participating member of CENIC’s Business Advisory Council and board. Additionally, K-12 representatives are participating members of CENIC’s audit and finance committees. Education believes that this participation on behalf of K-12 provides equal input (compared with other public segments participating in CENIC) into CENIC’s decisions regarding rates and the use of surplus revenues. Finally, the first amendment to the master

agreement executed by ICOE and CENIC indicates that for fiscal year 2006–07 CENIC now recovers the fixed portion of commodity Internet costs using a flat rate contribution by the participating entities. Consequently, CENIC was able to reduce its per-unit rate for the entities' actual usage of the commodity Internet from \$95 to \$29, a reduction of almost 70 percent.

Finding #4: CENIC has a portion of the High-Speed Network's funds in its consolidated equipment replacement account.

During its September 12, 2002 meeting, CENIC's board approved the following three action items related to the High-Speed Network funds held by CENIC for equipment replacement: (1) the creation of a consolidated designated equipment replacement account as part of its CalREN account, the transfer of \$5.7 million in High-Speed Network funds from an account designated solely for the High-Speed Network into this new account, and the transfer of future High-Speed Network equipment replacement funds into this new account; (2) the transfer of \$970,000 of the interest income in an account designated solely for the High-Speed Network into the consolidated designated equipment replacement account; and (3) the transfer of \$6 million from the consolidated designated equipment replacement account into a one-year certificate of deposit with a bank, the borrowing of \$6 million from the same bank, and the use of the certificate of deposit as collateral against the loan. According to CENIC's accounting records, on June 30, 2004, an additional \$1.5 million was placed into the consolidated designated equipment replacement reserve account using state appropriations for the High-Speed Network.

The board's decision to include the High-Speed Network's equipment replacement funds into a consolidated account appears inconsistent with CENIC's agreement with UC, which requires CENIC to set up and use a separate financial account for the High-Speed Network funds and to not use that account to hold or disperse any other funds. The purpose of establishing a separate financial account for the High-Speed Network funds is to ensure that these funds are being used to benefit the project. The transfer of these funds to CENIC's consolidated account makes it difficult to identify those funds belonging to the High-Speed Network.

Further, CENIC could not provide us with a technology refresh plan. An effective technology refresh plan establishes the points along the service life of a product or system at which it is optimal to change system components. Without a technology refresh plan, we do not believe CENIC can support its assertion that it needs the full \$7.2 million, or that only \$4.9 million represents funds for the replacement of equipment specific to the High-Speed Network.

Finally, although CENIC is holding \$7.2 million in High-Speed Network funds for equipment replacement, any interest earned on this money does not accrue to the benefit of the High-Speed Network. Specifically, its agreement with ICOE does not contain a provision that limits the use of any interest earned on state appropriations to the High-Speed Network. By including this provision in its agreement, ICOE can ensure that the project benefits directly from any interest earnings.

To ensure that High-Speed Network equipment replacement funds are used to benefit the K-12 education community, we recommended that Education should direct ICOE to request that CENIC reestablish a reserve for equipment replacement that is in an account solely for the High-Speed Network. Further, CENIC should consult with ICOE on the development of a technology refresh plan, which ICOE should use to establish its own equipment replacement funds for the High-Speed Network. Finally, ICOE should amend its agreement with CENIC to stipulate that interest earned on the funds held in the High-Speed Network's equipment replacement account accrues to the benefit of the High-Speed Network.

Education's Action: Corrective action taken.

Our review of ICOE's amended master agreement with CENIC found that it requires K-12 equipment replacement funds to be segregated into a separate account. Additionally, ICOE and CENIC developed a 2006–2009 technology refresh plan in January 2007 to address the appropriate use of the funds for the replacement of equipment specific to the High-Speed Network. Education stated that upon the advisory board's approval, and contingent upon available funding, the implementation of the plan will occur over two years and modifications will be made as necessary in response to industry changes. Finally, Education reported that the fiscal year 2006–07 budget control language requires that "any interest earned on state monies is used for operating the CalREN serving the UC, CSU, CCC, and K-12 segments. Any segment-specific cash reserves held by CENIC for an individual segment shall be held separately and accrue interest to that segment." The amended agreement between ICOE and CENIC stipulates the use of interest earned, including interest earned on funds held in an equipment replacement account, in accordance with this budget control language.

Finding #5: ICOE's agreement does not require CENIC to increase the amount that it holds on behalf of ICOE by any interest earned on funds related to E-rate or California Teleconnect Fund discounts.

In accordance with their contract executed on December 6, 2004, ICOE and CENIC plan to use unspent E-rate and California Teleconnect Fund discounts to continue the operation of the High-Speed Network in fiscal year 2005–06. The contract states, "To the extent that program revenue balances generated by E-rate and California Teleconnect fund discounts from fiscal year 2002–03, or prior fiscal years exist, such balances will be held by CENIC to help meet cash flow needs." The contract further stipulates, "Such funds will be held in trust by CENIC for the benefit of the High-Speed Network and will not be expended without advance consultation with ICOE." Finally, ICOE and CENIC agreed that any E-rate and California Teleconnect Fund discounts for fiscal year 2004–05 circuit expenditures received in that year shall be held by CENIC and applied against the network circuits, backbone fees, and related costs in fiscal year 2005–06.

E-rate—or, more precisely, the Schools and Libraries Universal Service Support Mechanism—is a federal program that provides discounts to assist most schools and libraries in the United States to obtain affordable telecommunications and Internet access. Eligible schools can receive discounts ranging from 20 percent to 90 percent. All customers eligible to receive E-rate discounts for telecommunication services can also receive discounts from the California Public Utilities Commission, via the California Teleconnect Fund program. The discounts are 50 percent and must be applied after deducting the E-rate discount.

As of December 2005, according to CENIC's estimate, a total of \$10 million was available for use toward the fiscal year 2005–06 High-Speed Network operational costs. However, ICOE's agreement does not require CENIC to increase the amount that it holds on behalf of ICOE by any interest earned on the funds. Until ICOE modifies its agreement with CENIC, the State will continue to lose the ability to use interest earnings to reduce High-Speed Network costs.

We recommended that to ensure that any interest earnings received for E-rate and California Teleconnect Fund discounts accrue to the benefit of the High-Speed Network, Education should direct ICOE to amend its agreement and require CENIC to credit any interest earnings to the High-Speed Network project. Additionally, ICOE should require CENIC to provide a detailed accounting of E-rate and California Teleconnect Fund discounts so that it can verify that it received the appropriate amount of interest.

Education's Action: Corrective action taken.

Education reported that the fiscal year 2006–07 budget control language requires that “any interest earned on state monies be used for operating the CalREN serving the UC, CSU, CCC, and K-12 segments. Any segment-specific cash reserves held by CENIC for an individual segment shall be held separately and accrue interest to that segment.” The amended agreement between ICOE and CENIC stipulates the use of interest earned, including interest earned on E-rate and California Teleconnect Fund discounts, in accordance with this budget control language.

The amended master agreement requires CENIC to keep detailed records and to work closely with ICOE to monitor and track revenues and interest related to E-rate and California Teleconnect Fund discounts. Further, Education stated that if CENIC holds E-rate and California Teleconnect Fund discounts on behalf of K-12 in the future, periodic audits will be conducted to ensure the appropriate amounts of revenue are received and that, if such funds are retained by CENIC instead of paid over immediately to ICOE, appropriate interest is credited to K-12.

Finding #6: Although ICOE has worked to increase awareness of content it postponed awarding grant funds to develop content hosted on the High-Speed Network.

As lead education agency for the High-Speed Network, ICOE is responsible for technical oversight of the project, financial and administrative services, collaboration and coordination with other agencies and projects, and the advancement of network uses.

ICOE currently provides certain videoconferencing services at no cost to schools in California that are connected to the High-Speed Network. Videoconferencing is a tool that connects two or more locations with interactive voice and video. Additionally, in November 2004, ICOE began operating its own High-Speed Network Web site that includes links and information related to learning resources, such as the UC College Preparatory Initiative, and the California Digital Library. Moreover, ICOE's application coordination committee (application committee) is evaluating some methods related to linking with academic content, from various sources, that are aligned with the California content standards for placement on the High-Speed Network. For example, ICOE plans to identify and work with academic content providers to develop strategies for placing their content on the network.

ICOE created the Advancing Network Uses Grant program to support the development and sharing of applications and learning resources that meet the critical needs of California's schools and that make good use of the benefits of the High-Speed Network. However, ICOE did not award the grant funds of roughly \$650,000 in fiscal year 2005–06 as planned because it was uncertain as to whether the High-Speed Network would receive state funding in fiscal year 2005–06. According to ICOE, should state funds be appropriated in the future, and provided enough funding exists, it will award funds to the winners of that previous grant competition.

Finally, both CENIC and ICOE have made an effort to increase the usage of the High-Speed Network by assisting schools and school districts in connecting their LANs to existing node sites, which is commonly referred to as the last mile connection. However, in June 2005, given the uncertainty of the fiscal year 2005–06 budget, ICOE decided to table the awarding of \$1.1 million in last mile grants. ICOE estimated that it would cost roughly \$10 million to connect the remaining roughly 500 schools and school districts without any connection. It further stated that when funds become available, it would determine how best to proceed with the last mile grant program.

We recommended that to maximize the benefits of the High-Speed Network, Education should ensure that ICOE does the following:

- Continue its efforts to implement statewide videoconferencing.
- Continue the efforts of its application committee to identify academic content and application uses to place on the High-Speed Network.
- Continue with its plans to fund the Advancing Network Uses Grant applicants.
- Proceed with its last mile grant program.

Education's Action: Partial corrective action taken.

Education stated that ICOE has implemented a fully functional statewide videoconferencing system. Education also stated that the application committee continues to assist the High-Speed Network project staff in identifying applications and Web-based resources to support teaching and learning.

Finally, Education stated that the Budget Act of 2006 did not include funding for the Advancing Network Uses Grant and last mile grant program, but it will continue to work with resource providers and to seek ways to cost-effectively connect schools and districts across the State. During fiscal year 2006–07, the High-Speed Network project staff collected up-to-date information on the state of connectivity in California. If resources are available, the project staff will be able to prioritize location for the last mile grant program.

Finding #7: ICOE is in the early stages of developing a suitable plan for evaluating the success of the High-Speed Network.

Although Education requires administrators of certain education technology projects to work with ICOE on the High-Speed Network project, ICOE is in the early stages of developing a method to evaluate the statewide success of the High-Speed Network. According to ICOE, it is working closely with Education to obtain existing data from certain education technology projects and is evaluating these data to determine if they will assist it in tracking the types of applications the K-12 education community is using. Establishing a method to track K-12 network use is key to measuring the success of the High-Speed Network project.

Until ICOE establishes a process to measure the success of the High-Speed Network that includes tracking the type of applications the K-12 education community is using, and the Legislature establishes clear goals for the program, it is difficult to determine whether the network has achieved such goals.

We recommended that Education should ensure that ICOE develops a process to measure the success of the High-Speed Network.

Education's Action: Partial corrective action taken.

Education stated that it and ICOE are collaborating with various stakeholders to assess the impact technology has on education. Specifically, they are coordinating the use of information collected from certain education technology projects and will continue to work toward developing analyses

and reports as well as modifying data collection tools as appropriate. Additionally, ICOE contracted with an evaluator who will assist it with the development of an evaluation framework with specific goals and objectives for the program. Education expects to finalize the framework and present it to the advisory board in February 2007.

DEPARTMENT OF EDUCATION

School Districts' Inconsistent Identification and Redesignation of English Learners Cause Funding Variances and Make Comparisons of Performance Outcomes Difficult

REPORT NUMBER 2004-120, JUNE 2005

Audit Highlights . . .

Our review of the administration and monitoring of English learner programs by the Department of Education (department) and a sample of school districts found that:

- The department provides school districts leeway in setting certain criteria they use to identify students as English learners and to redesignate them as fluent.*
- Differences in school districts' identification and redesignation criteria cause funding variances and a lack of comparability in performance results.*
- Sixty-two percent of the 180 English learners we reviewed, who were candidates for redesignation but had not been redesignated, met school districts' criteria for fluent status but were still counted as English learners.*
- School district and department monitoring of schools' adherence to the redesignation process is inadequate.*
- Of 180 tested expenditures, eight were for unallowable purposes and 43 were questionable.*

continued on next page . . .

The Department of Education's response as of December 2006 and eight school districts' responses as noted in districts' action headings¹

The Joint Legislative Audit Committee (audit committee) requested that the Bureau of State Audits (bureau) review the administration and monitoring of state and federal English learner program (English learner) funds at the Department of Education (department) and a sample of school districts. Specifically, the audit committee asked us to examine the processes the department and a sample of school districts use to determine the eligibility of students for the English learner programs, including an evaluation of the criteria used to determine eligibility for these programs and a determination of whether school districts redesignate students once they become fluent in English. In addition, the audit committee asked us to review and evaluate the department's processes for allocating program funds, monitoring local recipients' management and expenditure of program funds, and measuring the effectiveness of the English learner programs. Lastly, the audit committee asked us to, for selected school districts, test a sample of expenditures to determine whether they were used for allowable purposes. We focused our audit on the three main English learner programs whose funds are distributed by the department—federal Title III-Limited English Proficient and Immigrant Students (Title III), state Economic Impact Aid (Impact Aid), and the state English Language Acquisition Program (ELAP). In doing so, we noted the following findings:

Finding #1: School districts are inconsistent in the criteria they use to identify and redesignate English learners.

Although the department has provided guidance to school districts for establishing criteria to identify students as English learners and to redesignate them as fluent in English, it has allowed the school

¹ The eight school districts we reviewed are: Anaheim Union High School District (Anaheim), Long Beach Unified School District (Long Beach), Los Angeles Unified School District (Los Angeles), Pajaro Valley Unified School District (Pajaro), Sacramento City Unified School District (Sacramento), San Diego City Unified School District (San Diego), San Francisco Unified School District (San Francisco), and Stockton Unified School District (Stockton).

- ☑ *The department performs limited monitoring of school districts' expenditure of English learner program funds.*
 - ☑ *The State's evaluation of the impact of particular English learner programs is weak.*
 - ☑ *The funding formula for Impact Aid is complicated and likely outdated.*
-

districts some latitude in setting test score thresholds for redesignation. State law requires school districts to use California English Language Development Test (CELDT) results as the primary indicator for their initial identification of pupils as English learners, and as the first of four specific criteria for redesignating English learners as fluent. State law also requires the department, with the approval of the California State Board of Education (board), to use at least the four criteria defined in law to establish procedures for redesignating English learners to fluent status. In September 2002, the department published board-approved guidance for school districts to use in developing their initial and redesignation criteria. The department's guidance on redesignation criteria consists of student performance on the CELDT and the California Standards Test (CST) in English Language Arts (CST-ELA), as well as a teacher evaluation of academic performance, and parental opinion. However, because these are not regulations, school districts are not required to adhere to the department's guidelines. As a result, school districts' criteria for the initial identification of English learners vary and some school districts have established more stringent criteria that their English learners must meet to attain fluent status when compared to other school districts. In noting this fact, we are not concluding that a particular criterion or scoring standard is preferable to another, but rather that inter-district variation exists.

We recommended that the department, in consultation with stakeholders, establish required initial designation and redesignation criteria related to statewide tests that would provide greater consistency in the English learner population across the State. The department should pursue legislative action, as necessary, to achieve this goal. Further, school districts should ensure that their redesignation criteria include each of the four criteria required by state law for redesignating English learners to fluent status.



Department's Action: None (one-year response as of August 2006).

The department states that guidance on the redesignation of English learners is in accord with current law and that if the law changes and flexibility is impacted, it will consult with stakeholders. The department does not indicate that it has taken any action to consult with stakeholders or to seek legislation to provide greater consistency in the English learner population across the State.

Stockton's Action: Corrective action taken.

Stockton's redesignation form now covers the four criteria required by state law, including a section for teacher comments and documentation.

Finding #2: Inadequate monitoring of the redesignation process causes students who have met school district criteria for fluency to remain in the English learner population.

Although the schools we reviewed generally were consistent in adhering to their districts' initial identification processes, we noted that most of the same schools failed to fully complete, and in some cases even begin, the process of redesignating English learners to fluent status. In reviewing redesignations at eight school districts, we found that 111 (62 percent) of the 180 English learners we reviewed met the school districts' redesignation criteria but had not been redesignated as fluent in the school district records. We focused our testing on English learners who were candidates for redesignation in fiscal year 2003-04, but who had not been redesignated as fluent. There were about 42,000 such students at the eight school districts we reviewed. Further, although state regulations require school districts to maintain in students' records documentation of input from teachers, other certified staff, and parents regarding redesignation, almost none of the students we reviewed who met school district criteria for fluency had documentation in their records explaining why they were still designated as English learners. We also found that an additional 21 of the students we reviewed had been redesignated as fluent, according to documentation at their schools, but continued to be reported as English learners in the districts' student databases and reported as such to the department. When these databases overstate the number of English learners, school districts receive more funding than they are entitled to receive.

One factor contributing to these errors is the inadequate monitoring effort school districts employ to ensure that schools adhere to their redesignation processes. Another factor is the department's coordinated compliance review (compliance review), which includes testing of fluent students to ensure that they meet redesignation criteria, but did not, until May 2005, include guidance for its consultants to test current English learners' records to ensure that they are designated correctly. Without adequate monitoring, the school districts and the department lack assurance that English learners who have met the criteria for fluency are consistently redesignated.

We recommended that the department require school districts to document redesignation decisions, including decisions against redesignating students who are candidates for fluent status. Further, we recommended that school districts monitor their designation and redesignation processes more closely to ensure that schools actually complete the process and that school district databases accurately reflect all redesignations.

Department's Action: None (one-year response as of August 2006).

The department's 2005-06 English Learner Monitoring Instrument, posted on its Web site, includes a requirement to document redesignation decisions. The department says that it has distributed this instrument at various meetings and trainings throughout the State.

Anaheim's Action: Corrective action taken (one-year response as of June 2006).

Anaheim stated that in the summer of 2005 it implemented a process for obtaining the latest information on the English proficiency status of students entering its schools from elementary feeder districts and for updating its junior high student records accordingly. Further, Anaheim says that it has reviewed English learner cumulative files at most of its schools. The district also indicates that in the winter of 2006, it undertook a concerted effort to redesignate the

maximum number of eligible students. To facilitate this process it streamlined instructions and reevaluated its redesignation criteria, adding a page to its form to allow redesignation teams to clarify and memorialize their thinking process relative to final redesignation decisions.

Note: Anaheim did not need to respond to the recommendation related to school district expenditures.

Long Beach's Action: Corrective action taken (one-year response as of October 2006).

Long Beach stated that in the last 18 months it has implemented automated procedures to facilitate additional monitoring of student designations and redesignations. It said that three times a year it creates lists of students eligible for redesignation. School sites use these lists to complete the redesignation process including collecting teacher and parent input. The district's redesignation forms now include a section that clearly indicates why students who were not redesignated have been retained as English learners.

Los Angeles' Action: Corrective action taken (one-year response as of June 2006).

Los Angeles says that it modified its student information databases to automatically redesignate English learners when they meet district criteria and a parent notification letter has been printed. It also indicated that its Language Acquisition Branch is reviewing district data to monitor the redesignation process for students meeting district criteria.

Pajaro's Action: Corrective action taken (one-year response as of December 2006).

Pajaro stated that in September 2006 the district's Program Evaluation unit developed possible candidates for redesignation based on CST and CELDT scores. Bilingual Resource Teachers then collected redesignation completed forms and sent a copy to the district's director of Federal and State Programs who reviewed the documents for accuracy. An audit of the Student Information System was completed to ensure that redesignated students were coded as fluent in English. For students that qualify for redesignation based on test scores but who remain English learners, schools must explain their decision to deny redesignation and maintain supporting evidence.

Sacramento's Action: Partial corrective action taken (six-month response as of January 2006; no one-year response provided).

Sacramento says that it has modified its processes to include new monitoring standards. In addition, Multilingual Education Specialists formally monitor English learner items within the database for compliance three times a year, and documentation is sent to the associate superintendent for review.

San Diego's Action: Partial corrective action taken (one-year response as of October 2006).

San Diego indicates that it sent a memorandum to all district principals in September 2005 outlining redesignation criteria and that it offered redesignation workshops in November 2005. In addition, it sent a plan for monitoring and evaluating English learner programs to the department in October 2005 that identified staff responsible for supporting and monitoring the redesignation process, but did not establish specific processes for monitoring redesignations.

San Francisco's Action: Partial corrective action taken (one-year response as of December 2006).

San Francisco stated that in the fall of 2006, it provided training to principals and teachers on compliance requirements related to redesignations. It also indicated that it has monitored redesignations during principal evaluations. In addition, San Francisco says that consultants and the executive directors of its Multilingual Programs, and Research and Evaluation units will meet regularly to monitor the effectiveness of the data collection and reporting system in accurately reflecting all redesignations.

Stockton's Action: Partial corrective action taken (six-month response as of November 2005; no one-year response provided).

Stockton says it revised its Master Plan to include a section that addresses redesignation monitoring, specifically the timely and accurate data entry of redesignated students. The district also stated that in order to keep its database current, it has re-instituted a bi-monthly process to follow up with schools.

Finding #3: Diverse designation and redesignation criteria and inconsistent implementation of these criteria may cause funding variances and hinder comparisons of performance results.

School districts' use of more stringent designation and redesignation criteria, and a failure to implement redesignation criteria, can positively affect their funding and the outcomes for one of the three annual measurable achievement objectives (annual objectives) the department has established in accordance with Title III of the federal No Child Left Behind Act of 2001. Taking in and retaining high-scoring English learners gives some school districts a funding advantage because funding formulas are based on English learner counts. The inclusion and retention of more-advanced students also can be expected to make it easier for these districts to meet one of the annual objectives.

Title III and ELAP funding is linked directly to English learner counts. Impact Aid funding also takes into account the number of English learners. School districts that opt for more stringent designation and redesignation criteria increase their English learner counts and in turn increase their English learner funding. Furthermore, school districts that do not fully implement their established redesignation criteria and thus fail to redesignate all eligible students maintain higher English learner counts and receive higher funding than otherwise would be the case. However, we found varying designation and redesignation criteria, as well as numerous errors in the redesignation process, at all sampled school districts. Therefore, we cannot determine how much of an effect divergent criteria and a failure to implement these criteria have on English learner funding.

Further, school districts with relatively stringent initial designation and redesignation criteria may find it easier to meet the annual objective that measures students' progress in learning English because they tend to have higher percentages of students who have attained proficiency on the CELDT. According to this objective, English learners attaining proficiency on the CELDT need only maintain their proficiency to meet the annual progress target, while those who do not attain proficiency must improve their proficiency level to meet the objective. Based on statewide department data, in fiscal year 2003–04, 77 percent of English learners who previously attained proficiency on the CELDT were able to maintain their proficiency level, while only 57 percent of English learners who had not attained proficiency on the CELDT were able to improve their overall proficiency level. Consequently, performance results for this objective are probably skewed by the varying redesignation policies, and it is questionable whether these performance results are really comparable across school districts.

We recommended that the department consider changing the annual objective that measures students' annual progress in learning English to offer less incentive for school districts to maintain students as English learners.

Department's Action: Partial corrective action taken (one-year response as of August 2006).

The department states that a bookmark standard setting procedure for the CELDT was held in February 2006 and that as part of this procedure the minimum scores for the Early Advanced and Advanced levels were raised. The department does not, however, indicate that it changed the basic structure of the objective. The department expects that the change in the minimum scores will result in fewer students scoring at the English proficient level of the CELDT who do not meet the academic criteria for redesignation. The new performance levels will apply to CELDT results and Title III annual objectives for the 2006–07 school year.

Finding #4: Minimal monitoring of expenditures allows school districts to use some funds for unallowable costs.

The total funding for the three largest English learner programs was roughly \$605 million in fiscal year 2003–04, and the department distributed most of these funds to school districts. These funds must be used exclusively for supplementary services and activities geared toward the English learner population for each of the three programs. However, the department provides little guidance to school districts on how to document their use of these funds, and it does limited monitoring of the districts' expenditures, thus increasing the risk that these funds may be used for unintended purposes. In fact, we noted that some school districts have inadequate documentation practices and sometimes spend funds for unallowable or questionable purposes. Of the 180 expenditure transactions we tested, eight were for unallowable purposes and 43 were questionable. Most of the questionable expenditures related to purchases that had no contemporaneous documentation linking the expenditures to English learners or were for transactions for the purchase of goods or services that included non-English learners as well as English learners.

For example, Los Angeles used Title III funds to make two separate purchases, totaling nearly \$3.8 million, of mathematics materials for students in general instructional programs—an unallowed use of these funds. In addition, Stockton and Los Angeles spent ELAP funds at schools or on activities that are not covered by the grant award. Los Angeles spent \$11 million in ELAP funds in fiscal year 2003–04 on an extended learning program that covered a range of underachieving students in kindergarten through eighth grade, even though ELAP funds are restricted to English learners in grades four through eight.

We recommended that the department perform the steps necessary to ensure the school districts we reviewed have taken appropriate action to resolve their unallowable expenditures of supplemental English learner program funds. In addition, we recommended the department revise the documentation policy it provides to school districts to better ensure that expenditures are directed clearly at activities that serve the English learner programs' target populations. Lastly, to ensure that expenditure files clearly demonstrate that supplemental English learner program funds are directed at activities that serve the law's target populations, we recommended that school districts implement documentation policies.

Department's Action: Partial corrective action taken (one-year response as of August 2006).

The department says it has verified that the school districts either transferred or reimbursed the unallowable expenditures of supplemental English learner program funds identified in the report. The department also states it has informed school districts that expenditures charged to English learner programs must have adequate documentation to support all costs, however, it does not indicate that it has revised its documentation policy.

Long Beach's Action: Partial corrective action taken (one-year response as of October 2006).

Long Beach says that its Office of Program Assistance for Language Minority Students requires all school sites to submit strategic plans listing the activities, supplemental materials, and personnel related to allocated categorical funds. School sites are not allowed to rollover a previous year's plan. The Office of Program Assistance for Language Minority Students approves the strategic plans and all related expenditures.

Los Angeles' Action: Partial corrective action taken (one-year response as of June 2006).

Los Angeles indicates that it is conducting periodic Administrative Academy and other training using revised materials that emphasize district documentation policies and English learner program guidelines. It also says that it revisited its Coordinated Compliance Self-Review process to improve the procedures for analyzing school level English learner program expenditures and verifying supporting documentation. Los Angeles also sent a memorandum regarding ELAP, which included budget guidelines and payroll documentation procedures, to its administrators and administrative staff. The district says it reissued its Program and Budget Handbook in spring 2006 after reviewing the document to assure that documentation policies were clearly stated.

Pajaro's Action: Partial corrective action taken (one-year response as of December 2006).

Pajaro says that in September 2006 it provided follow-up training to principals on allowable expenditures of Impact Aid, Title III, and ELAP funds. In addition, the Director of Federal and State Programs now approves all ELAP expenditures.

Sacramento's Action: Partial corrective action taken (six-month response as of January 2006; no one-year response provided).

Sacramento said that it confirms the correct allocation of bilingual program funds during annual meetings with school sites. It states that it will ensure that it documents the results of these reviews, which can then be agreed to related expenditure files.

San Diego's Action: None (one-year response as of October 2006).

San Diego says that site administrators must approve all expenditures and that a budget analyst monitors expenditures from the central office. San Diego noted that the department's compliance review training guide does not require a documentation trail. San Diego did not indicate it has taken any steps itself to improve documentation.

San Francisco's Action: Partial corrective action taken (one-year response as of December 2006).

San Francisco indicated that the executive director of its Multilingual Programs unit has been meeting with account clerks and relevant administrators to ensure that proper documentation is maintained.

Stockton's Action: Partial corrective action taken (six-month response as of November 2005; no one-year response provided).



Stockton indicates that it has established a new database system to document expenditures for programs, training, and materials for English learners, but it does not say whether it has implemented policies to ensure that expenditure files clearly demonstrate that funds are directed at activities that serve the law's target populations.

Finding #5: The department measures English learner progress in language proficiency and academics, but its evaluation of the contribution of specific English learner programs is weak.

In accordance with federal law, the department has defined annual objectives to measure school districts' success in increasing the percentage of English learners who develop and attain English proficiency. However, school districts inconsistently define their English learner populations, so it is difficult to compare one district's success to another's in meeting the targets for one of the annual objectives. Moreover, state law does not require program-specific evaluations of Impact Aid, and a recent independent evaluation of school districts' implementation of ELAP has not provided conclusive evidence or reliable data on ELAP's effectiveness. Without dependable program-specific evaluations, the State cannot isolate and measure the effectiveness of particular English learner programs.

State law required the department to hire independent evaluators to conduct a five-year study on the impact of Proposition 227 and to evaluate ELAP. However, the evaluators have been unable to reach decisive conclusions on the program's value, in part because school districts combine ELAP with other funding sources to pay for a variety of English learner services and because student performance results are not comparable across school districts. Although the evaluators have not been able to provide decisive conclusions, they have provided meaningful insight and several recommendations regarding ELAP based on school districts' responses to a survey.

We recommended that the department review the evaluators' recommendations, subsequent to the submission of the final report in October 2005, and take necessary actions to implement those recommendations it identifies as having merit to ensure that the State benefits from recommendations in reports on the effects of the implementation of Proposition 227 and ELAP.

Department's Action: Partial corrective action taken (one-year response as of August 2006).

The department says that it is taking necessary actions to implement the six recommendations from the final report that it believes have merit. With regard to a recommendation to specify clear performance standards for key statewide measures for English learner progress and achievement, it indicates that the State Board of Education will review redesignation guidelines to conform with new CELDT proficiency level minimums for the separate listening and speaking scores.

Finding #6: Funding formulas are generally equitable, but a poverty statistic for impact aid needs updating.

Although the department's formulas for distributing English learner program funds are generally sound, the funding formula for Impact Aid is complicated and likely outdated. The Legislative Analyst's Office (legislative analyst) has observed that the complexity of the Impact Aid formula results in district allocations that are hard to understand based on underlying school district demographics and that the formula is weighted heavily toward poverty. Further, a key statistic used in the formula, the number of students in families receiving assistance under the California Work Opportunity and Responsibility to Kids (CalWORKs) program, has become less reflective of the population of students in poverty and is currently unavailable to the department. The governor vetoed a bill redirecting funds to study the Impact Aid formula, instead directing the Department of Finance and the Secretary of Education to work with the legislative analyst and the department to develop options for restructuring the formula. The department indicates that it will collaborate to develop a long-term solution for allocating Impact Aid funds, including determining an appropriate replacement for the CalWORKs data.

We recommended the department continue to work with the Department of Finance, the legislative analyst, and the Legislature to revise the Impact Aid funding formula to include statistics that better measure the number of students in poverty.

Department's Action: Corrective action taken (one-year response as of August 2006).

Assembly Bill 1802, approved by the governor in July 2006, repealed and replaced the existing provisions regarding the calculation and allocation of economic impact aid. Economically disadvantaged pupils, English learner counts, and 2005–06 levels of Economic Impact Aid are major factors in determining funds under the revised formula.

CALIFORNIA STUDENT AID COMMISSION

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.*
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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 December 2006

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 FFEL Program.

Student Aid's ability to generate an operating surplus from the Federal Family Education Loan (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 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 stated that many large lenders have decided to pay the federal default fee for the remainder of the academic year (October 1, 2006 through September 30, 2007) on behalf of borrowers whose loans it guarantees. However, Student Aid was unable to provide us with documentation to support this statement. Specifically, Student Aid stated that it does not require any legal documents such as contracts or agreements from the lenders specifying their commitment to pay the fee and the circumstances under which they will pay the fee for the borrower. Student Aid also stated that it and EDFUND are actively pursuing a multi-year default fee strategy for new loans guaranteed after July 1, 2007.

Further, Student Aid stated that EDFUND is projecting significant increases in revenues net of expenses for the federal fiscal year 2007 budget and annual forecasts through federal fiscal year 2011. According to our review of EDFUND's unaudited data, on average, roughly 25 percent of its projected increases are the result of a change to the federal law that is aimed at expanding graduate and professional student borrowing, which took effect on July 1, 2006.

Finally, Student Aid stated that EDFUND's chief financial officer regularly reports financial data to its staff, commissioners, and the EDFUND board. Our review of EDFUND's unaudited data found that it has shifted its collection strategy and has moved away from a focus on consolidations.

Legislative Action: Unknown.

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 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 should 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.

Student Aid's Action: Partial corrective action taken.

Student Aid stated that as of December 8, 2006, it and Education had not renegotiated a new VFA. Student Aid also stated that it, the EDFUND board, and California administrative officials are aware of the ongoing efforts by the EDFUND president to renegotiate and finalize the new VFA. In addition, Student Aid stated that its commissioners and EDFUND board members agreed that available capital should be used to invigorate core guarantee business because this focus could produce greater and more immediate revenue returns. However, according to Student Aid, it also agreed that EDFUND would continue to be alert to potential opportunities to partner with other entities and to present these options to Student Aid. Finally, Student Aid hired a consultant in November 2006 to assist it in further delineating the roles and responsibilities between it and EDFUND.

Legislative Action: Unknown.

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.

EDFUND's Personnel, Evaluation, and Nominations (PEN) Committee developed a draft comprehensive executive compensation policy that incorporates the general principles recommended by the consultant hired to assist it with the evaluation of the existing policy. Student Aid stated that the EDFUND board would review and approve the draft policy by February 2007 and forward it to Student Aid's PEN Committee and commissioners for approval. Student Aid also stated that EDFUND has retained legal counsel to determine whether or not the draft policy fully complies with all applicable federal and state regulations.

According to Student Aid, it used the same consultant hired by EDFUND to review its policy statement and guidelines memorandum titled EDFUND Incentive Compensation Plans and recommend changes. Student Aid stated that the EDFUND board would review and approve its draft policy statement and guidelines by February 2007 and forward it to Student Aid's PEN Committee and commissioners for approval.

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 stated that the commission's executive director and EDFUND's president have reached agreement on EDFUND's federal fiscal year 2006 performance goals except for one issue that addresses the credit to be given for the turnover rate and recovery rate metrics.

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 type 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.

Also, on September 7, 2006, Student Aid 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 its board. However, Student Aid approved the policy with the understanding that EDFUND's annual budget should reflect a separate line item to highlight any funds to be used for employee-wide events. Finally, EDFUND's spending policy prohibits it from using corporate funds to subsidize the costs of guests participating in its employee-wide events.

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 obtained 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 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 should also ensure that EDFUND follows through on its efforts to revise its contracting policies.

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.

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

In addition, according to Student Aid, except for three items, EDFUND has addressed the operational issues raised by Student Aid staff presented in its 2006–07 Loan Program Business Plan and Budget. The unresolved items relate to the multi-year default fee strategy for new loans guaranteed after July 1, 2007, and the Student Aid executive director's and EDFUND president's resolution of EDFUND's federal fiscal year 2006 performance goals involving the credit to be given for the turnover rate and recovery rate metrics.

Further, Student Aid informed the bureau that it hired a consultant in November 2006 to assist it in further delineating the roles and responsibilities between it and EDFUND and that this consultant will also be responsible for evaluating the activities of its oversight division including, but not limited to, the verification of reports submitted by EDFUND.

Finally, Student Aid has been unable to demonstrate that it addressed three of the six tasks cited in our report, which are to reexamine the basic assumptions of the current business model, reassess existing strategies, and undertake a thorough organizational risk assessment in relation to the existing portfolio and future growth strategies. Although it stated that these are activities EDFUND has historically addressed and continues to do so, Student Aid stated that it would provide the bureau with this information in April 2007.

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: Partial corrective action taken.

Student Aid reported that EDFUND began keeping confidential minutes of its closed sessions as of the beginning of 2006. However, according to Student Aid, a policy/procedure for conducting closed sessions and maintaining the confidential minutes book has not been finalized.

UNIVERSITY OF CALIFORNIA

Stricter Oversight and Greater Transparency Are Needed to Improve Its Compensation Practices

REPORT NUMBER 2006-103, MAY 2006

University of California's response as of November 2006

Audit Highlights . . .

Our review of the compensation practices of the University of California (university) revealed the following:

- The Corporate Personnel System (CPS) used by the university's Office of the President (president's office) to track the pay activity of university campuses contains inconsistencies and overly vague categories that did not allow us to determine the reliability of various compensation and funding source classifications contained within it and that limit its usefulness as an oversight tool.*
- Despite these problems, the CPS is the most detailed and complete centrally maintained source of information, and in fiscal year 2004–05 it reflects that university employees earned approximately \$9.3 billion—comprised of \$8.9 billion in regular pay and \$334 million in additional compensation.*
- The president's office appears to regularly grant exceptions to university compensation policy. In a sample of 100 highly paid university employees, 17 benefited from an exception to compensation policy.*

continued on next page . . .

The Joint Legislative Audit Committee (audit committee) requested that the Bureau of State Audits review the compensation practices of the University of California (university) and to identify systemwide compensation by type and funding source. In addition, we were asked to categorize the compensation of highly paid individuals receiving the most funds from state appropriations and student tuition and fees, and to determine whether they receive any additional compensation or employment inducements not appearing in the university's centrally maintained records.

The audit committee also asked us to determine the extent to which university compensation programs are disclosed to the Board of Regents (regents) and to the public, including the types of programs that exist, their size and cost, and the benefits that participants receive. Finally, we were asked to survey other universities about their compensation disclosure practices and the number of participants and expenses for those programs. Our survey found that the University of California's disclosure practices were similar to those of other universities.

Finding #1: Lack of consistency within the Corporate Personnel System (CPS) limits its usefulness.

The personnel information reporting system used by the university, the CPS, contains inconsistencies and overly vague categorizations. For example, we found a number of instances in which campuses included specific types of compensation, such as housing and auto allowances, in other categories not related to such allowances or in broad nondescriptive categories. Consequently, we could not determine the reliability of the amounts recorded in various compensation and funding source classifications contained within the CPS. In addition, the weaknesses of the CPS limit its usefulness as an oversight tool for the Office of the President (president's office) to monitor campuses' compliance with compensation policies. However, because the CPS is the most detailed and centrally maintained source of this information, our report presented several tables summarizing that total pay to university employees in fiscal year 2004–05 was \$9.3 billion, of which \$8.9 billion was regular pay and \$334 million was additional compensation.

- ☑ *Some university campuses circumvented or violated university policy, resulting in a \$130,000 overpayment to an employee and improper increases to others' retirement covered compensation.*
 - ☑ *The university did not consistently disclose its officers' nonsalary compensation, such as housing allowances, to the Board of Regents, as required by policy.*
-

To improve its ability to monitor campus compliance, we recommended that the president's office issue clear directives prescribing consistent use of the CPS and require campuses to consistently classify compensation into standard categories. We also suggested that the president's office consider developing additional automated controls and edits within the CPS to ensure that expenditures are properly charged and to help avoid the possibility of errors.

University's Action: Pending.

The university states that it is developing guidance to clarify and ensure the proper use of transaction codes within the CPS. As of November 2006 the university had issued draft guidelines to campuses, which are in the process of identifying the types of transactions that could cause the most concern. After putting in place guidance to provide greater clarity about the intended use of CPS categories, the university indicates it will develop appropriate edits and analysis tools to screen for anomalies. Additionally, the university states it is developing an automated system to make compensation data for the senior leadership group available for querying and reporting, and it will employ consistent and standard data definitions. The university indicates implementation of this system is on schedule and that it expects to use the system as the basis for the next annual report on senior management group compensation, which is due in March 2007.

Finding #2: The president's office regularly granted exceptions to the compensation policy.

The president's office regularly granted individuals exceptions to the university's compensation policy. University policy authorizes the president's office to approve policy exceptions that provide employees with benefits for which they otherwise would not be eligible. Seventeen of the 100 individuals in our sample benefited from an exception to policy, such as housing or moving allowances above established limits, auto allowances, or participation in the university's senior management severance pay plan.

To preserve the integrity of its compensation policies, we recommended that the president's office limit the number of exceptions to policy it allows. We suggested accomplishing this objective by the regents requiring the university to track and annually report exceptions to compensation policy that various university officers and officials grant during a fiscal year and provide justification for each exception.

University's Action: Partial corrective action taken.

The university states it hired a human resources consulting firm to perform a comprehensive review of its compensation policies, which it expects to be completed over the next 12 to 15 months. The university believes that this review will result in clearer policies on the procedures campuses must follow when seeking exceptions to policy. It has also issued an interim policy requiring campuses to document the basis and rationale for all exceptions to existing compensation policies and to report them to a newly created position of Senior Vice President—Chief Compliance and Audit Officer, which the university hopes to fill in January 2007. This position will evaluate exceptions to policy to determine if they were made in accordance with the intent of existing policy, and report any concerns to the president and the regents. In addition, the university also states that the new position will be responsible for developing additional monitoring and oversight activities.

Finding #3: The circumvention of policy caused a significant overpayment and inappropriate increases in retirement-covered compensation.

Some campuses circumvented or violated university policies, resulting in an overpayment to a university employee and questionable forms of compensation provided to others. These instances included an employee at the University of California at San Diego (San Diego) who received an overpayment of \$130,000 and a San Diego vice chancellor who continued to receive a \$68,000 administrative stipend and an \$8,900 auto allowance despite being on sabbatical. Our review also revealed that some campuses violated the university's retirement plan policy by including inappropriate forms of compensation, such as housing and auto allowances, in three employees' retirement-covered compensation, a percentage of which they may receive when they retire.

We recommended that the president's office improve its oversight of campuses' compliance with university policies by developing a mechanism to annually identify unauthorized exceptions to policy. We also recommended that the president's office determine if it is appropriate to require repayment of university funds for the instances we identified and if so, develop a repayment plan with each employee. We further recommended that the president's office remove the inappropriate forms of retirement-covered compensation we identified from the employees' retirement earnings and establish a mechanism to detect such violations.

University's Action: Partial corrective action taken.

To address our recommendation that the university annually identify unauthorized exceptions to compensation policies, the university states the comprehensive review of its compensation policies will result in improved policies on this issue. In addition, the university indicates that the newly created position of Senior Vice President—Chief Compliance and Audit Officer, will be responsible for developing additional monitoring and oversight practices for the campuses' compensation actions. The university states it has resolved the exceptions identified in our audit report by either obtaining the regents' approval of those exceptions or notifying the regents about them. At their May 2006 meeting, the regents approved guidelines for developing the corrective actions the university should take on these exceptions. At their July and September 2006 meetings, the regents' compensation committee approved the university's corrective actions for matters that arose from improper application of university policy or the failure to seek the regents' approval. For the faculty members who were not part of senior management, the exceptions were referred to academic administrators for resolution and the university indicates the action on these exceptions is pending. Additionally, the university indicates correcting all inappropriate forms of retirement-covered compensation we identified and states that its efforts to clarify the use of codes within CPS should reduce the risk of similar errors in the future.

Finding #4: The university consistently violated policies the regents established to ensure adequate review of executive compensation.

The regents' policies require them to approve all forms of compensation for officers of the university. Although the university consistently obtained approval for officers' salaries, in a sample of 10 officers we found that the university violated its policy by failing to disclose eight auto allowances, four housing allowances, two transfers of sabbatical credits, and an acceleration of health insurance contributions when the regents considered the individuals' appointment. Additionally, we found that the usefulness of the university's annual report on compensation to the regents was limited because the fiscal years 2003–04 and 2004–05 reports contained errors and were submitted late.

We recommended that the regents require the president's office to disclose all forms of compensation for university officers and for all employees whose compensation exceeds an established threshold. We further stated that this disclosure should occur when the regents approve the employees' salaries and at least annually in an accurate and timely report to the regents. Finally, the university should ensure that its annual report on compensation is accurate and timely.

University's Action: Partial corrective action taken.

In September 2006 the university developed two policies regarding how it will ensure better disclosure of employee compensation to the regents and the public. These practices include specifically identifying the elements of employee compensation to disclose in its annual report on senior management compensation, and for recent hires of executives and those earning an amount that requires the regents' approval, and the methods it will use to disclose this information. Additionally, the university has developed a compensation checklist, which it indicates the regents receive when approving employee compensation. The university asserts that the new system containing compensation data for the senior leadership group, which it is currently implementing, will substantially improve the quality of information included in its annual report on senior management group compensation to the regents.