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Information/Action Item

California Student Aid Commission

Presentation of the June 30, 2010 Operating Fund and Federal Fund financial statements for federal student loan program

Perry-Smith LLP has completed their independent audit of the Operating Fund and Federal Fund financial statements for the year ended June 30, 2010. The auditors will make a formal presentation on the financial statements, related correspondence, and the results of the audit.

Recommended Action: Accept the Operating Fund and Federal Fund audited financial statements for the year ended June 30, 2010.

Responsible Person(s): Janet McDuffie, Chief
Administration & External Affairs Division

Tina Treis
Perry-Smith Partner

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To the Honorable Members
California Student Aid Commission
Rancho Cordova, California

We are pleased to present this letter related to the conduct of the audit of the financial statements of the Student Loan Operating Fund and the Federal Student Loan Fund (collectively "the Funds") as of and for the year ended June 30, 2010. This report is intended to inform the Honorable Members of the California Student Aid Commission (the "Commission") about significant matters related to the conduct of the annual audit so that they can appropriately discharge their FFEL Program responsibility, and that we comply with our professional responsibilities.

The following summarizes certain matters required by professional standards to be communicated to you in your FFEL Program responsibility for the Commission's financial reporting process.

The Auditor's Responsibility Under Generally Accepted Auditing Standards

Our audit of the financial statements of the Funds of the Commission for the year ended June 30, 2010 was conducted in accordance with auditing standards generally accepted in the United States of America and *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether caused by error, fraudulent financial reporting or misappropriation of assets. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. Accordingly, the audit was designed to obtain reasonable, rather than absolute, assurance about the financial statements. We believe that our audit accomplished that objective.

In accordance with *Governmental Auditing Standards*, we have also performed tests of controls and compliance with laws and regulations that contribute to the evidence supporting our opinion on the financial statements. However, they do not provide a basis for opining on the Funds' internal control or compliance with laws and regulations.

Adoption of, or Change in, Accounting Policies

The Commission and management have the ultimate responsibility for the appropriateness of the accounting policies used by the Funds. Significant accounting policies are included in Note 2 to the financial statements. Following are descriptions of significant accounting policies or their application which were either initially selected or changed during the year:

- The Funds adopted Governmental Accounting Standards Board Codification Section (GASB Cod. Sec.) 1000, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments* (GASB Cod. Sec. 1000), on July 1, 2009. The Statement is intended to incorporate the hierarchy of generally accepted accounting principles (GAAP) for state and local governments into the Governmental Accounting Standard's Board (GASB) authoritative literature. The "GAAP hierarchy" consists of the sources of accounting principles used in the preparation of financial statements of state and local governmental entities that are presented in conformity with GAAP, and the framework for selecting those principles. The adoption of this update did not have a material impact on the Funds' net assets, change in net assets and cash flows.

- The Funds adopted GASB Cod. Sec. 2250, *Codification of Accounting and Financial Reporting Guidance Contained in the AICPA Statements on Auditing Standards* (GASB Cod. Sec. 2250), on July 1, 2009. The objective of this Statement is to incorporate into the GASB authoritative literature certain accounting and financial reporting guidance presented in the American Institute of Certified Public Accountants' Statement on Auditing Standards. This Statement addresses three issues not included in the authoritative literature that establishes accounting principles – related party transactions, going concern considerations, and subsequent events. The presentation of principles used in the preparation of financial statements is more appropriately included in accounting and financial reporting standards rather than in the auditing literature. This Statement does not establish new accounting standards but rather incorporates the existing guidance (to the extent appropriate in a governmental environment) in the GASB standards. The adoption of this Statement did not have a material impact on the Funds' net assets, change in net assets and cash flows.

Adoption of, or Change in, Accounting Policies (Continued)

The following financial accounting standard has been issued but was not required to be adopted for the year ended June 30, 2010:

Fund Balance Reporting and Governmental Fund Type Definitions

In February 2009, the Governmental Accounting Standards Board (GASB) issued GASB Codification Section (GASB Cod. Sec.) 1300 and 1800, *Fund Balance Reporting and Governmental Fund Type Definitions* (GASB Cod. Sec. 1300 and 1800). The objective of this Statement is to enhance the usefulness of fund balance information by providing clearer fund balance classifications that can be more consistently applied and by clarifying the existing governmental fund type definitions. This Statement establishes fund balance classifications that comprise a hierarchy based primarily on the extent to which a government is bound to observe constraints imposed upon the use of the resources reported in governmental funds. The initial distinction that is made in reporting fund balance information is identifying amounts that are considered *nonspendable,* such as fund balance associated with inventories. This Statement also provides for additional classification as restricted, committed, assigned, and unassigned based on the relative strength of the constraints that control how specific amounts can be spent. The *restricted* fund balance category includes amounts that can be spent only for the specific purposes stipulated by constitution, external resource providers, or through enabling legislation. The *committed* fund balance classification includes amounts that can be used only for the specific purposes determined by a formal action of the government's highest level of decision-making authority. Amounts in the *assigned* fund balance classification are intended to be used by the government for specific purposes but do not meet the criteria to be classified as restricted or committed. In governmental funds other than the general fund, assigned fund balance represents the remaining amount that is not restricted or committed. *Unassigned* fund balance is the residual classification for the government's general fund and includes all spendable amounts not contained in the other classifications. In other funds, the unassigned classification should be used only to report a deficit balance resulting from overspending for specific purposes for which amounts had been restricted, committed, or assigned. Governments are required to disclose information about the processes through which constraints are imposed on amounts in the committed and assigned classifications. GASB Cod. Sec. 1300 and 1800 is effective for periods beginning after June 15, 2010. Early implementation is encouraged. Fund balance reclassifications made to conform to the provisions of this Statement should be applied retroactively by restating fund balance for all prior periods presented. The financial statements of the Funds are proprietary funds and are not expected to be impacted by GASB Cod. Sec. 1300 and 1800.

Significant or Unusual Transactions

We did not identify any significant or unusual transactions or significant accounting policies in controversial or emerging areas for which there is a lack of authoritative guidance or consensus.

Alternative Treatments Discussed with Management

We did not discuss with management any alternative treatments within accounting principles generally accepted in the United States of America for accounting policies and practices related to material items during the current audit period.

Accounting Estimates and Management Judgments

Accounting estimates are an integral part of the preparation of financial statements and are based upon management's current judgment. The process used by management encompasses their knowledge and experience about past and current events and certain assumptions about future events. Management has informed us that they used all the relevant facts available to them at the time to make the best judgments about accounting estimates, and we considered this information in the scope of our audit. You may wish to monitor throughout the year the process used to compute and record these accounting estimates.

We have evaluated the reasonableness of accounting estimates in relationship to the financial statements taken as a whole and concluded that management's approach to these estimation processes is reasonable.

Financial Statement Disclosures

In our meeting with you, we will discuss with you the overall neutrality, consistency, and clarity of the disclosures in the financial statements.

Significant Audit Adjustments

There were no audit adjustments made to the original trial balance presented to us to begin our audit.

Uncorrected Misstatements

We noted one uncorrected misstatement, that was determined by management to be immaterial to the financial statements taken as a whole, that was not made to the financial statements relating to expenses denied by the Commission for reimbursement to EdFund from the Operating Fund. This uncorrected misstatement is summarized in the accompanying schedule.

Other Information in Documents Containing Audited Financial Statements

We are not aware of any documents that contain the audited financial statements. If such documents were to be published, we would have a responsibility to determine that such financial information was not materially inconsistent with the audited financial statements of the Funds.

Disagreements with Management

We encountered no disagreements with management over the application of significant accounting principles, the basis for management's judgments on any significant matters, the scope of the audit or significant disclosures to be included in the financial statements.

Consultations with Other Accountants

We are not aware of any consultations management had with other accountants about accounting or auditing matters.

Major Issues Discussed with Management Prior to Retention

No major issues were discussed with management prior to our retention to perform the aforementioned audit.

Difficulties Encountered in Performing the Audit

We did not encounter any difficulties in dealing with management relating to the performance of the audit.

Material Written Communications Between Management and Our Firm

Enclosed you will find copies of all material written communications between our firm and the management of the Commission.

* * * * *

We will be pleased to respond to any questions you have about the foregoing. We appreciate the opportunity to continue to be of service to the Commission.

This report is intended solely for the information and use of the Commission and management and is not intended to be and should not be used by anyone other than the specified parties.

Perry-Smith LLP

Sacramento, California
January 13, 2011

CALIFORNIA STUDENT AID COMMISSION

SUMMARIZED SCHEDULE OF UNCORRECTED MISSTATEMENTS

JUNE 30, 2010

	Effect – Increase (Decrease)				
Description	Assets	Liabilities	Equity	Revenue	Expenses
Current Year Differences					
- Reverse expenses denied for reimbursement to EdFund		$ (463,673)			$ (463,673)
Total Effect			$ 463,673	**$ -**	**$ (463,673)**
Balance Sheet Effect	**$ -**	**$ (463,673)**	**$ 463,673**		

CALIFORNIA STUDENT AID COMMISSION

CALIFORNIA STUDENT AID COMMISSION

December 23, 2010

Perry-Smith LLP
400 Capitol Mall, Suite 1200
Sacramento, CA 95814

In connection with your audits of the basic financial statements of the Operating and Federal Funds (collectively the "Funds") of the California Student Aid Commission ("Commission") as of and for the years ended June 30, 2010 and 2009, we confirm that we are responsible for the fair presentation in the financial statements of financial position, changes in financial position, and cash flows in conformity with accounting principles generally accepted in the United States of America.

We confirm to the best of our knowledge and belief, as of December 23, 2010 the following representations made to you during your audit.

1. The financial statements referred to above are fairly presented in conformity with accounting principles generally accepted in the United States of America.
2. We have identified for you all organizations that are a part of this reporting entity or with which we have a relationship, as these organizations are defined in Section 2100 of the Governmental Accounting Standards Board's Codification of Governmental Accounting and Financial Reporting Standards that are:
    a. Component units.
    b. Other organizations for which the nature and significance of their relationship with the Commission are such that exclusion would cause the reporting entity's financial statements to be misleading or incomplete.
    c. Jointly governed organizations in which we participated. ELM Resources has been identified as a jointly governed organization and as such, the investment is not reported using "equity method of accounting" as provided under Government Accounting Standards and is disclosed in footnote 4 to the financial statements.
3. We are a component unit of the State of California, as this term is defined in Section 2100 of the Governmental Accounting Standards Board's Codification of Governmental Accounting and Financial Reporting Standards.
4. We have identified for you all of our funds, governmental functions, and identifiable business-type activities.
5. We have properly classified all funds and activities.
6. We have properly determined and reported the major governmental and enterprise funds based on the required quantitative criteria. We have determined the following funds to be major for public interest reasons: Operating and Federal. We believe that all judgmentally determined major funds are particularly important to the financial statement users.
7. We are responsible for compliance with laws and regulations applicable to the State of California including adopting, approving, and amending budgets.
8. We have identified and disclosed to you all laws and regulations that have a direct and material effect on the determination of financial statement amounts including legal and contractual provisions for reporting specific activities in separate funds.

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9. We have made available to you:
   a. All financial records and related data of the Funds, in existence at any time during the period covered by your audit.
   b. All minutes of the meetings of the Commission, EdFund Board, and appropriate committees or summaries of actions of recent meetings for which minutes have not been prepared.
   c. All communications from grantors, lenders, other funding sources or regulatory agencies concerning noncompliance with:
      (1) Statutory, regulatory or contractual provisions or requirements.
      (2) Financial reporting practices that could have a material effect on the financial statements.
10. We have no knowledge of fraud or suspected fraud affecting the entity involving:
    a. Management.
    b. Employees who have significant roles in the internal control, or
    c. Others where the fraud could have a material effect on the financial statements.
11. We acknowledge our responsibility for the design and implementation of programs and controls to provide reasonable assurance that fraud is prevented and detected.
12. We have no knowledge of any allegations of fraud or suspected fraud affecting the Commission received in communications from employees, former employees, regulators, or others.
13. We are aware of no significant deficiencies, including material weaknesses, in the design or operation of internal control that could adversely affect the entity's ability to record, process, summarize, and report financial data, other than the significant deficiency reported for the proper accrual of grant administration costs.
14. There have been no communications from regulatory agencies concerning noncompliance with, or deficiencies in, financial reporting practices.
15. We have no plans or intentions that may materially affect the carrying value or classification of assets and liabilities, other than the Guaranty Designation Transfer described in Note 18 to the financial statements.
16. The following have been properly recorded and/or disclosed in the financial statements:
    a. Related party transactions, including those with the primary government having accountability for the Commission, component units for which the Commission is accountable, and other organizations for which the nature and significance of their relationship with the Commission are such that exclusion would cause the reporting entity's financial statements to be misleading or incomplete, joint ventures in which the Commission has an interest, and jointly governed organizations in which the Commission participates, as defined in Section 2100 of the GASB's Codification of Governmental Accounting and Financial Reporting Standards, and interfund transactions, including interfund accounts receivable and payable, advances, sale and purchase transactions, interfund transfers, long-term loans, leasing arrangements and guarantees, all of which have been recorded in accordance with the economic substance of the transaction and appropriately classified and reported.

b. Guarantees, whether written or oral, under which the Government is contingently liable.

c. Arrangements with financial institutions involving compensating balances or other arrangements involving restrictions on cash balances.

d. Amounts of contractual obligations for construction and purchase of real property or equipment not included in the liabilities or encumbrances recorded on the books.

e. Any liabilities which are subordinated in any way to any other actual or possible liabilities.

f. All leases and material amounts of rental obligations under long-term leases.

g. All significant estimates and material concentrations known to management which are required to be disclosed in accordance with the AICPA's Statement of Position 94-6, *Disclosure of Certain Significant Risks and Uncertainties*. Significant estimates are estimates at the balance sheet date which could change materially within the next year. Concentrations refer to volumes of business, revenues, available sources of supply, or markets for which events could occur which would significantly disrupt normal finances within the next year.

17. We are responsible for making the accounting estimates included in the financial statements. Those estimates reflect our judgment based on our knowledge and experience about past and current events and our assumptions about conditions we expect to exist and courses of action we expect to take. In that regard, adequate provisions have been made:

    a. To reduce receivables to their estimated net collectable amounts.

    b. To reduce assets which have permanently declined in value to their realizable values.

    c. For pension obligations, post-retirement benefits other than pensions and deferred compensation agreements attributable to employee services rendered through December 23, 2010.

    d. For any material loss to be sustained in the fulfillment of, or from the inability to fulfill, any service commitments.

    e. For any material loss to be sustained as a result of purchase commitments.

18. There are no:

    a. Material transactions that have not been properly recorded in the accounting records underlying the financial statements.

    b. Violations or possible violations of laws or regulations whose effects should be considered for disclosure in the financial statements or as a basis for recording a loss contingency. In that regard, we specifically represent that we have not been designated as, or alleged to be, a "potentially responsible party" by the Federal Environmental Protection Agency or any equivalent state agencies in connection with any environmental contamination.

    c. Other material liabilities or gain or loss contingencies that are required to be accrued or disclosed by GASB Statement No. 10.

19. There are no unasserted claims or assessments that our lawyer has advised us are probable of assertion and must be disclosed in accordance with GASB Statement No. 10.

20. We have no direct or indirect, legal or moral, obligation for any debt of any organization, public or private, that is not disclosed in the financial statements.
21. We have satisfactory title to all owned assets.
22. We have complied with all aspects of contractual agreements that would have a material effect on the financial statements in the event of noncompliance.
23. Net asset components and fund balance reserves and designations are properly classified and, if applicable, approved.
24. Expenses have been appropriately classified in or allocated to functions and programs in the statement of revenues, expenses and changes in net assets, and allocations have been made on a reasonable basis.
25. Revenues are appropriately classified in the statement of revenues, expenses and changes in net assets within program revenues.
26. Capital assets, including infrastructure assets, are properly capitalized, reported, and depreciated.
27. Required supplementary information is properly measured and presented.
28. Effective November 1, 2010, Educational Credit Management Corporation (ECMC) became the designated guaranty agency for the Commission's FFEL Program portfolio. ECMC is assessing the EdFund personnel, facilities, and other operational expenses and incorporating those deemed useful for administering the FFEL Program activities now under their control. As part of this transition, the U.S. Department of Education (ED) agreed to fund $100 million from the Operating Fund to the 2010-11 State of California budget to support Cal Grant program awards. The $100 million has been transferred from the Operating Fund to the 2010-11 State of California budget to support the Cal Grant program awards. ED has funded $75 million from the Operating Fund and is scheduled to fund the remaining $25 million in January 2011.
29. As an auxiliary organization of the Commission, EdFund made lease payments on an unoccupied building (Building B) of $3,343,624 between July 3, 2008 and June 30, 2010. On December 16, 2010, ED issued a final program review report to the Commission which determined that paying rent on an unoccupied building is an improper use of the Operating Fund under the FFEL Program since the payment of these costs is not in support of a guaranty agency-related activity or for other student financial aid-related activities. The required action from ED is for the Commission to immediately cease making future lease payments for the unoccupied building through the Operating Fund. In addition, the Commission must reimburse the Operating Fund for the lease payments made to date on Building B. The Commission does not have any independent authority or the requisite appropriation to make such a payment. As such, no action has been taken to reimburse the Operating Fund. The source of repayment has not yet been determined and as a result, the amount receivable and impact to the related statement of revenues, expenses and changes in net assets has not been reflected in these financial statements.
30. The Commission denies the reimbursement of expenses to EdFund from the Operating Fund when EdFund does not provide the Commission with requested backup documentation of a product or service or when the Commission determines the expense to be a gift of California State Funds, a waste of public funds or not allowable under Federal regulations. Denied expenses for the years ended June 30, 2010 and 2009 were $463,673 and $215,283, respectively.

31. EdFund administered the Federal Family Education Loan (FFEL) Program for the Commission. ED terminated its guaranty agency agreements with the Commission as of October 1, 2010 and transferred the FFEL Program to ECMC effective November 1, 2010. As of December 6, 2010, all EdFund employees had become ECMC employees. Because EdFund does not have any employees at this time, there is no representation from EdFund management regarding the financial statements of the Operating and Federal Funds of the Commission for the years ended June 30, 2010 and 2009.

No events or transactions, other than those disclosed in the financial statements, have occurred subsequent to the balance sheet date that would require adjustment to, or disclosure in, the financial statements.

During the course of your audit, you may have accumulated records containing data which should be reflected in our books and records. All such data have been so reflected. Accordingly, copies of such records in your possession are no longer needed by us.

As of and for the Year Ended June 30, 2010

We believe that the effects of the uncorrected misstatements aggregated by you and summarized below are immaterial, both individually and in the aggregate to the basic financial statements. For purposes of this representation, we consider items to be material, regardless of their size, if they involve the misstatement or omission of accounting information that, in light of surrounding circumstances, makes it probable that the judgment of a reasonable person relying on the information would be changed or influenced by the omission or misstatement.

		Effect - Debit <Credit>			
DESCRIPTION	ASSETS	LIABILITIES	EQUITY	REVENUE	EXPENSES
To reverse expenses denied for reimbursement to EdFund		$463,673			$(463,673)
Total		$463,673			$(463,673)

California Student Aid Commission

Diana Fuentes-Michel
Executive Director

Janet McDuffie, Chief Administration and External Affairs

THE OPERATING FUND AND FEDERAL FUND OF THE CALIFORNIA STUDENT AID COMMISSION

FINANCIAL STATEMENTS

FOR THE YEARS ENDED JUNE 30, 2010 AND 2009

AND

INDEPENDENT AUDITOR'S REPORT

THE OPERATING FUND AND FEDERAL FUND OF THE CALIFORNIA STUDENT AID COMMISSION

FINANCIAL STATEMENTS

For the Years Ended June 30, 2010 and 2009

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INDEPENDENT AUDITOR'S REPORT

The Honorable Members
California Student Aid Commission
Rancho Cordova, California

We have audited the accompanying financial statements of the Student Loan Operating Fund (Operating Fund) and Federal Student Loan Reserve Fund (Federal Fund) of the California Student Aid Commission (the "Commission") as of and for the years ended June 30, 2010 and 2009, as shown in the accompanying table of contents. These financial statements are the responsibility of the Commission's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Commission's Operating and Federal Funds' internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 1, the financial statements present only the Operating Fund and Federal Fund of the Loan Program of the Commission and do not purport to, and do not, present fairly the financial position of the California Student Aid Commission as of June 30, 2010 and 2009, and the changes in its financial position and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial positions of the Operating Fund and Federal Fund of the California Student Aid Commission as of June 30, 2010 and 2009, and their changes in financial position and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

INDEPENDENT AUDITOR'S REPORT
(Continued)

As discussed in Note 18, effective November 1, 2010, Educational Credit Management Corporation became the designated guaranty agency for the Commission's Federal Family Education Loan (FFEL) Program portfolio and the Operating Fund and Federal Fund are no longer under the administration of the Commission. As part of this transition, the U.S. Department of Education (ED) agreed to fund $100 million from the Operating Fund to the 2010-11 State of California budget to support Cal Grant program awards. ED has funded $75 million from the Operating Fund and is scheduled to fund the remaining $25 million in January 2011.

As discussed in Note 18, on December 16, 2010, the U.S. Department of Education (ED) issued a final program review report to the Commission which determined that paying rent on an unoccupied building (Building B) is an improper use of the Operating Fund under the FFEL Program. Based on ED's final program review report, the Commission must reimburse the Operating Fund for the lease payments made on Building B. The source of repayment has not yet been determined and as a result, the amount receivable and impact to the related statement of revenues, expenses and changes in net assets has not been reflected in these financial statements.

The accompanying management's discussion and analysis on pages 3 through 11 is not a required part of the financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

In accordance with *Government Auditing Standards*, we have also issued a report dated December 23, 2010 on our consideration of the Operating Fund's and Federal Fund's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Perry-Smith LLP

Sacramento, California
December 23, 2010

MANAGEMENT'S DISCUSSION AND ANALYSIS

This section of the California Student Aid Commission's (Commission) Federal Family Education Loan (FFEL) Program financial audit report presents discussion and analysis of the program's financial performance during the fiscal years ended June 30, 2010, 2009 and 2008. The FFEL Program, created by the federal government in 1965 as a means of making loans available to students attending college, allows undergraduate and graduate students at eligible postsecondary schools to obtain federally guaranteed loans from private lenders at advantageous interest rates. The U.S. Department of Education (ED) has administrative responsibility over the FFEL Program and designates guaranty agencies to perform the daily operational and oversight functions. Federal legislation governing the FFEL Program established two distinct funds, the Student Loan Operating Fund (Operating Fund) and Federal Student Loan Reserve Fund (Federal Fund), to finance program activities. The information contained in this management discussion and analysis should be read in conjunction with the financial statements following this section.

More recently, the FFEL Program structure was significantly altered with the passage of the Health Care and Education Affordability Reconciliation Act of 2010 (H.R. 4872) on March 30, 2010. H.R. 4872 eliminates new lending under the FFEL Program effective July 1, 2010 and moves all federal student loan funding to the Direct Loan Program, thus removing private banks from student lending and expanded the role of government contractors in administering student loans. While H.R. 4872 discontinues new FFEL Program loan guarantees, the other guaranty agency functions of default aversion, prevention, claims processing and collections for the outstanding FFEL Program portfolio remain the responsibility of the guaranty agency.

This financial audit report consists of four parts: *The Independent Auditor's Report, Management's Discussion and Analysis* (this section), *Basic Financial Statements* (Balance Sheets, Statements of Revenues, Expenses, and Changes in Net Assets, and Statements of Cash Flows), and the *Notes to the Financial Statements*, which explain in further detail information contained in the financial statements.

The Commission, as a designated guarantor, administers the FFEL Program through a contractual arrangement with its auxiliary organization, EdFund. Commission responsibilities also include grant program administration. FFEL Program functions consist of guarantor activities as defined by federal regulations, while the grant program encompasses all activities related to the Commission's administration of the state Cal Grant awards and other specialized programs. The accompanying financial statements present the financial position of the Operating and Federal Funds only and do not present the financial position or results of operations of any other Commission fund or activity.

Effective November 1, 2010, ED terminated its guaranty agency agreements with the Commission and transferred the State of California's guarantor designation from the Commission to another guarantor, Educational Credit Management Corporation (ECMC). This transfer includes California's Federal Fund assets and liabilities and the rights, and obligations (including the continuing outstanding FFEL Program loan portfolio) of the Commission's guaranty agency activities. The Commission worked with ED to structure a seamless transition to ECMC, while maintaining a high level of support for California's students, borrowers and educational institutions. The transition plan also provided financial support for the Cal Grant program, disposition of the Commission's Operating Fund by October 31, 2010, and other administrative, financial and operational issues.

Financial Highlights

Stafford and PLUS loan guarantee volume reached $8.0 billion for the year ended June 30, 2010, a decrease of 23.7 percent from the $10.5 billion in loans guaranteed for the year ended June 30, 2009. This loan volume decline reflects the shift by schools from FFEL to Federal Direct Lending (DL) in preparation for discontinuing new lending under the FFEL Program effective July 1, 2010.

FDF subsidy paid from the Operating Fund was $10.6 million for the year ended June 30, 2010, or 83.5 percent lower than the $64.0 million paid in 2009. The decrease was expected as the FDF program was terminated effective July 1, 2009. The subsidy paid in 2010 is for loans guaranteed by June 30, 2009, but not funded until after that date. These FDF strategies have helped maintain market share and cumulatively saved borrowers approximately $431.4 million since the FDF and insurance premiums (the FDF predecessor) were first waived in 1996.

Effective May 2008, the Ensuring Continued Access to Student Loans Act of 2008 (ECASLA) was enacted in response to the lack of liquidity in the financial markets as FFEL Program lenders were unable to find buyers for their securitized student loan offerings. ECASLA provides avenues for lenders to sell these loans to the federal government. Although these solutions provide the liquidity needed for lenders to continue funding student loans, a negative consequence is that these loans are no longer retained in the guarantor's portfolio. As of June 2010 and 2009, lenders transferred $8.1 billion and $1.9 billion, respectively, in loan guarantees to ED under the loan purchase program authorized by ECASLA. These loan purchases are a primary cause of the outstanding loan portfolio declining 7.0 percent, from $36.3 billion in 2009 to $33.8 billion in 2010.

Operating Fund operating income of $81.5 million in 2010 is $64.6 million higher than the $16.9 million generated in 2009 and results from modest revenue increases coupled with reductions in personnel and operating costs and the elimination of the FDF subsidy. These positive operating performances generated operating margins of 45.4 percent and 9.7 percent in 2010 and 2009, respectively.

Gross collection recoveries on loan defaults reached $522.9 million in 2010 compared to $447.1 million in 2009. Of these amounts, $386.6 million was remitted to ED in federal share during 2010, resulting in a 18.1 percent increase from the $327.3 million remitted the previous year. Similarly, net recoveries on loan defaults of $112.5 million and $108.5 million were retained as revenue to the Operating Fund in 2010 and 2009, respectively. The gross collection recovery performance reflects a 17.0 percent improvement from 2009 signifying EdFund's continued achievements in shifting collection efforts to an emphasis on rehabilitation loan recoveries, an increased defaulted loan portfolio, and improved defaulted loan recovery rates through enhanced automation tools and increased internal and external collection recovery performance.

In 2010 and 2009 the state appropriated $32 million and $24 million, respectively, from the Operating Fund to fund Cal Grant program awards. Cal Grant program awards are made to students to help pay the costs for postsecondary education.

MANAGEMENT'S DISCUSSION AND ANALYSIS
(Continued)

Program Overview

The FFEL Program consists of two funds: the Operating and Federal Funds (Funds). The Operating Fund is agency-owned and managed, while the Federal Fund is the property of the United States government and is regulated by the Secretary of Education.

The Operating Fund, a state fund within the custody and control of the Commission, reflects transactions related to guarantor activities as specified by law. These activities include loan origination and guaranty processing, default aversion and collections on defaulted loans. The Operating Fund also reflects other student financial aid related activities as selected by the guaranty agency, including activities related to administration of state specialized grant programs. Operating Fund revenues are derived principally from collection recoveries on defaulted student loans and performance based fees paid by ED for new loan disbursements, portfolio maintenance and successful default aversion efforts.

The Federal Fund, whose assets are the property of ED, primarily reflects transactions related to the Commission's student loan insurance activity. These transactions include payments to lenders for defaulted claims offset by the associated reinsurance reimbursement received from ED, along with default aversion fees paid to the Operating Fund. Federal Fund revenues are recognized from the federal default fee and claim purchase complement from collection recoveries.

The Operating Fund and Federal Fund follow accounting for business-type activities using the flow of economic resources measurement focus and accrual basis of accounting. Accordingly, revenues are recognized when earned and expenses are recognized when the liability is incurred regardless of the timing of the related cash flow. The most significant example is the allowance for the default aversion fee. Upon fee billing, an estimated liability for future refunds is recorded in the Operating Fund and a corresponding receivable in the Federal Fund. These entries recognize the long-term obligation to refund the fee for those loans that subsequently default and trigger fee repayment.

Regulatory changes required by the passage of the Higher Education Reconciliation Act (HERA) in 2007 included a federal requirement that all guaranty agencies deposit a Federal Default Fee (FDF) to their Federal Fund equal to 1 percent of the disbursement amount for Stafford and PLUS loans guaranteed on and after July 1, 2006 to cover the cost of insuring the loan. The FDF is the primary source of revenue to the Federal Fund.

To help mitigate education costs for students and remain competitive in the market, on September 7, 2006 the Commission approved an FDF policy designed to share the FDF payment to benefit student borrowers. These programs resulted in FDF subsidy costs paid on behalf of student borrowers through June 30, 2009. The FDF subsidy program was discontinued effective July 1, 2009, but FDF subsidy disbursements continue for eligible loans guaranteed prior to termination date until the associated loan disbursements are completed.

MANAGEMENT'S DISCUSSION AND ANALYSIS
(Continued)

Net recoveries on loan defaults are the primary source of revenue to the Operating Fund. After a loan defaults, the Commission continues its collection efforts and is allowed to retain as revenue to the Operating Fund up to 16 percent of the amount collected. For loans that have been rehabilitated (9 on-time payments made by the defaulted borrower in a 10-month period) or consolidated by a third-party refinancing, the Commission is allowed by federal regulation to retain a percentage of the total amount received relating to the retirement of the default obligation. The remaining amounts are returned to the federal government.

Rehabilitation loans continue to account for the largest portion of collection recoveries and offer benefits to borrowers through improved credit histories and the ability to qualify again for federal student loans. Gross rehabilitation loan volume increased to $343.3 million in 2010 from $281.2 million in 2009, for a 22.1 percent increase. Additionally, improved collection rates in regular collections, wage garnishment, and federal direct consolidation collections also contributed to the $4.1 million growth in net collection recoveries from the prior year.

The federal Higher Education Act authorizes certain fees be paid to the Operating Fund for administering the FFEL Program on behalf of the federal government based on guaranty agency performance. These administrative and program fees are the Loan Processing and Issuance Fees (LPIF), Account Maintenance Fee (AMF), and Default Aversion Fee (DAF).

The LPIF is calculated at a rate of 0.40 percent of disbursed dollars from new loan guarantees. The AMF is calculated annually at 0.06 percent based on the original principal outstanding (OPO) amount of loans at federal year end September 30, 2009 and 2008. Interim quarterly installment payments paid by ED are based on year-end estimates and reconciled each federal fiscal year-end. Beginning December 31, 2009, and quarterly thereafter, ED changed the AMF calculation methodology to quarterly payments paid by ED based on actual quarterly OPO balances divided by 4 and multiplied by 0.06 percent. OPO balance includes the cumulative loan guarantee volume less cumulative cancellations, claims paid, loans transferred and loans paid in full. LPIF and AMF are paid entirely by ED.

The Operating Fund also receives DAF revenue, which is paid as an incentive to prevent delinquent loans from defaulting. These fees are paid from the Federal Fund directly to the Operating Fund based on the dollar amount of first-time default aversion assistance requests multiplied by 1 percent. Should the loan subsequently default, the DAF must be repaid based on 1 percent of the loan amount at time of claim.

On February 4, 2010, EdFund entered into a contract with a school to provide borrower counseling (delinquency prevention and default aversion) services to its students for loans not covered by the traditional FFEL guarantor model. Upon notification that EdFund had entered into this contract, the Commission informed the Department of Finance (DOF) that statute required DOF's approval of this new line of business. DOF approved the new line of business pursuant to provisions of Senate Bill 89 on March 24, 2010. The contract was terminated effective November 4, 2010.

MANAGEMENT'S DISCUSSION AND ANALYSIS
(Continued)

One of the Commission's primary functions as a guarantor is to guarantee the outstanding principal and interest due to the lenders when a borrower fails to return their loan to a current repayment status within the regulatory required timeframe. Under federal regulations, the Commission is required to maintain a minimum balance in its Federal Fund to purchase loans from lenders when all default aversion efforts fail to return delinquent borrowers to a current repayment status. Lenders are currently paid an amount representing 97 percent of principal and calculated interest. The federal government then reimburses the Federal Fund a percentage of the default claims paid to lenders based on the loan guarantee dates as follows:

• Loans guaranteed before October 1, 1993	100 percent
• Loans guaranteed on October 1, 1993 – September 30, 1998	98 percent
• Loans guaranteed on or after October 1, 1998	95 percent

For each collection payment received, the Commission is required to deposit into the Federal Fund an amount equal to the payment multiplied by the reinsurance rate complement. The reinsurance complement is either 2 percent or 5 percent, depending on the year the loan was guaranteed. However, federal direct consolidation recoveries require no complement revenue to the Federal Fund.

MANAGEMENT'S DISCUSSION AND ANALYSIS
(Continued)

Overview of the Financial Statements

The following table provides a summary of the balance sheets and statements of revenues, expenses, and changes in net assets for both the Operating Fund and Federal Fund for fiscal years ended June 30, 2010, 2009 and 2008.

	Operating Fund *Amounts in thousands*			Federal Fund *Amounts in thousands*		
Summary of Balance Sheets	**2010**	**2009**	**2008**	**2010**	**2009**	**2008**
Current assets	$ 122,621	$ 64,276	$ 62,985	$ 146,777	$ 151,240	$ 119,400
Other noncurrent assets	1	20,015	20,143	—	—	—
Total assets	122,622	84,291	83,128	146,777	151,240	119,400
Current liabilities	20,096	31,272	23,448	12,941	37,250	40,247
Noncurrent liabilities	48	39	39	—	—	—
Total liabilities	20,144	31,311	23,487	12,941	37,250	40,247
Net assets:						
Restricted	—	—	—	133,836	113,990	79,153
Unrestricted	102,478	52,980	59,641	—	—	—
Total net assets	$ 102,478	$ 52,980	$ 59,641	$ 133,836	$ 113,990	$ 79,153

	Operating Fund *Amounts in thousands*			Federal Fund *Amounts in thousands*		
Summary of Revenues, Expenses and Changes in Net Assets	**2010**	**2009**	**2008**	**2010**	**2009**	**2008**
Operating revenues:						
Net recoveries on loan defaults	$ 112,548	$ 108,468	$ 90,911	$ —	$ —	$ —
Administrative and program fee income	65,668	65,767	60,156	—	—	—
Borrower counseling services	1,206	—	—	—	—	—
VFA revenue	—	—	4,911	—	—	—
Lender premium fees	—	—	1,683	—	—	—
Federal default fee	—	—	—	71,762	79,418	57,431
Claim purchase complement	—	—	—	18,924	15,811	11,021
Other	—	—	4	23	27	10
Operating revenues	179,422	174,235	157,665	90,709	95,256	68,462
Operating expenses:						
Administrative	87,324	93,314	93,787	—	—	—
Fee subsidies	10,566	64,052	26,014	13,873	9,966	18,037
Loan default expense	—	—	—	57,224	51,226	43,964
Other	—	—	—	—	—	2
Operating expenses	97,890	157,366	119,801	71,097	61,192	62,003
Operating income	81,532	16,869	37,864	19,612	34,064	6,459
Nonoperating revenues (expenses):						
Interest income	363	1,190	1,952	234	773	1,397
Grant administrative costs	(397)	(596)	(1,712)	—	—	—
Financial aid awareness program	—	(124)	(2,470)	—	—	—
Nonoperating revenues (expenses)	(34)	470	(2,230)	234	773	1,397
Transfers:						
Cal Grant program awards	(32,000)	(24,000)	—	—	—	—
Change in net assets	49,498	(6,661)	35,634	19,846	34,837	7,856
Net assets, beginning of year	52,980	59,641	24,007	113,990	79,153	71,297
Net assets, end of year	$ 102,478	$ 52,980	$ 59,641	$ 133,836	$ 113,990	$ 79,153

Financial Analysis of the Operating Fund

- At fiscal year ended June 30, 2010, total net assets of the Operating Fund reflect an increase from the prior year of $49.5 million to $102.5 million compared to a $6.6 million decrease to $53.0 million at June 30, 2009. Net assets are comprised entirely of unrestricted net assets. This net asset change is primarily due to the items noted below.

MANAGEMENT'S DISCUSSION AND ANALYSIS
(Continued)

- In fiscal year 2010, total operating revenues increased by $5.2 million (or 3.0 percent from 2009) to $179.4 million, primarily in net recoveries on loan defaults. Though the economy remains weak as indicated by the unemployment rate remaining at 9.5 percent for June 2009 and June 2010, the collection recovery rates of 31.9 percent and 32.3 percent in 2010 and 2009, respectively, continue to signify the positive returns from EdFund's collection strategy.

- Net recoveries on loan defaults increased to $112.5 million in 2010 from $108.5 million in 2009, most notably in rehabilitation loan recoveries. Rehabilitation loans offer benefits to the defaulted borrower by improving their credit rating while bringing their student loan balances out of default status, and providing increased revenues to the Operating Fund because of higher retention rates on this collection type.

- Administrative and program fee income of $65.7 million in 2010 approximate the $65.8 million earned in 2009. However, the fee income mix changed as LPIF and AMF decreased $4.0 million in 2010 and DAF increased $3.9 million in 2010. The decrease in LPIF is consistent with schools migration from the FFEL Program to the DL Program. The decrease in AMF is impacted by loans purchased by the federal government under ECASLA. The increase in DAF reflects the successful default aversion programs and counseling provided to borrowers.

- Borrower counseling services is a new program added in 2010. The program offers delinquency prevention and default aversion services to students for loans not covered by the traditional FFEL guarantor model. A contract was entered into with an educational institution in February, 2010 and generated $1.2 million in revenues for the Operating Fund. The contract will end on November 4, 2010.

- Administrative operating expenses decreased $6.0 million in 2010 and $0.5 million in 2009. The decrease in 2010 reflects the change in operations attributable to the elimination of new loan guarantees in the FFEL Program under H.R. 4872 and other expense reduction efforts. The 2009 expenses remained relatively constant to 2008 and although net recoveries increased in 2009, associated collection costs were contained by shifting additional collection efforts internally, which is more cost effective, and revising the external agency fees.

- The significant federal default fee subsidy decrease to $10.6 million in 2010, from $64.1 million in 2009, is attributable to the termination of the FDF program effective July 1, 2009. FDF subsidy paid in 2010 is for loans guaranteed prior to June 30, 2009, but not funded until after that date.

- Transfers from the Operating Fund to the State General Fund for Cal Grant program awards increased by $8.0 million in 2010. The State appropriated $32.0 million to help fund Cal Grant program awards in 2010 and $24.0 million in 2009.

MANAGEMENT'S DISCUSSION AND ANALYSIS
(Continued)

Financial Analysis of the Federal Fund

At fiscal year ended June 30, 2010, the total net assets of the Federal Fund increased from the prior year by $19.8 million to $133.8 million compared to a $34.8 million increase to $114.0 million at year ended June 30, 2009. Net assets are comprised entirely of restricted balances mandated by federal regulation to meet required minimum reserve levels. This net asset increase is primarily due to the items noted below.

- In 2010, total operating revenues decreased $4.5 million to $90.7 million. FDF revenue decreased $7.6 million to $71.8 million in 2010 as schools transitioned lending from the FFEL Program to DL Program in preparation for the June 30, 2010 deadline as mandated by H.R. 4872. The decrease was mitigated by a $3.1 million increase in complement revenues to $18.9 million in 2010, due to increases in collection recoveries. Decreases in other revenues and interest income comprise the remaining changes from prior year.

- Fee subsidies consist primarily of DAF subsidies and early withdrawal fee subsidies in 2008 only, recorded net of refund allowance estimates. In fiscal years 2010 and 2009, the Operating Fund charged the Federal Fund $13.8 million and $10.0 million in DAF expenses, respectively.

- Loan default expense increased by $6.0 million in 2010 compared to 2009 due to a rise in the rate of default claims in relation to total loans in repayment.

Significant Known Facts, Decisions, or Conditions

Guaranty Designation Transfer

Chapter 132 of the California Statutes of 2007 (Senate Bill 89) authorized the sale or other transaction of the Commission's student loan guarantee portfolio and certain related assets and liabilities of the student loan program. Senate Bill 89 also authorized the State Director of Finance (DOF) to consummate other transactions to maximize the value of the State's student loan guarantee program.

ED informed the Commission and DOF on July 20, 2010 that it would not agree to or approve any transfer of the guaranty agency responsibilities in California arranged under the State's current sale process. ED also indicated that the guaranty agency agreement with the Commission would be terminated no later than the close of business on October 31, 2010.

In its letter of August 27, 2010, ED indicated that the action to terminate is in accordance with section 428(c)(9)(E) of the Higher Education Act of 1965, as amended. ED also indicated that the U.S. Secretary of Education selected Educational Credit Management Corporation (ECMC) as the successor guaranty agency to assume California's Federal Fund assets and liabilities and the rights, and obligations (including the continuing outstanding FFEL Program loan guarantees) of the Commission's guaranty agency activities, including administration of the Operating Fund.

Effective November 1, 2010 ECMC became the designated guaranty agency for the Commission's FFEL Program portfolio. ECMC is assessing the EdFund personnel, facilities, and other operational expenses and incorporating those deemed useful for administering the FFEL Program activities now under their control. As part of this transition, ED agreed to fund $100 million from the Operating Fund to the 2010-11 State of California budget to support Cal Grant program awards. ED has funded $75 million from the Operating Fund and is scheduled to fund the remaining $25 million in January 2011.

EdFund Lease

As an auxiliary organization of the Commission, EdFund made lease payments on an unoccupied building (Building B) of $3,343,624 between July 3, 2008 and June 30, 2010. On December 16, 2010, ED issued a final program review report to the Commission which determined that paying rent on an unoccupied building is an improper use of the Operating Fund under the FFEL Program since the payment of these costs is not in support of a guaranty agency-related activity or for other student financial aid-related activities. The required action from ED is for the Commission to immediately cease making future lease payments for the unoccupied building through the Operating Fund. In addition, the Commission must reimburse the Operating Fund for the lease payments made to date on Building B. The Commission does not have any independent authority or the requisite appropriation to make such a payment. As such, no action has been taken to reimburse the Operating Fund.

Denied Expenses

The Commission denies the reimbursement of expenses to EdFund from the Operating Fund when EdFund does not provide the Commission with requested backup documentation of a product or service or when the Commission determines the expense to be a gift of California state funds, a waste of public funds or not allowable under Federal regulations. Denied expenses for the years ended June 30, 2010 and 2009 were $463,673 and $215,283, respectively.

THE OPERATING FUND AND FEDERAL FUND OF THE CALIFORNIA STUDENT AID COMMISSION

BALANCE SHEETS

June 30, 2010 and 2009

	Operating Fund	
	2010	2009
ASSETS		
Current assets:		
Cash and cash equivalents (Note 4)	$ 77,473,237	$ 591,310
Interest receivable	113,686	71,465
Other receivables (Note 12)	1,124,171	753
Due from Federal Fund (Note 15)	12,940,556	37,249,624
Due from Federal government (Note 6)	8,668,839	11,912,185
Due from lending institutions (Note 8)	2,230,112	14,437,484
Due from other funds	70,808	13,557
Advance to EdFund (Note 15)	20,000,000	-
Total current assets	122,621,409	64,276,378
Noncurrent assets:		
Capital assets, net of accumulated depreciation (Note 5)	1,069	15,074
Advance to EdFund (Note 15)	-	20,000,000
Total noncurrent assets	1,069	20,015,074
Total assets	$ 122,622,478	$ 84,291,452
LIABILITIES AND NET ASSETS		
Current liabilities:		
Accounts payable	$ 166,449	$ 177,785
Due to EdFund (Note 15)	220,416	11,055,630
Allowance for default aversion fees (Note 6)	18,598,709	18,028,082
Allowance for early withdrawal fees (Note 7)	1,111,138	2,011,033
Total current liabilities	20,096,712	31,272,530
Noncurrent liabilities:		
Post retirement obligation (Note 14)	48,000	39,000
Total liabilities	20,144,712	31,311,530
Net assets:		
Investment in capital assets (Note 5)	1,069	15,074
Unrestricted	102,476,697	52,964,848
Total net assets	102,477,766	52,979,922
Total liabilities and net assets	$ 122,622,478	$ 84,291,452

The accompanying notes are an integral part of these financial statements.

THE OPERATING FUND AND FEDERAL FUND OF THE CALIFORNIA STUDENT AID COMMISSION

BALANCE SHEETS

June 30, 2010 and 2009

	Federal Fund	
	2010	**2009**
ASSETS		
Current assets:		
Cash and cash equivalents (Note 4)	$ 21,505,138	$ 8,657,954
Interest receivable	61,246	98,072
Due from Federal government (Note 3)	68,187,996	47,636,067
Due from EdFund and other funds (Note 15)	29,139,890	19,396,000
Due from lending institutions (Note 8)	8,173,022	55,412,781
Default aversion fees receivable (Note 6)	18,598,709	18,028,082
Early withdrawal fees receivable (Note 7)	1,111,138	2,011,033
Total assets	$ 146,777,139	$ 151,239,989
LIABILITIES AND NET ASSETS		
Current liabilities:		
Due to Operating Fund (Note 15)	$ 12,940,556	$ 37,249,624
Net assets:		
Restricted (Note 13)	133,836,583	113,990,365
Total liabilities and net assets	$ 146,777,139	$ 151,239,989

The accompanying notes are an integral part of these financial statements.

THE OPERATING FUND AND FEDERAL FUND OF THE CALIFORNIA STUDENT AID COMMISSION

STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS

For the Years Ended June 30, 2010 and 2009

	Operating Fund	
	2010	**2009**
Operating revenues:		
Net recoveries on loan defaults (Note 8)	$ 112,548,629	$ 108,467,923
Administrative and program fees income (Note 6)	65,667,707	65,766,602
Borrower counseling services (Note 12)	1,205,966	-
Total operating revenues	179,422,302	174,234,525
Operating expenses:		
Loan program personnel costs	49,549,319	51,840,024
Operating expenses (Note 16)	20,243,231	23,606,453
Contracted collection costs	17,531,785	17,866,972
Federal default fee subsidy (Note 11)	10,566,219	64,052,318
Total operating expenses	97,890,554	157,365,767
Operating income	81,531,748	16,868,758
Nonoperating revenues (expenses):		
Interest income (Note 4)	362,749	1,190,503
Grant administrative costs (Note 9)	(396,653)	(595,991)
Financial aid awareness programs (Note 9)	-	(124,182)
Total nonoperating (expenses) revenues	(33,904)	470,330
Transfers:		
Transfer to State of California's General Fund for Cal Grant program awards (Note 9)	(32,000,000)	(24,000,000)
Change in net assets	49,497,844	(6,660,912)
Net assets, beginning of year	52,979,922	59,640,834
Net assets, end of year	$ 102,477,766	$ 52,979,922

The accompanying notes are an integral part of these financial statements.

THE OPERATING FUND AND FEDERAL FUND OF THE CALIFORNIA STUDENT AID COMMISSION

STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS

For the Years Ended June 30, 2010 and 2009

	Federal Fund	
	2010	2009
Operating revenues:		
Federal default fee (Note 11)	$ 71,761,555	$ 79,418,299
Claim purchase complement	18,924,171	15,811,337
Other revenues	23,527	26,541
Total operating revenues	90,709,253	95,256,177
Operating expenses:		
Loan default expenses (Note 10)	57,224,196	51,225,989
Default aversion fee (Note 6)	13,873,258	9,966,087
Total operating expenses	71,097,454	61,192,076
Operating income	19,611,799	34,064,101
Nonoperating revenues:		
Interest income (Note 4)	234,419	773,356
Change in net assets	19,846,218	34,837,457
Net assets, beginning of year	113,990,365	79,152,908
Net assets, end of year	$ 133,836,583	$ 113,990,365

The accompanying notes are an integral part of these financial statements.

THE OPERATING FUND AND FEDERAL FUND OF THE CALIFORNIA STUDENT AID COMMISSION

STATEMENTS OF CASH FLOWS

For the Years Ended June 30, 2010 and 2009

	Operating Fund	
	2010	**2009**
Cash flows from operating activities:		
Receipts from:		
Collections	$ 121,843,386	$ 95,757,377
Administrative fees	68,632,273	69,592,762
Other sources	143,096	-
Payments for:		
General administrative and other expenses	(67,717,061)	(92,079,253)
Federal default fee subsidy	(13,959,301)	(62,749,868)
Net cash provided by operating activities	108,942,393	10,521,018
Cash flows from noncapital financing activities:		
Payments for grant administrative costs	(382,648)	(467,490)
Financial aid awareness programs	-	(124,182)
Transfer for Cal Grant program awards	(32,000,000)	(24,000,000)
Net cash used in noncapital financing activities	(32,382,648)	(24,591,672)
Cash flows provided by investing activities:		
Interest received	322,182	1,405,043
Increase (decrease) in cash and cash equivalents	76,881,927	(12,665,611)
Cash and cash equivalents, beginning of year	591,310	13,256,921
Cash and cash equivalents, end of year	$ 77,473,237	$ 591,310
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	$ 81,531,748	$ 16,868,758
Adjustments to reconcile operating income to net cash provided by operating activities:		
Change in assets and liabilities:		
Receivables	(1,123,418)	1,137
Federal government	3,243,346	(2,693,754)
General Fund	(57,251)	(21,775)
Lending institution	12,207,372	(14,437,484)
EdFund	(10,836,868)	2,553,777
Federal Fund	24,309,068	2,997,858
Accounts payable	(11,336)	10,620
Allowance for default aversion and early withdrawal fees	(329,268)	5,241,881
Post retirement obligation	9,000	-
Total adjustments	27,410,645	(6,347,740)
Net cash provided by operating activities	$ 108,942,393	$ 10,521,018

The accompanying notes are an integral part of these financial statements.

THE OPERATING FUND AND FEDERAL FUND OF THE CALIFORNIA STUDENT AID COMMISSION

STATEMENTS OF CASH FLOWS

For the Years Ended June 30, 2010 and 2009

	Federal Fund	
	2010	**2009**
Cash flows from operating activities:		
Receipts from:		
Reimbursement on default purchases	$ 1,295,439,659	$ 1,109,464,821
Federal default fee	75,002,386	77,863,769
Other sources	20,863,452	13,179,471
Payments for:		
Administrative fees	(13,594,478)	(16,486,001)
Purchases of default student loans	(1,364,884,599)	(1,189,813,281)
General administrative and other expenses	(251,332)	(1,392)
Net cash provided by (used in) operating activities	12,575,088	(5,792,613)
Cash flows provided by investing activities:		
Interest received	272,096	776,300
Increase (decrease) in cash and cash equivalents	12,847,184	(5,016,313)
Cash and cash equivalents, beginning of year	8,657,954	13,674,267
Cash and cash equivalents, end of year	$ 21,505,138	$ 8,657,954
Reconciliation of operating income to net cash provided by (used in) operating activities:		
Operating income	$ 19,611,799	$ 34,064,101
Adjustments to reconcile operating income to net cash provided by (used in) operating activities:		
Change in assets and liabilities:		
Federal government	(20,551,929)	21,680,313
EdFund	(9,744,741)	2,115,493
Operating Fund	(24,309,068)	(2,997,858)
Due to lending institutions	47,239,759	(55,412,781)
Allowance for default aversion and early withdrawal fees	329,268	(5,241,881)
Total adjustments	(7,036,711)	(39,856,714)
Net cash provided by (used in) operating activities	$ 12,575,088	$ (5,792,613)

The accompanying notes are an integral part of these financial statements.

THE OPERATING FUND AND FEDERAL FUND OF THE CALIFORNIA STUDENT AID COMMISSION

NOTES TO FINANCIAL STATEMENTS

1. ORGANIZATION AND OPERATIONS

The California Student Aid Commission (the "Commission"), an agency of the State of California created in 1955, is responsible for the administration of California's student financial aid programs. These programs include the Federal Family Education Loan (FFEL) Program, state grant program and other specialized programs.

The FFEL Program, established by Congress in 1965, is administered by the U.S. Department of Education (ED) through the Commission and other guaranty agencies. As a guaranty agency, the Commission guarantees loans made available through lending institutions to students attending colleges, universities, postsecondary and vocational schools. The FFEL Program allows the Commission to guarantee repayment of principal and accrued interest to lenders for eligible student loans. The Commission has the responsibility of processing loans submitted for guarantee, issuing loan guarantees, partnering with lenders to prevent defaults, paying lender claims for loans that default, and performing collection activities on loans after purchase.

The 1998 Reauthorization of the Higher Education Act (1998 Amendments) were enacted on October 6, 1998 and changed the manner in which the FFEL Program is administered. Under the 1998 Amendments, the Commission established a Federal Student Loan Reserve Fund (Federal Fund) and a Student Loan Operating Fund (Operating Fund) as required to account for FFEL Program activities. The FFEL Program is composed of Stafford, PLUS and Consolidation loans, and the residual activities of the Guaranteed Student Loan Program, which ceased to provide loans in 1967. The Federal Fund assets and earnings on those assets may only be used to pay for claim payments, default aversion fees and any other purposes authorized by ED and are considered the property of ED. The Operating Fund is a state fund within the custody and control of the Commission and its assets and earnings may be used for all guaranty agency and student financial aid-related activities. The accompanying financial statements reflect the activities of the Operating Fund and Federal Fund (Funds) of the Commission.

On March 30, 2010, the Health Care and Education Affordability Reconciliation Act of 2010 (H.R. 4872) was signed into law which significantly changed the FFEL Program by eliminating new lending under the FFEL Program effective July 1, 2010 and moving all federal student loan funding to the Direct Loan Program. H.R. 4872 removed private banks from student lending and expanded the role of government contractors in administering student loans. While H.R. 4872 discontinued new FFEL Program loan guarantees, the other guaranty agency functions of default aversion, prevention, claims processing and collections for the outstanding FFEL Program portfolio remain the responsibility of the guaranty agency.

The Commission also administers the state Cal Grant program, under which state funded monetary grants are given to students to help pay for college expenses. A portion of the Cal Grant program awards along with certain administrative costs associated with these programs are included in the Operating Fund's accompanying financial statements.

2. SIGNIFICANT ACCOUNTING POLICIES

(a) Basis of Accounting

The Commission's Operating Fund and Federal Fund follow fund accounting under accounting principles generally accepted in the United States of America in which resources are classified for accounting and reporting purposes into funds established according to their purpose. The two funds are accounted for as business-type activities using the flow of economic resources measurement focus and the accrual basis of accounting. Revenues are recognized when earned and expenses are recognized when the liability is incurred regardless of the timing of the related cash flow.

The Federal Fund largely reflects the organization's FFEL Program insurance activities, while the Operating Fund accounts for FFEL Program operational activity, financial aid awareness and related outreach, a portion of grant administration activity and state Cal Grant program awards. In accordance with Government Accounting Standards Board (GASB) Codification Section P80, *Proprietary Fund Accounting and Financial Reporting*, the Operating and Federal Funds apply all applicable GASB pronouncements as well as Financial Accounting Standards Board (FASB) pronouncements and Accounting Principles Board (APB) opinions, issued on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements. These Funds have not applied accounting standards issued after November 30, 1989 by the FASB.

(b) Cash and Cash Equivalents

For the purposes of the financial statements, cash and cash equivalents are defined as financial instruments with an original maturity of three months or less. Funds invested in the Surplus Money Investment Fund (SMIF) are considered cash equivalents.

(c) Capital Assets

Capital assets are those assets purchased or acquired with an original cost of $5,000 or more. Additions, improvements or other capital outlays that significantly extend the useful life of an asset are capitalized. These assets are reported at historical cost and are depreciated using the straight-line method over estimated useful lives of three to five years. Repair and maintenance costs are expensed as incurred. Depreciation of $14,005 and $128,501 is included in the Operating Fund's grant administrative costs for the years ended June 30, 2010 and 2009, respectively.

THE OPERATING FUND AND FEDERAL FUND OF THE
CALIFORNIA STUDENT AID COMMISSION

NOTES TO FINANCIAL STATEMENTS
(Continued)

2. **SIGNIFICANT ACCOUNTING POLICIES** (Continued)

(d) Net Assets

The Commission's net assets are classified as follows:

- Invested in capital assets – represents the Commission's total net investment in capital assets.
- Restricted net assets–expendable – represent resources that the Commission is legally or contractually obligated to spend in accordance with restrictions imposed by external third parties.
- Unrestricted net assets – represent resources derived from and expended on behalf of the fund.

(e) Operating Revenues and Expenses

Operating revenues and expenses generally result from activities associated with the FFEL Program including loan origination and guarantee, default prevention, defaulted loan purchase activities and collection on defaulted loans. All revenues and expenses not classified as operating are reported as either nonoperating revenues and expenses or General Fund transfers. Nonoperating revenues and expenses include interest income, a portion of grant program administrative costs and financial awareness programs.

(f) Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions. These estimates and assumptions affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Management estimates include useful lives in depreciating capital assets and anticipated future refunds of default aversion fees and early withdrawal fees. Actual results could differ from these estimates.

(g) Reclassifications

Certain reclassifications have been made to prior year balances for clarification and to conform to classifications used in 2010.

THE OPERATING FUND AND FEDERAL FUND OF THE
CALIFORNIA STUDENT AID COMMISSION

NOTES TO FINANCIAL STATEMENTS
(Continued)

2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(h) New Financial Accounting Pronouncement

Fund Balance Reporting and Governmental Fund Type Definitions

In February 2009, the Governmental Accounting Standards Board (GASB) issued Statement of Governmental Accounting Standard No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions,* (GASB No. 54). The Statement was issued to address a lack of consistency in fund balance reporting by providing clearer fund balance classifications and by clarifying the existing definitions of governmental fund types. GASB 54 is effective for periods beginning after June 15, 2010. The financial statements of the Operating Fund and Federal Fund are proprietary funds and not impacted by GASB 54.

3. GUARANTEED LOANS OUTSTANDING

As of June 30, 2010 and 2009, the Commission was the guarantor of a portfolio of outstanding loans with original principal amounts of approximately $33.8 billion and $36.3 billion, respectively. These loans were made to students by participating lenders and are guaranteed by ED.

Management anticipates that a certain portion of the FFEL Program loans outstanding as of June 30, 2010 will go into default status in the future requiring the use of the Federal Fund to purchase these defaulted loans from lenders. The Federal Fund will subsequently be reimbursed by ED at the applicable reinsurance rate associated with these defaulted loans. At June 30, 2010 and 2009, reinsurance reimbursements on defaulted loan purchases due from the Federal government were $68,187,996 and $47,636,067, respectively.

4. CASH AND CASH EQUIVALENTS

Cash is maintained in the Surplus Money Investment Fund (SMIF). The SMIF consists of available cash of all special funds of the State of California which do not have investment authority of their own. Cash balances in excess of needs in any of these participating funds are invested by the State Treasurer. The State Treasurer's Office reports its investments at fair value. The Pooled Money Investment Board (PMIB) provides regulatory oversight over the State Treasurer's pooled investment program and is responsible for determining whether any cash balances of the participating funds are in excess of current needs and available for investment, or whether it is necessary to liquidate previous investments to meet current requirements. The PMIB is comprised of the State Treasurer as chair, the State Controller and the State Director of Finance. The Commission follows the investment policy of the State Treasurer. Additional information, including investment credit type, interest rate risk, and concentration of credit risk is available at the State Controller's website (www.sco.ca.gov).

THE OPERATING FUND AND FEDERAL FUND OF THE
CALIFORNIA STUDENT AID COMMISSION

NOTES TO FINANCIAL STATEMENTS
(Continued)

4. CASH AND CASH EQUIVALENTS (Continued)

All of the resources of the SMIF are invested through the Pooled Money Investment Account (PMIA). The State Treasurer is restricted by state code as to the types of investments that can be made in the following categories: U.S. Government securities; securities of federally-sponsored agencies; domestic corporate bonds; interest-bearing time deposits in California banks, savings and loan associations and credit unions; prime-rated commercial paper; repurchase and reverse repurchase agreements; security loans; banker's acceptances; negotiable certificates of deposit and loans to various bond funds.

At June 30, 2010 and 2009 the allocation of the carrying value plus accrued interest purchased of the SMIF investments and cash held by the Operating Fund and Federal Fund are approximated as follows (in 000's):

	June 30, 2010		June 30, 2009	
	Operating Fund	Federal Fund	Operating Fund	Federal Fund
SMIF:				
U.S. Treasury Securities	$ 36,150	$ 10,034	$ 156	$ 2,285
Federal Agency Securities	10,301	2,859	117	1,716
IBRD Debt FR	335	93	3	51
Bank Notes	447	124	-	-
Certificates of Deposit	8,447	2,345	53	781
Commercial Paper	8,668	2,406	25	361
Corporate Bonds	140	39	4	52
Time Deposits	4,629	1,285	65	948
AB 55 and General Fund loans	8,356	2,320	168	2,464
Total	$ 77,473	$ 21,505	$ 591	$ 8,658

The value of the deposits in the State Treasurer's pooled investment program (program), including the SMIF, is equal to the dollars deposited in the program. The fair value of the position in the program may be greater or less than the value of the deposits, with the difference representing the unrealized gain or loss. As of June 30, 2010 and 2009, this difference was immaterial to the valuation of the deposits held by the Operating Fund and Federal Fund in the SMIF. The pool is run with "dollar in, dollar out" participation. There are no share-value adjustments to reflect changes in fair value. The Operating Fund and Federal Fund share in the interest earnings of PMIA based on the ratio that their dollar-day contributions bear to the dollar-day investments of the PMIA.

The Operating Fund has an investment in ELM Resources as a jointly governed organization. ELM Resources provides loan processing services for member guarantors, lenders and servicers. This investment has nominal value and no ongoing financial interest or ongoing financial responsibility for the Operating Fund.

THE OPERATING FUND AND FEDERAL FUND OF THE CALIFORNIA STUDENT AID COMMISSION

NOTES TO FINANCIAL STATEMENTS
(Continued)

5. CAPITAL ASSETS

Capital asset activity for the year ended June 30, 2010 is as follows:

	2010			
	Beginning Balance	Additions	Transfers/ Disposals	Ending Balance
Vehicles	$ 20,559	$ -	$ -	$ 20,559
Computer equipment	330,468	-	(21,194)	309,274
Computer software	840,807	-	-	840,807
Office equipment	1,346,732	-	(7,087)	1,339,645
	2,538,566	-	(28,281)	2,510,285
Less accumulated depreciation:				
Vehicles	(20,559)	-	-	(20,559)
Computer equipment	(325,168)	(5,300)	21,194	(309,274)
Computer software	(834,666)	(6,141)	-	(840,807)
Office equipment	(1,343,099)	(2,564)	7,087	(1,338,576)
	(2,523,492)	(14,005)	28,281	(2,509,216)
Capital assets, net	$ 15,074	$ (14,005)	$ -	$ 1,069

Capital asset activity for the year ended June 30, 2009 is as follows:

	2009			
	Beginning Balance	Additions	Transfers/ Disposals	Ending Balance
Vehicles	$ 20,559	$ -	$ -	$ 20,559
Computer equipment	330,468	-	-	330,468
Computer software	840,807	-	-	840,807
Office equipment	1,661,089	-	(314,357)	1,346,732
Furniture and fixtures	14,481	-	(14,481)	-
	2,867,404	-	(328,838)	2,538,566
Less accumulated depreciation:				
Vehicles	(20,559)	-	-	(20,559)
Computer equipment	(276,671)	(48,497)	-	(325,168)
Computer software	(757,227)	(77,439)	-	(834,666)
Office equipment	(1,654,891)	(2,565)	314,357	(1,343,099)
Furniture and fixtures	(14,481)	-	14,481	-
	(2,723,829)	(128,501)	328,838	(2,523,492)
Capital assets, net	$ 143,575	$ (128,501)	$ -	$ 15,074

THE OPERATING FUND AND FEDERAL FUND OF THE
CALIFORNIA STUDENT AID COMMISSION

NOTES TO FINANCIAL STATEMENTS
(Continued)

6. ADMINISTRATIVE AND PROGRAM FEES

The 1998 Amendments established that certain fees would be paid to the Operating Fund for administering the FFEL Program on behalf of the federal government based on guaranty agency performance. These fees are known as the Loan Processing and Issuance Fee (LPIF), Account Maintenance Fee (AMF) and Default Aversion Fee (DAF).

The LPIF is based on the original principal amount of new loans disbursed during the period. The fee is calculated at a rate of 0.40 percent of disbursed dollars and paid to the Operating Fund by ED on a quarterly basis.

The AMF is calculated annually at 0.06 percent based on the original principal outstanding (OPO) amount of loans at federal year end September 30, 2009 and 2008. Interim quarterly installment payments paid by ED are based on year-end estimates and reconciled each federal fiscal year-end. Beginning December 31, 2009, and quarterly thereafter, ED changed the AMF calculation methodology to quarterly payments paid by ED based on actual quarterly OPO balances divided by 4 and multiplied by 0.06 percent.

The DAF is earned for default aversion activities on delinquent loans at the time lenders request default aversion assistance, between the 60th and 120th days of a borrower's delinquency. A fee of 1 percent of principal and interest on the loan may be charged to the Federal Fund at the time the guaranty agency receives a request from a lender for default aversion assistance. However, the fee must be refunded by the Operating Fund to the Federal Fund if the loan is later paid as a default claim. Accordingly, an estimate of DAF refunds has been calculated and is presented as an Operating Fund liability and Federal Fund receivable. The net DAF is transferred from the Federal Fund to the Operating Fund on a monthly basis.

As of June 30, 2010 and 2009, the administrative and program fees receivable, which are included in the amount due from Federal government, consisted of the following:

	2010	2009
Operating Fund:		
AMF receivable	$ 5,123,975	$ 5,779,123
LPIF receivable	3,544,864	6,133,062
	$ 8,668,839	$ 11,912,185

For the years ended June 30, 2010 and 2009, total administrative and program fee revenue recognized is as follows:

	2010	2009
Operating Fund:		
LPIF	$ 29,438,583	$ 32,575,421
AMF	22,355,866	23,225,094
DAF, net of related provision	13,873,258	9,966,087
	$ 65,667,707	$ 65,766,602

THE OPERATING FUND AND FEDERAL FUND OF THE
CALIFORNIA STUDENT AID COMMISSION

NOTES TO FINANCIAL STATEMENTS
(Continued)

6. ADMINISTRATIVE AND PROGRAM FEES (Continued)

Gross DAF income for the years ended June 30, 2010 and 2009 was $25,811,294 and $26,081,919, respectively. The estimated allowance for DAF refunds is netted against DAF income. Based on current and historical data, management estimated that certain DAF income will have to be refunded from the Operating Fund to the Federal Fund. The dollar amount of the allowance for DAF as of June 30, 2010 and 2009 was $18,598,709 and $18,028,082, respectively. The activity in the allowance for DAF for the years ended June 30, 2010 and 2009 is as follows:

Ending balance as of July 1, 2008	$ 11,636,985
Provision	16,115,832
Refunds	(9,724,735)
Ending balance as of June 30, 2009	18,028,082
Provision	11,938,036
Refunds	(11,367,409)
Ending balance as of June 30, 2010	$ 18,598,709

7. EARLY WITHDRAWAL FEE PROGRAM

The 1998 Amendments allowed ED to establish a Voluntary Flexible Agreement (VFA) as a pilot program allowing selected guaranty agencies to negotiate alternative fee structures and implement other default prevention initiatives and programs. The Commission entered into a VFA with ED in January 2001 and one program paid an Early Withdrawal Fee (WAF) from the Federal Fund to counsel students withdrawing from school early about loan repayment options and responsibilities. The agreement specified that should the student subsequently default on their student loans, the WAF must be refunded to the Federal Fund based on 1 percent of the default claim amount. This refund necessitated establishing an allowance for WAF refunds as an Operating Fund liability and Federal Fund receivable.

In October 2007, ED enacted the VFA 90-day cancellation provision and issued all VFA guaranty agencies termination notices effective January 1, 2008. As such, the WAF program ended on January 1, 2008. However, WAF refunds from ongoing loan defaults trigger allowance transactions between funds.

THE OPERATING FUND AND FEDERAL FUND OF THE
CALIFORNIA STUDENT AID COMMISSION

NOTES TO FINANCIAL STATEMENTS
(Continued)

7. EARLY WITHDRAWAL FEE PROGRAM (Continued)

At June 30, 2010 and 2009, the Operating Fund has an allowance for WAF refunds of $1,111,138 and $2,011,033, respectively. The remaining allowance balance is an estimate recognizing the inherent risk of future WAF refunds for fees collected prior to VFA termination. The activity in the allowance for WAF for the years ended June 30, 2010 and 2009 is as follows:

Ending balance as of July 1, 2008	$ 3,160,249
Refunds	(1,149,216)
Ending balance as of June 30, 2009	2,011,033
Refunds	(899,895)
Ending balance as of June 30, 2010	$ 1,111,138

8. NET RECOVERIES ON LOAN DEFAULTS

The Commission is required by federal statutes to pursue collections on loans upon default of payment. The collection retention rate retained by the Operating Fund varies depending upon type of collection, and for regular payments is 16 percent. For loans that have been rehabilitated (9 on-time payments made by the defaulted borrower in a 10-month period) or consolidated out of default by a third-party refinancing, the Commission is allowed by federal regulation to retain a percentage of the total amount received relating to the retirement of the post-default obligation. Net recoveries on loan defaults for the years ended June 30, 2010 and 2009 are as follows:

	2010	2009
Net regular payment recoveries	$ 24,977,150	$ 23,564,068
Net rehabilitation loans	77,714,538	75,737,540
Net federal direct consolidation loans	9,856,941	9,166,315
Total net collection recoveries	$ 112,548,629	$ 108,467,923

The Operating Fund and Federal Fund reflect a due from lending institutions receivable of $2,230,112 and $8,173,022, respectively, as of June 30, 2010 and $14,437,484 and $55,412,781, respectively, as of June 30, 2009. These amounts represent the collection retention due each fund for rehabilitation loan proceeds from lenders, in accordance with the rehabilitation loan agreement terms. A portion of the Federal Fund due from lending institutions represents the Federal Default Fee receivable as of June 30, 2010 and 2009.

THE OPERATING FUND AND FEDERAL FUND OF THE
CALIFORNIA STUDENT AID COMMISSION

NOTES TO FINANCIAL STATEMENTS
(Continued)

9. GRANT PROGRAM FUNDING

Since 2003 the State of California has periodically appropriated funding for portions of the Commission's grant administrative budget, outreach and training activities, and Cal Grant program awards as a reimbursement from the Operating Fund to the General Fund. For the years ended June 30, 2010 and 2009, the Commission administrative activities expended from the Operating Fund as nonoperating expenses were $396,653 and $595,991, respectively. For the year ended June 30, 2009, the Commission financial aid awareness programs expended $124,182 from the Operating Fund as nonoperating expenses. There were no such expenditures for the year ended June 30, 2010.

Also, for the years ended June 30, 2010 and 2009, the Commission transferred $32,000,000 and $24,000,000, respectively, from the Operating Fund to the State of California's General Fund to support Cal Grant program awards. Cal Grant program awards are made to students to help pay the costs for postsecondary education.

10. LOAN DEFAULT EXPENSES

Loan default expenses represent the purchase of defaulted loans net of lender repurchases and reinsurance received by ED as recorded in the Federal Fund. Lenders are paid an amount representing 97 percent of principal and calculated interest on defaulted loan purchases as paid from the Federal Fund. ED then reimburses the Federal Fund a percentage of the default claims paid based on the default rates of the portfolio as follows:

• Loans guaranteed before October 1, 1993	100 percent
• Loans guaranteed on October 1, 1993 – September 30, 1998	98 percent
• Loans guaranteed on or after October 1, 1998	95 percent

11. FEDERAL DEFAULT FEE AND FEDERAL DEFAULT FEE SUBSIDY

As directed by federal legislation, the Federal Default Fee (FDF) is assessed on all loans guaranteed on or after July 1, 2006 and is equal to 1 percent of the principal amount of the loan. The FDF must be deposited into the Federal Fund within 45 days of disbursement and shall be deducted and collected from the proceeds of the loan or by payment from other non-federal sources.

To help mitigate education costs for students, on September 7, 2006 the Commission approved an FDF policy designed to share the FDF payment with lenders that meet certain criteria, on behalf of student borrowers. Effective July 1, 2007, the FDF strategy was implemented and lender participation was voluntary. The FDF policy allows for an annual review of the FDF share program and associated program amendments. As such, on March 24, 2008 the Commission approved a revised 2008-09 FDF program effective May 1, 2008. This new FDF strategy partnered with certain FFEL Program lenders to fund the fee for borrowers attending schools with cohort default rates of 9 percent or less. The FDF program was terminated effective July 1, 2009, but FDF subsidy disbursements continue for eligible loans guaranteed prior to termination date until the associated loan disbursements are completed.

THE OPERATING FUND AND FEDERAL FUND OF THE CALIFORNIA STUDENT AID COMMISSION

NOTES TO FINANCIAL STATEMENTS
(Continued)

12. BORROWER COUNSELING SERVICES

On February 4, 2010, EdFund entered into a contract with a school to provide borrower counseling (delinquency prevention and default aversion) services to its students for loans not covered by the traditional FFEL guarantor model. The Department of Finance approved the new line of business pursuant to provisions of SB 89 on March 24, 2010. The contract will be terminated effective November 4, 2010. For the year ended June 30, 2010, the Operating Fund reported revenues of $1,205,966 for borrower counseling services, for which a receivable of $1,122,784 is included in other receivables.

13. RESERVE FOR LOAN DEFAULTS

Pursuant to the 1998 Amendments, Section 428(c)(9), a guaranty agency is required to maintain a minimum Federal Fund reserve level of at least 0.25 percent of the total original principal amount of all outstanding loans guaranteed by such agency. The purpose of the reserve is to ensure the Commission is able to fulfill obligations relative to the overall outstanding portfolio. The minimum reserve is calculated as of the Federal Fiscal Year End date of September 30. The Federal Fund was in compliance with the required minimum reserve calculation at September 30, 2009 and 2008.

14. RETIREMENT BENEFITS

As of June 30, 2010 and 2009, 10 and 12 of the Commission's permanent civil service employees, respectively, were assigned to EdFund, the Commission's auxiliary (see Note 15), in direct support of FFEL Program activities and 2 of the Commission's non-assigned employees functioned in a FFEL Program oversight capacity that was funded from the Operating Fund. Full-time civil service employees participate in the California Public Employees' Retirement System (PERS). PERS, a multiple-employer defined benefit retirement plan, is administered by a Board of Administration composed of individuals (1) elected by PERS membership; (2) appointed by elected State of California officials; and (3) elected State of California officials. PERS provides retirement, disability, and death benefits. Such benefits are based on the employee's years of service, age, and final compensation. PERS issues a publicly available financial report that includes financial statements and required supplementary information, which is available on the California Public Employees' Retirement System website (www.calpers.ca.gov), 400 P Street, Sacramento, CA 94229-2701.

Civil service employees may participate in PERS at one of three levels. As of June 30, 2010 and 2009, all 10 and 12 of the employees, respectively, assigned to EdFund were classified as first-tier. As of June 30, 2010, the 2 Commission FFEL Program oversight employees are classified as first-tier. First-tier participants contribute a portion of their salaries to a retirement fund. The Department of Personnel Administration's website (www.dpa.ca.gov) has additional information about civil service retirement programs.

THE OPERATING FUND AND FEDERAL FUND OF THE
CALIFORNIA STUDENT AID COMMISSION

NOTES TO FINANCIAL STATEMENTS
(Continued)

14. RETIREMENT BENEFITS (Continued)

In addition to the employee's contributions to PERS, the State also contributes into PERS towards civil service retirement benefits. The State's contribution varies annually based on the Budget Act. First-tier employees vest after five years of State service and may receive retirement benefits at age 50. State records relating to pension benefit obligations and net assets available for benefits are not separately available for the Funds.

The Operating Fund paid total pension expense and funded contributions of $96,931 and $143,693 in 2010 and 2009, respectively, for employees assigned to EdFund. The Operating Fund also paid $19,411 in 2010 and $32,557 in 2009, for Commission FFEL Program oversight employees. All contributions were paid as of June 30, 2010 and 2009, respectively.

For the year ended June 30, 2010, the Operating Fund recognized an Annual Required Contribution (ARC) of $14,000. For the year ended June 30, 2009, the Operating Fund was not required to recognize additional ARC. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal costs each year and amortize any unfunded actuarial liabilities or funding excess. At June 30, 2010, the Commission funded $5,000 and $9,000 was unfunded. There was no additional funding requirement at June 30, 2009. The Net OPEB Obligation (NOO) liability at June 30, 2010 and 2009 was $48,000 and $39,000, respectively. Additional information about the California Employers' Retiree Benefit Trust (CERBT) Fund, and the OPEB model and assumptions used in the actuarial valuation, is available as the California Public Employees' Retirement System website (www.calpers.ca.gov).

15. RELATED PARTY TRANSACTIONS

The Commission established EdFund effective January 2, 1997. EdFund is governed by a 13-member Board of Directors who are nominated and appointed by the Commission. The current Board bylaws require at least one commissioner, one EdFund employee and one student enrolled in a California postsecondary educational institution serving as directors at all times. The President of EdFund and the Executive Director of the Commission serve as ex-officio members of the Board.

EdFund provides operational and support services essential to the administration of the FFEL Program through an Operating Agreement with the Commission. The Operating Agreement is for one year and is renewed annually.

On January 2, 1997, the Commission advanced $20,000,000 to EdFund for operating capital. This advance is reported in the Operating Fund as an advance to EdFund. EdFund uses this advance to pay monthly operating expenses which are subsequently reimbursed by the Operating Fund.

As of June 30, 2010 and 2009, the net amount due to EdFund from the Operating Fund was $220,416 and $11,055,630, respectively. As of June 30, 2010 and 2009, the net amount due from EdFund to the Federal Fund was $29,139,890 and $19,396,000, respectively.

THE OPERATING FUND AND FEDERAL FUND OF THE CALIFORNIA STUDENT AID COMMISSION

NOTES TO FINANCIAL STATEMENTS
(Continued)

15. RELATED PARTY TRANSACTIONS (Continued)

As of June 30, 2010 and 2009, the amount due from the Federal Fund to the Operating Fund totaled $12,940,556 and $37,249,624, respectively, due to deposit delays between funds.

The Commission denies the reimbursement of expenses to EdFund from the Operating Fund when EdFund does not provide the Commission with requested backup documentation of a product or service or when the Commission determines the expense to be a gift of California state funds, a waste of public funds or not allowable under Federal regulations. Denied expenses for the years ended June 30, 2010 and 2009 were $463,673 and $215,283, respectively.

16. LEASES

The Commission and EdFund lease office and storage space under operating lease agreements. Total rental expense recorded in the Operating Fund, which includes utilities for one of two major leases, for the years ended June 30, 2010 and 2009 approximated $5,053,000 and $5,546,000, respectively. The future minimum lease payments for the noncancelable operating leases are as follows (in 000's):

Year Ending June 30,		
2011	$	5,124
2012		4,888
2013		4,950
2014		4,995
2015		5,070
Thereafter		15,384
	$	40,411

17. CONTINGENCIES

During the normal course of business, the FFEL Program is involved in various legal proceedings and investigations of its operations and activities. While these proceedings and investigations may lead to a possible liability, in the opinion of the Commission's management, these possible liabilities will not have a material adverse effect on the financial position or operations of the Operating Fund or Federal Fund.

18. SUBSEQUENT EVENTS

Guaranty Designation Transfer

Chapter 132 of the California Statutes of 2007 (Senate Bill 89) authorized the sale or other transaction of the Commission's student loan guarantee portfolio and certain related assets and liabilities of the student loan program. Senate Bill 89 also authorized the State Director of Finance (DOF) to consummate other transactions to maximize the value of the State's student loan guarantee program.

THE OPERATING FUND AND FEDERAL FUND OF THE
CALIFORNIA STUDENT AID COMMISSION

NOTES TO FINANCIAL STATEMENTS
(Continued)

18. SUBSEQUENT EVENTS (Continued)

Guaranty Designation Transfer (Continued)

ED informed the Commission and DOF on July 20, 2010 that it would not agree to or approve any transfer of the guaranty agency responsibilities in California arranged under the State's current sale process. ED also indicated that the guaranty agency agreement with the Commission would be terminated no later than the close of business on October 31, 2010.

In its letter of August 27, 2010, ED indicated that the action to terminate is in accordance with section 428(c)(9)(E) of the Higher Education Act of 1965, as amended. ED also indicated that the U.S. Secretary of Education selected Educational Credit Management Corporation (ECMC) as the successor guaranty agency to assume California's Federal Fund assets and liabilities and the rights, and obligations (including the continuing outstanding FFEL Program loan guarantees) of the Commission's guaranty agency activities, including administration of the Operating Fund.

Effective November 1, 2010 ECMC became the designated guaranty agency for the Commission's FFEL Program portfolio. ECMC is assessing the EdFund personnel, facilities, and other operational expenses and incorporating those deemed useful for administering the FFEL Program activities now under their control. As part of this transition, ED agreed to fund $100 million from the Operating Fund to the 2010-11 State of California budget to support Cal Grant program awards. ED has funded $75 million from the Operating Fund and is scheduled to fund the remaining $25 million in January 2011.

EdFund Lease

As an auxiliary organization of the Commission, EdFund made lease payments on an unoccupied building (Building B) of $3,343,624 between July 3, 2008 and June 30, 2010. On December 16, 2010, ED issued a final program review report to the Commission which determined that paying rent on an unoccupied building is an improper use of the Operating Fund under the FFEL Program since the payment of these costs is not in support of a guaranty agency-related activity or for other student financial aid-related activities. The required action from ED is for the Commission to immediately cease making future lease payments for the unoccupied building through the Operating Fund. In addition, the Commission must reimburse the Operating Fund for the lease payments made to date on Building B. The source of repayment has not yet been determined and as a result, the amount receivable and impact to the related statement of revenues, expenses and changes in net assets has not been reflected in these financial statements.

INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

The Honorable Members
California Student Aid Commission
Rancho Cordova, California

We have audited the financial statements of the Student Loan Operating Fund (Operating Fund) and Federal Student Loan Reserve Fund (Federal Fund) of the California Student Aid Commission (the "Commission"), as of and for the year ended June 30, 2010, and have issued our report thereon dated December 23, 2010. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Operating Fund and Federal Fund of the Commission's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Operating Fund and Federal Fund of the Commission's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Operating Fund and Federal Fund of the Commission's internal control over financial reporting.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Operating Fund and Federal Fund of the Commission's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed one instance of noncompliance required to be reported under *Government Auditing Standards*.

INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*
(Continued)

Compliance and Other Matters (Continued)

As an auxiliary organization of the Commission, EdFund made lease payments on an unoccupied building (Building B) of $3,343,624 between July 3, 2008 and June 30, 2010. On December 16, 2010, the U.S. Department of Education (ED) issued a final program review report to the Commission which determined that paying rent on an unoccupied building is an improper use of the Operating Fund under the Federal Family Education Loan Program since the payment of these costs is not in support of a guaranty-related activity or for other student financial aid-related activities. Based on ED's final program review report, the Commission must reimburse the Operating Fund for these lease payments made on Building B.

This report is intended solely for the information and use of the Honorable Members, management, and others within the organization, and is not intended to be and should not be used by anyone other than these specified parties.

Perry-Smith LLP

Sacramento, California
December 23, 2010