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Action

California Student Aid Commission

Presentation of the June 30, 2008 Operating Fund and Federal Fund Audited Financial Statements

Perry-Smith LLP has completed their independent audit of the Operating Fund and Federal Fund financial statements for the year ended June 30, 2008. 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, 2008.

Responsible Person: Janet McDuffie, Chief
Administration and External Affairs

Tina Treis
Perry-Smith Partner

PERRY-SMITH LLP
ACCOUNTANTS

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Sacramento, CA 95814
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To the Audit Committee and 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, 2008. This report is intended to inform the Audit Committee and the Honorable Members of the California Student Aid Commission about significant matters related to the conduct of the annual audit so that it can appropriately discharge its oversight 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 oversight responsibility for California Student Aid 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 California Student Aid Commission for the year ended June 30, 2008 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 Audit Committee 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. Management did not adopt any significant new accounting policies nor have there been any changes in existing significant accounting policies during the current period which should be brought to your attention for approval.

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, 2008:

Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions

In June 2004, the Governmental Accounting Standards Board ("GASB") issued Statement of Governmental Accounting Standard No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, ("GASB No. 45"). GASB No. 45 addresses how state and local governments should account for and report their costs and obligations related to postemployment healthcare and other nonpension benefits. Collectively, these benefits are commonly referred to as other postemployment benefits, or OPEB. GASB No. 45 generally requires that state and local governmental employers account for and report the annual cost of OPEB and the outstanding obligations and commitments related to OPEB in essentially the same manner as they currently do for pensions. Annual OPEB cost for most employers will be based on actuarially determined amounts that, if paid on an ongoing basis, generally would provide sufficient resources to pay benefits as they come due. The provisions of Statement 45 may be applied prospectively and do not require governments to fund their OPEB plans. An employer may establish its OPEB liability at zero as of the beginning of the initial year of implementation; however, the unfunded actuarial liability is required to be amortized over future periods. GASB No.45 also establishes disclosure requirements for information about the plans in which an employer participates, the funding policy followed, the actuarial valuation process and assumptions, and, for certain employers, the extent to which the plan has been funded over time. GASB No. 45 is effective in three phases based on a government's total annual revenues. The largest employers would be required to implement the requirements of Statement 45 for periods beginning after December 15, 2006. Medium-sized employers have one additional year to implement the standards, and the smallest employers have two additional years. Earlier implementation is encouraged. The adoption of GASB No. 45 did not have a material impact on the Funds' financial statements for the year ended June 30, 2008.

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.

PERRY-SMITH LLP
ACCOUNTANTS

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.

Significant Client Proposed Audit Adjustments

There were two audit adjustments made to the original trial balance presented to us to begin our audit. These adjustments were reviewed with management and management agreed to record these adjustments in the Funds' accounting records. These adjustments are summarized in the accompanying schedule.

Uncorrected Misstatements

We did not identify any uncorrected misstatements to the financial statements.

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.

PERRY-SMITH LLP
ACCOUNTANTS

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 California Student Aid 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 California Student Aid Commission.

This report is intended solely for the information and use of the Audit Committee 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
December 30, 2008

CALIFORNIA STUDENT AID COMMISSION

SUMMARIZED SCHEDULE OF SIGNIFICANT AUDIT ADJUSTMENTS

JUNE 30, 2008

	Effect – Increase (Decrease)				
Description	**Assets**	**Liabilities**	**Equity**	**Revenue**	**Expenses**
Current Year Differences					
- To remove the Federal default fee Tier 2 expense as reflected in financial reporting spread-sheets		$(8,189,870)	$ 8,189,870		$(8,189,870)
- To accrue Other Post Retirement Liability under GASB 45		39,000	(39,000)		39,000
Total Effect				**$ -**	**$(8,150,870)**
Balance Sheet Effect	**$ -**	**$(8,150,870)**	**$ 8,150,870**		

CALIFORNIA STUDENT AID COMMISSION EDFUND

December 30, 2008

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

In connection with your audit 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, 2008 and 2007, 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 30, 2008 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.
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.

California Student Aid Commission
P.O. Box 419026
Rancho Cordova, CA 95741-9026
916.526.7590
Toll-free 1.888.CA.GRANT

EdFund
P.O. Box 419045
Rancho Cordova, CA 95741-9045
916.526.7900
Toll-free 1.877.2EDFUND

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 the Operating and Federal Funds.
9. We have made available to you:
   a. All financial records and related data of the Operating and Federal 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.
   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 or employees who have significant roles in the internal control.
    b. 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, analysts, regulators, short sellers, 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 subsequent event regarding the sale of the Commission's loan guarantee function as included in footnote 20 of the financial statements. However, the impact of the proposed transaction is not determinable and therefore proforma information has not been disclosed in 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 and advances receivable and payable, 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. Line of credit or similar arrangements.

e. Agreements to repurchase assets previously sold.

f. Any other liens or encumbrances on assets or revenues or any assets or revenues which were pledged as collateral for any liability or which were subordinated in any way.

g. The fair value of investments.

h. Amounts of other contractual arrangements that create on or off balance sheet commitments or liabilities.

i. The Voluntary Flexible Agreement (VFA) was terminated effective January 1, 2008. In March 2008, ED preliminarily accepted the proposal to continue the early withdrawal counseling program and issued a new VFA contract for consideration by the Commission in July 2008. The new contract has not been signed by either party.

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

k. Debt issue provisions.

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

m. 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.

n. Risk financing activities.

o. The effect on the financial statements of statements which has been issued, but which we have not yet adopted, including GASB No. 53: *Accounting and Financial Reporting for Derivative Instruments*, and GASB Statement No. 51, *Accounting and Financial Reporting for Intangible Assets.*

p. Special and extraordinary items.

q. Deposits and investment securities category of custodial credit risk.

r. Impairment of capital assets.

s. New governmental accounting pronouncements in effect for the fiscal year ended June 30, 2008 for which management determined there was not a significant impact on the Funds include GASB 50 – Pension Disclosures – An Amendment of GASB Statements 25 and 27.

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 obsolete, damaged, or excess inventories to their estimated net realizable values.

    c. To reduce investments, intangibles, and other assets which have permanently declined in value to their realizable values.

    d. For risk retention, including uninsured losses or loss retentions (deductibles) attributable to events occurring through December 30, 2008 and/or for expected retroactive insurance premium adjustments applicable to periods through December 30, 2008.

    e. For pension obligations, post-retirement benefits other than pensions and deferred compensation agreements attributable to employee services rendered through December 30, 2008.

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

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

    h. For environmental clean up obligations.

18. There are no:

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

    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 Statement of Financial Accounting Standards No. 5 and/or 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 Statement of Financial Accounting Standards No. 5 and/or 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 (invested in capital assets, net of related debt; restricted; and unrestricted) 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. There are no liens or encumbrances on such assets nor has any asset been pledged as collateral except as disclosed in the notes to the financial statements.
27. Required supplementary information is properly measured and presented.
28. The statements include the Operating and Federal Funds of the Commission. The basic financial statements disclose all other related organizations.
29. The financial statements properly classify all funds and activities.
30. The Commission is in possession of a long-term note receivable from EdFund in the amount of $20,000,000 payable upon request of the Commission. There is no current intent to call the long-term note receivable.
31. The 2007-08 State Budget Act shifted the following items from the Operating Fund in 2006-07 to the State General Fund in 2007-08:
    a. Grant administrative costs, including capital assets, personnel costs, pension benefits and leases.
    b. Financial aid awareness programs, Cal-SOAP only.
32. Net Assets as a percentage of original principal outstanding (OPO) was below the 0.25% reserve requirement at 6/30/08. However, this requirement was met at 9/30/08, 9/30/07, and 9/30/06, which is the compliance requirement under the Integrated Regulations, 34 CFR 682.418 (e) Minimum Federal Fund Level.

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.

California Student Aid Commission

Diana Fuentes-Michel
Executive Director

Janet McDuffie, Chief Management Services Division

EdFund

Dr. Sam Kipp
President, EdFund

Martin Scanlon
Chief Financial Officer and Vice President
Finance & Administration

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

FINANCIAL STATEMENTS

FOR THE YEARS ENDED JUNE 30, 2008 AND 2007

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, 2008 and 2007

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PERRY-SMITH LLP
ACCOUNTANTS

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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, 2008 and 2007, 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 audits 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, 2008 and 2007, 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, 2008 and 2007, 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.

PERRY-SMITH LLP
ACCOUNTANTS

INDEPENDENT AUDITOR'S REPORT
(Continued)

The accompanying management's discussion and analysis on pages 3 through 10 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 30, 2008 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 30, 2008

MANAGEMENT'S DISCUSSION AND ANALYSIS

The following Management's Discussion and Analysis (MD&A) of the California Student Aid Commission's (Commission) Federal Family Education Loan (FFEL) Program activities and performance provides the reader with an introduction and overview of the financial performance of the Student Loan Operating Fund (Operating Fund) and the Federal Student Loan Reserve Fund (Federal Fund) during fiscal years ended June 30, 2008, 2007 and 2006. The information contained in this MD&A should be read in conjunction with the financial statements following this section.

This 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 is responsible for both loan and grant programs. The loan program consists of activities related to the Commission's responsibility as a designated guarantor for the FFEL Program. The FFEL Program, created by the federal government in 1965 to address the lack of loans available for students to attend college, allows undergraduate and graduate students at eligible postsecondary schools to obtain federally guaranteed loans from private lenders at advantageous interest rates. The grant program encompasses all activities related to the Commission's administration of the state Cal Grants and specialized programs. From 2003-04 through 2006-07 the state appropriated funding for the Commission's grant administrative budget from the Operating Fund. However, in 2007-08 funding for the Commission's grant administration returned to the state's General Fund. 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.

Financial Highlights

The Commission administers the FFEL program in conjunction with its auxiliary organization, EdFund. During 2007-08 the program faced several changes resulting from the passage of H.R. 2669, the College Cost Reduction and Access Act (CCRAA). CCRAA reflected the position of many in Congress that the margins for private lenders in the FFEL Program were too great and that savings to the federal government could only be achieved by reducing program subsidies. The result was an estimated $16 billion in cuts to lender subsidies and $4.5 billion in cuts to guarantor subsidies over five years. Effective October 1, 2007, the act reduced guarantor collection retention rates on defaulted loan recoveries from 23 percent down to 16 percent, and the account maintenance fee payment to guarantors from 0.10 percent down to 0.06 percent. Additionally, the exceptional performer program was repealed resulting in reduced lender insurance rates for lenders whose default claims were funded under this program.

During 2006-07 changes required by the passage of the Higher Education Reconciliation Act (HERA) included a new 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 loans guaranteed on and after July 1, 2006. Honoring a long-standing commitment to borrowers, the Commission waived this fee through September 30, 2006. For loans guaranteed on or after October 1, 2006, the FDF was again assessed to borrowers and forwarded by lenders for deposit into the Federal Fund. However, to help mitigate education costs for students, 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 of $26.0 million in 2007-08 and $25.5 million in 2006-07. As a result, the total number of scholastic institutions served increased by 11 percent through the addition of 194 new colleges and universities during 2007-08, while 70 new schools were added in 2006-07.

MANAGEMENT'S DISCUSSION AND ANALYSIS
(Continued)

Loan guarantees in 2007-08, excluding consolidations, were $7.3 billion compared with $6.7 billion guaranteed in 2006-07. Additionally, annual consolidation loan guarantees were $2.0 billion compared with the $2.9 billion processed in 2006-07. This change reflects EdFund management's focus on increasing the Stafford and PLUS loan portfolio through FDF initiatives. As such, the FDF strategies have helped maintain market share and cumulatively saved borrowers approximately $356.7 million since insurance premiums (the FDF predecessor) were first waived in 1996-97.

The Commission remitted $235.8 million to the U.S. Department of Education (ED) in 2007-08 for the federal share of defaulted loans recovered, a 35.7 percent increase from the $173.8 million remitted in the previous fiscal year. This increase reflects the exceptional success of EdFund's default management's collection strategy to promote and improve rehabilitation loan recovery rates through enhanced automation tools and increased external and internal recovery performance.

The Commission, via the performance based features of the Voluntary Flexible Agreement (VFA), received $4.9 million and $7.7 million in 2007-08 and 2006-07, respectively, solely from Early Withdrawal Fee funding generated from borrower default prevention counseling efforts. The Operating Fund did not qualify for shared claims saving or performance based collections during 2007-08 or 2006-07. In October 2007, ED enacted the VFA cancellation provision and issued all VFA guaranty agencies termination notices effective January 1, 2008. Subsequently, ED agreed to consider new VFA submissions that complied with cost neutrality standards. In response, EdFund management, on behalf of the Commission, submitted a new VFA proposal as allowed by section 308 of the 2008 Congressional Consolidated Appropriations bill. In March 2008, ED preliminarily accepted the proposal to continue the early withdrawal counseling program and issued a new VFA contract for consideration by the Commission in July 2008. The new contract has not been signed by either party.

In addition to supporting the Commission's guaranty agency responsibilities, the Operating Fund was used from 2003-04 through 2006-07 to fund the Commission's grant administrative costs; in 2007-08 funding for the Commission's grant administrative budget was returned to the state's General Fund. The Commission's outreach and grant programs include:

- Operating Fund contributions of $2.5 million and $12.1 million during 2007-08 and 2006-07, respectively, in financial aid awareness programs. Of these amounts, the California Student Opportunity and Access Program (Cal-SOAP), to provide financial aid outreach and tutoring services to disadvantaged students represented $8.6 million in 2006-07. Cal-SOAP funding returned to the state General Fund in 2007-08.
- $1.7 million and $14.4 million during 2007-08 and 2006-07, respectively, to cover the administrative cost incurred in managing the Commission's grant and specialized programs. This decrease reflects the reassignment of budget responsibility for grant programs to the state's General Fund for the 2007-08 fiscal year.

Program Overview

The loan 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 regulated by the Secretary of Education.

MANAGEMENT'S DISCUSSION AND ANALYSIS
(Continued)

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 default collection. 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.

Net recoveries on loan defaults are deposited in 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, down from 23 percent retained prior to October 1, 2007. For loans that have been rehabilitated (effective July 1, 2006, 9 on-time payments in a 10-month period; previously, 12 consecutive monthly payments made by the defaulted borrower) 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 post-default obligation. The remaining amounts are returned to the federal government.

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 Default Aversion Fee (DAF), the Loan Processing and Issuance Fees (LPIF), and the Account Maintenance Fee (AMF).

The LPIF is calculated at a rate of 0.40 percent of disbursed dollars from new loan guarantees. The AMF is calculated at 0.06 percent of the original principal outstanding portfolio (OPO) balance at federal year end, 0.10 percent prior to October 1, 2007. OPO balance includes the cumulative guarantee volume less cumulative cancellations, claims paid, and loans paid in full. Due to HERA changes, AMF was paid entirely by ED beginning in 2006-07.

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.

MANAGEMENT'S DISCUSSION AND ANALYSIS
(Continued)

The Voluntary Flexible Agreement (VFA) is a pilot program allowing selected guaranty agencies to negotiate alternative fee structures. Program criteria include cost-neutrality requirements that result in no overall increase in total costs to the FFEL Program. VFA income is revenue to the Operating Fund. The Commission negotiated the following three revenue sources as part of its VFA:

- Shared claim savings
- Early withdrawal fee
- Performance based collections

Shared claim savings are paid by the federal government based on the dollar amount of reinsurance claims paid below a 3 percent default trigger rate. The early withdrawal fee (WAF) is paid for counseling borrowers who withdraw early from school. Similar to DAF, the WAF is paid from the Federal Fund to the Operating Fund and must be repaid if the loan defaults in the future. However, loans paid a WAF are not eligible to receive a DAF. Performance based collections revenue is based on two conditions. First, the collection recovery rate must be greater than that established in 1999-00. Second, the Commission's collection recovery rate must be greater than the national average. If these two conditions are met, the federal government will increase collection retention by each basis point above the hurdle rate established in fiscal year 1999-00.

As previously noted, in October 2007 ED enacted the VFA cancellation provision and issued all VFA guaranty agencies termination notices effective January 1, 2008. Subsequently, ED agreed to consider new VFA submissions that complied with cost neutrality standards. In response, EdFund management, on behalf of the Commission, submitted a new VFA proposal as allowed by section 308 of the 2008 Congressional Consolidated Appropriations bill. In March 2008, ED preliminarily accepted the proposal to continue the early withdrawal counseling program and issued a new VFA contract for consideration by the Commission in July 2008. The new contract has not been signed by either party.

During 2006-07 a new lender premium fee revenue source was added to the Operating Fund. Based on a contractual relationship with a lending partner, this fee included a scaled premium paid by the lender when purchasing loans qualifying for rehabilitation. Criteria for compensation included the total loan amount (principal, interest and collection costs) and type of collection. However, recent federal CCRAA legislative changes result in rehabilitation loan purchases becoming less profitable for lenders causing the lender to cancel this premium fee agreement on March 31, 2008. Beginning April 1, 2008 the majority of rehabilitation loans are now funded at full value and rehabilitated consolidation loans are sold at a 2 percent discount.

In 2005-06 the minimum reserve subsidy, funded from the Operating Fund, was needed to supplement Federal Fund revenues to ensure the federally mandated minimum reserve requirement was maintained. After the first quarter of 2006-07, this subsidy was discontinued as the Federal Fund was able to maintain its required minimum reserve level independently due to the mandatory depositing of the federal default fee as required by the HERA.

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 loans guarantee dates as follows:

- Loans guaranteed before October 1, 1993 — 100 percent
- Loans guaranteed between October 1, 1993 - September 30, 1998 — 98 percent
- Loans guaranteed on or after October 1, 1998 — 95 percent

Effective January 2004, qualified lenders designated for exceptional performance (EP) received 100 percent reimbursement on claims submitted for insurance during the 12-month period following the date the lender and its guarantors receive notification. This reimbursement rate dropped to 99 percent beginning July 1, 2006. Federal legislation eliminated lender EP status entirely effective October 1, 2007.

The FDF is the primary source of revenue to the Federal Fund. As previously stated, this fee replaced the insurance premium and is based on 1 percent of the loan disbursement amount for loans guaranteed on or after July 1, 2006.

In 2006-07, claim purchase complement revenues increased significantly in the Federal Fund due to the associated shift in collection strategy on defaulted loans away from federal direct loan consolidations to rehabilitation loan recoveries. The continued results of this strategy in 2007-08 illustrate the exceptional success of EdFund's default management's collection strategy to promote and improve rehabilitation loan recovery rates. Additionally, the significant increase in default claims during the second quarter in response to the EP lender program termination created a large influx of loans available for successful rehabilitation collections. EP lenders accelerated filing their default claims before the program ended to secure a higher insurance rate. 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, 2008, 2007 and 2006.

	Operating Fund Amounts in thousands			Federal Fund Amounts in thousands		
Summary of Balance Sheets	2008	2007	2006	2008	2007	2006
Current assets	$ 62,985	31,034	63,082	119,400	102,622	97,477
Other noncurrent assets	20,143	20,295	20,239	—	—	—
Total assets	83,128	51,329	83,321	119,400	102,622	97,477
Current liabilities	23,448	27,322	58,291	40,247	31,325	32,125
Noncurrent liabilities	39	—	—	—	—	8,208
Total liabilities	23,487	27,322	58,291	40,247	31,325	40,333
Net assets:						
Restricted	—	—	—	79,153	71,297	57,144
Unrestricted	59,641	24,007	25,030	—	—	—
Total net assets	$ 59,641	24,007	25,030	79,153	71,297	57,144

	Operating Fund Amounts in thousands			Federal Fund Amounts in thousands		
Summary of Revenues, Expenses and Changes in Net Assets	2008	2007	2006	2008	2007	2006
Operating revenues:						
Net recoveries on loan defaults	$ 90,911	73,514	53,083	—	—	—
Administrative and program fee income	60,156	63,777	58,420	—	—	—
VFA revenue	4,911	7,736	35,740	—	—	—
Lender premium fees	1,683	1,323	—	—	—	—
Federal default fee	—	—	—	57,431	47,238	—
Minimum reserve subsidy	—	—	—	—	9,392	69,089
Claim purchase complement	—	—	—	11,021	7,767	3,055
Other	4	607	94	10	720	25
Operating revenues	157,665	146,957	147,337	68,462	65,117	72,169
Operating expenses:						
Administrative	93,787	88,252	87,740	—	—	—
Minimum reserve subsidy	—	9,392	69,089	—	—	—
Fee subsidies	26,014	25,513	—	18,038	20,932	17,773
Loan default expense	—	—	—	43,964	28,556	21,452
Other	—	—	—	—	2,691	24,730
Operating expenses	119,801	123,157	156,829	62,002	52,179	63,955
Nonoperating revenues (expenses)						
Interest income	1,952	1,691	2,442	1,396	1,215	646
Cal Grant program awards	—	—	(51,000)	—	—	—
Grant administrative costs	(1,712)	(14,404)	(11,502)	—	—	—
Financial aid awareness program	(2,470)	(12,110)	(16,702)	—	—	—
	(2,230)	(24,823)	(76,762)	1,396	1,215	646
Change in net assets	$ 35,634	(1,023)	(86,254)	7,856	14,153	8,860

MANAGEMENT'S DISCUSSION AND ANALYSIS
(Continued)

Financial Analysis of the Operating Fund

At fiscal year ended June 30, 2008, total net assets of the Operating Fund reflect an increase from the prior year of $35.6 million to $59.6 million compared to a $1.0 million decrease to $24.0 million at June 30, 2007. Operating Fund net assets are primarily composed of unrestricted net assets. This net asset change is primarily due to the items noted below.

- In fiscal year 2008, total operating revenues remained fairly consistent increasing by $10.7 million (or 7.3 percent from 2007) to $157.7 million.
- Net recoveries on loan defaults increased significantly to $90.9 million in 2007-08 from $73.5 million in 2006-07. This increase reflects the exceptional success of management's collection strategy to promote and improve rehabilitation loan recovery. Rehabilitation loans enable borrowers to improve their credit rating while bringing their student loan balances out of default status, and provide increased revenues to the Operating Fund because of higher retention rates on this collection type.
- Administrative and program fee income decreased to $60.2 million in 2007-08 from $63.8 million in 2006-07 due to the passage of the CCRAA and the decrease in the AMF payment to guarantors from 0.10 percent to 0.06 percent.
- Lender premium fee increased to $1.7 million in 2007-08 from $1.3 million in revenues to the Operating Fund during 2006-07 due to increase in rehabilitation loan recovery volume. However, recent federal legislative changes resulted in this rehabilitation lender cancelling the lender premium fee arrangement on March 31, 2008 because rehabilitation loans are no longer as profitable for lenders.
- Administrative operating expenses increased $5.5 million, or 6.2 percent, for the year ended June 30, 2008 due to increased collection agency costs associated with the significant increase in net recoveries performance on loan defaults. Expenses increased less than 1 percent for the year ended June 30, 2007 reflecting management's emphasis on realizing operating efficiencies.
- The federal default fee subsidy established in 2006-07 remained relatively consistent, funding $26.0 million and $25.5 million from the Operating Fund on the behalf of student borrowers during 2007-08 and 2006-07, respectively.
- Minimum reserve subsidy was eliminated during the current year from $9.4 million for the year ended June 30, 2007 as a result of the Federal Fund's ability to independently maintain its required minimum reserve level due to federal default fee and claim purchase complement revenues.
- Nonoperating revenues (expenses) decreased by $22.6 million to $2.2 million compared with $24.8 million at June 30, 2007. The decrease is due primarily to returning grant program administrative funding and financial aid awareness, including Cal-SOAP, to the state General Fund from the Operating Fund.

MANAGEMENT'S DISCUSSION AND ANALYSIS
(Continued)

Financial Analysis of the Federal Fund

At fiscal year ended June 30, 2008, the total net assets of the Federal Fund increased by $7.9 million to $79.2 million, compared to an increase of $14.2 million to $71.3 million at June 30, 2007. Net assets are comprised entirely of restricted balances mandated by federal regulation to meet required minimum reserve levels. This net asset change is primarily due to the items noted below.

- In 2007-08, total operating revenues increased $3.3 million to $68.5 million as federal default fee and complement revenues improve significantly over prior year eliminating the need for a minimum reserve subsidy.
- Fee subsidies consist of DAF and WAF subsidies associated with the VFA and are recorded net of refund allowance estimates. In fiscal years 2007-08 and 2006-07, the Operating Fund charged the Federal Fund $13.1 million and $13.2 million in DAF expenses and $4.9 million and $7.7 million in WAF expenses, respectively. The WAF decrease results from ED canceling the VFA contract effective January 1, 2008.
- Loan default expense increased by $15.4 million in 2007-08 due to a rise in the rate of default claims across all school types, increases in the overall size of the outstanding portfolio, and a large influx in EP lender claim filings prior to the federal program ending reducing lender insurance rates.
- The significant decrease in other expenses 2007-08 and 2006-07 is due to fully depleting the restricted account used to fund default prevention initiatives.

Significant Known Facts, Decisions, or Conditions

<u>Sale of the Commission's Loan Guarantee Function</u>

Chapter 132 of the 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 Director of Finance to consummate other transactions to maximize the value of the state's student loan guarantee program. The 2008-09 State budget, signed into law on September 23, 2008, indicates the sale has been postponed due to a variety of factors affecting the student loan guaranty industry. However, the state administration is continuing its efforts, pursuant to Chapter 757 of the statutes of 2008 (Assembly Bill 519) that extends the sale authorization through January 10, 2011.

As a consequence of this proposed transaction, the state budget continues to use General Fund resources to finance the Commission's state operations budget and financial aid awareness programs. However, the state budget shifted $24 million from the General Fund to the Operating Fund to fund a portion of the Cal Grant costs in 2008-09. Further detail and information about the 2008-09 budget for the State of California is available through the Department of Finance budget website (www.ebudget.ca.gov).

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

BALANCE SHEETS

June 30, 2008 and 2007

	Operating Fund	
	2008	2007
ASSETS		
Current assets:		
Cash and cash equivalents (Note 4)	$ 13,256,921	$ 20,518,978
Interest receivable	259,873	224,767
Other receivables	1,890	74,580
Due from Federal government (Note 6)	9,218,431	10,216,066
Due from Federal Fund (Note 16)	40,247,482	-
Total current assets	62,984,597	31,034,391
Noncurrent assets:		
Capital assets, net of accumulated depreciation (Note 5)	143,575	294,967
Advance to EdFund (Note 16)	20,000,000	20,000,000
Total noncurrent assets	20,143,575	20,294,967
Total assets	$ 83,128,172	$ 51,329,358
LIABILITIES AND NET ASSETS		
Current liabilities:		
Accounts payable	$ 167,165	$ 1,628,852
Due to EdFund (Note 16)	8,475,721	7,412,962
Due to Federal Fund (Note 16)	-	2,004,819
Due to General Fund (Note 9)	8,218	3,064,942
Allowance for default aversion fees (Note 6)	11,636,985	10,148,049
Allowance for early withdrawal fees (Note 7)	3,160,249	3,062,314
Total current liabilities	23,448,338	27,321,938
Noncurrent liabilities:		
Post retirement obligation (Note 15)	39,000	-
Total liabilities	23,487,338	27,321,938
Net assets:		
Investment in capital assets (Note 5)	143,575	294,967
Unrestricted	59,497,259	23,712,453
Total net assets	59,640,834	24,007,420
Total liabilities and net assets	$ 83,128,172	$ 51,329,358

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, 2008 and 2007

	Federal Fund	
	2008	**2007**
ASSETS		
Current assets:		
Cash and cash equivalents (Note 4)	$ 13,674,267	$ 30,889,834
Restricted cash (Notes 4 and 10)	-	153,000
Total cash and cash equivalents	13,674,267	31,042,834
Interest receivable	75,351	204,286
Due from Federal government	69,316,380	34,093,345
Due from EdFund (Note 16)	21,537,158	22,066,309
Due from Operating Fund (Note 16)	-	2,004,819
Default aversion fees receivable (Note 6)	11,636,985	10,148,049
Early withdrawal fees receivable (Note 7)	3,160,249	3,062,314
Total assets	$ 119,400,390	$ 102,621,956
LIABILITIES AND NET ASSETS		
Current liabilities:		
Due to Operating Fund (Note 16)	$ 40,247,482	$ -
Due to lending institutions	-	23,117,642
Federal reserve recall (Note 10)	-	8,207,730
Total liabilities	40,247,482	31,325,372
Net assets:		
Restricted (Notes 10 and 14)	79,152,908	71,296,584
Total liabilities and net assets	$ 119,400,390	$ 102,621,956

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, 2008 and 2007

	Operating Fund	
	2008	2007
Operating revenues:		
Net recoveries on loan defaults (Note 8)	$ 90,911,614	$ 73,513,809
Administrative and program fee income (Note 6)	60,155,624	63,776,853
VFA revenue (Note 7)	4,911,242	7,736,096
Lender premium fees (Note 13)	1,682,647	1,322,542
Other revenues	3,707	607,520
Total operating revenues	157,664,834	146,956,820
Operating expenses:		
Loan program personnel costs (Note 15)	54,137,811	55,536,587
Operating expenses (Note 17)	21,897,948	23,556,657
Federal default fee subsidy (Note 12)	26,014,316	25,512,597
Minimum reserve subsidy (Note 14)	-	9,392,146
Contracted collection costs	17,751,349	9,159,345
Total operating expenses	119,801,424	123,157,332
Operating income	37,863,410	23,799,488
Nonoperating revenues (expenses):		
Interest income (Note 4)	1,952,485	1,691,024
Grant administrative costs (Notes 9 and 15)	(1,712,324)	(14,404,157)
Financial aid awareness programs (Note 9)	(2,470,157)	(12,108,924)
Total nonoperating revenues (expenses)	(2,229,996)	(24,822,057)
Change in net assets	35,633,414	(1,022,569)
Net assets, beginning of year	24,007,420	25,029,989
Net assets, end of year	$ 59,640,834	$ 24,007,420

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, 2008 and 2007

	Federal Fund	
	2008	2007
Operating revenues:		
Federal default fee (Note 12)	$ 57,431,072	$ 47,237,617
Minimum reserve subsidy (Note 14)	-	9,392,146
Claim purchase complement	11,020,962	7,767,186
Other revenues	9,955	719,589
Total operating revenues	68,461,989	65,116,538
Operating expenses:		
Loan default expenses (Note 11)	43,964,354	28,555,800
Default prevention and VFA expenses (Note 10)	1,356	2,459,248
Default aversion fee (Note 6)	13,125,681	13,196,309
Early withdrawal fee (Note 7)	4,911,242	7,736,096
Other operating expenses	-	231,064
Total operating expenses	62,002,633	52,178,517
Operating income	6,459,356	12,938,021
Nonoperating revenues:		
Interest income (Notes 4 and 10)	1,396,968	1,214,751
Change in net assets	7,856,324	14,152,772
Net assets, beginning of year	71,296,584	57,143,812
Net assets, end of year	$ 79,152,908	$ 71,296,584

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, 2008 and 2007

	Operating Fund	
	2008	2007
Cash flows from operating activities:		
Receipts from:		
Collections	$ 91,350,962	$ 69,568,641
Administrative fees	58,491,330	64,594,888
Voluntary flexible agreement	4,911,242	42,971,634
Lender premium fee	1,682,647	1,322,542
Other sources	3,707	607,521
Payments for:		
General administrative and other expenses	(137,629,686)	(94,710,837)
Federal default fee	(23,978,477)	(25,460,191)
Minimum reserve subsidy	-	(41,630,191)
Net cash (used in) provided by operating activities	(5,168,275)	17,264,007
Cash flows from noncapital financing activities:		
Payments for grant administrative costs	(1,560,932)	(14,028,098)
Financial aid awareness programs	(2,470,157)	(12,108,924)
Net cash used in noncapital financing activities	(4,031,089)	(26,137,022)
Cash used in capital financing activities:		
Purchase of capital assets	-	(112,246)
Cash flows provided by investing activities:		
Interest received	1,937,307	1,697,754
Decrease in cash and cash equivalents	(7,262,057)	(7,287,507)
Cash and cash equivalents, beginning of year	20,518,978	27,806,485
Cash and cash equivalents, end of year	$ 13,256,921	$ 20,518,978
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	$ 37,863,410	$ 23,799,488
Adjustments to reconcile operating income to net cash (used in) provided by operating activities:		
Change in assets and liabilities:		
Receivables	72,690	15,140
Federal government	997,635	24,740,247
General Fund	(3,056,724)	56,939
EdFund	1,042,831	(9,550,685)
Federal Fund	(42,252,301)	(25,520,861)
Accounts payable	(1,461,687)	399,893
Allowance for default aversion and early withdrawal fees	1,586,871	3,323,846
Post retirement obligation	39,000	-
Total adjustments	(43,031,685)	(6,535,481)
Net cash (used in) provided by operating activities	$ (5,168,275)	$ 17,264,007

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, 2008 and 2007

	Federal Fund	
	2008	2007
Cash flows from operating activities:		
Receipts from:		
Reimbursement on default purchases	$ 924,248,105	$ 638,631,136
Federal default fee	58,937,540	42,218,342
Minimum reserve subsidy	3,002,002	41,630,191
Other sources	10,856,028	8,619,965
Payments for:		
Administrative fees	21,662,346	(31,118,854)
Purchases of default student loans	(1,037,270,019)	(684,805,489)
General administrative and other expenses	(358,233)	(3,185,338)
Net cash (used in) provided by operating activities	(18,922,231)	11,989,953
Cash flows provided by investing activities:		
Interest received	1,553,664	1,098,842
(Decrease) increase in cash and cash equivalents	(17,368,567)	13,088,795
Cash and cash equivalents, beginning of year	31,042,834	17,954,039
Cash and cash equivalents, end of year	$ 13,674,267	$ 31,042,834
Reconciliation of operating income to net cash (used in) provided by operating activities:		
Operating income	$ 6,459,356	$ 12,938,021
Adjustments to reconcile operating income to net cash (used in) provided by operating activities:		
Change in assets and liabilities:		
Federal government	(43,430,764)	(4,777,921)
EdFund	501,388	(17,566,867)
Operating Fund	42,252,301	25,520,861
Due to lending institutions	(23,117,641)	(800,295)
Allowance for default aversion and early withdrawal fees	(1,586,871)	(3,323,846)
Total adjustments	(25,381,587)	(948,068)
Net cash (used in) provided by operating activities	$ (18,922,231)	$ 11,989,953

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, which include the Federal Family Education Loan (FFEL) Program and state grant and specialized programs.

The FFEL Program was established by Congress and 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 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.

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. The administrative costs associated with these programs are included in the Operating Fund's accompanying financial statements; however, the Cal Grant awards are not included in the accompanying financial statements.

2. SIGNIFICANT ACCOUNTING POLICIES

(a) <u>Basis of Accounting</u>

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 OPERATING FUND AND FEDERAL FUND OF THE
CALIFORNIA STUDENT AID COMMISSION

NOTES TO FINANCIAL STATEMENTS
(Continued)

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

(a) Basis of Accounting (Continued)

The FFEL program consists of the Operating Fund and the Federal Fund. The Federal Fund largely reflects the organization's FFEL Program insurance activities, while the Operating Fund accounts for substantially all FFEL Program operational activity, financial aid awareness and related outreach, and non-FFEL program grant administration activity in support of the state Cal Grant and specialized programs. 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.

In accordance with Government Accounting Standards Board (GASB) Statement Number 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that Use Proprietary Fund Accounting*, 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) Restricted Cash and Cash Equivalents

Cash that is externally restricted for default prevention activities is included as a cash and cash equivalent in the Statements of Cash Flows.

(d) 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 their estimated useful lives of three to five years. Repairs and maintenance costs are expensed as incurred. Depreciation of $148,398 and $138,420 is included in the Operating Fund's grant administrative costs for the years ended June 30, 2008 and 2007, respectively.

2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(e) Net Assets

The Commission's net assets are classified as follows:

- Investment in capital assets – This represents the Commission's total investment in capital assets, net of outstanding debt obligations related to those capital assets to the extent the proceeds from the debt have been expended for capital assets.
- Restricted net assets – expendable – Restricted expendable net assets include resources that the Commission is legally or contractually obligated to spend in accordance with restrictions imposed by external third parties.
- Unrestricted net assets – Unrestricted net assets represent resources derived from and expended on behalf of the Operating Fund.

(f) Operating Revenues and Expenses

Operating revenues and expenses generally result from activities associated with the FFEL Program, including loan origination and guaranty, default prevention, default loan purchase activities, collection on defaulted loans, community outreach and other student financial aid related activities. All revenues and expenses not derived from the administration of the FFEL Program are reported as nonoperating revenues and expenses, including grant program administrative costs and grant disbursements.

(g) 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.

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

Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions

In June 2004, the Governmental Accounting Standards Board ("GASB") issued Statement of Governmental Accounting Standard No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions,* ("GASB No. 45"). GASB No. 45 addresses how state and local governments should account for and report their costs and obligations related to postemployment healthcare and other nonpension benefits. Collectively, these benefits are commonly referred to as other postemployment benefits, or OPEB. GASB No. 45 generally requires that state and local governmental employers account for and report the annual cost of OPEB and the outstanding obligations and commitments related to OPEB in essentially the same manner as they currently do for pensions. Annual OPEB cost for most employers will be based on actuarially determined amounts that, if paid on an ongoing basis, generally would provide sufficient resources to pay benefits as they come due. The provisions of Statement 45 may be applied prospectively and do not require governments to fund their OPEB plans. An employer may establish its OPEB liability at zero as of the beginning of the initial year of implementation; however, the unfunded actuarial liability is required to be amortized over future periods. GASB No.45 also establishes disclosure requirements for information about the plans in which an employer participates, the funding policy followed, the actuarial valuation process and assumptions, and, for certain employers, the extent to which the plan has been funded over time. Implementation of GASB No. 45 did not have a material impact on the Commissions' financial statements for the year ended June 30, 2008 (Note 15).

3. **GUARANTEED LOANS OUTSTANDING**

As of June 30, 2008 and 2007, the Commission was the guarantor of a portfolio of outstanding loans with original principal amounts of approximately $31.7 billion and $27.2 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, 2008 will go into default status in the future requiring the use of the Federal Fund to purchase defaulted loans from lenders. The Federal Fund will subsequently be reimbursed by ED at its applicable reinsurance rates associated with these defaulted loans.

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

NOTES TO FINANCIAL STATEMENTS
(Continued)

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, State Controller, and 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).

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, 2008 and 2007 the allocation of the carrying value plus accrued interest purchased of the SMIF investments and cash held by the Operating Fund and Federal Fund approximated as follows (in 000's):

	June 30, 2008		June 30, 2007	
	Operating Fund	Federal Fund	Operating Fund	Federal Fund
SMIF:				
U.S. Treasury Securities	$ 779	$ 829	$ 992	$ 1,573
Federal Agency Securities	3,969	4,224	4,390	6,959
Bank Notes	164	175	388	615
Certificates of Deposit	2,623	2,792	4,652	7,374
Commercial Paper	1,737	1,848	4,289	6,798
Corporate Bonds	48	51	115	182
Time Deposits	1,754	1,867	2,608	4,133
AB55 and General Fund loans	1,991	2,119	2,149	3,407
Other	192	(231)	936	2
Total	$ 13,257	$ 13,674	$ 20,519	$ 31,043

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

NOTES TO FINANCIAL STATEMENTS
(Continued)

4. CASH AND CASH EQUIVALENTS (Continued)

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, 2008 and 2007, this difference was immaterial to the valuation of the deposits held by the Federal Fund and Operating 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 Federal Fund and Operating 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.

5. CAPITAL ASSETS

Capital asset activity for the year ended June 30, 2008 is as follows:

	2008			
	Beginning Balance	Additions	Transfers/ Disposals	Ending Balance
Vehicles	$ 61,181		$ (40,622)	$ 20,559
Computer equipment	1,057,511		(727,043)	330,468
Computer software	846,967		(6,160)	840,807
Office equipment	2,446,042		(784,953)	1,661,089
Furniture and fixtures	14,481			14,481
	4,426,182		(1,558,778)	2,867,404
Less accumulated depreciation:				
Vehicles	(61,181)		40,622	(20,559)
Computer equipment	(940,152)	$ (63,562)	727,043	(276,671)
Computer software	(681,576)	(81,811)	6,160	(757,227)
Office equipment	(2,433,825)	(3,025)	781,959	(1,654,891)
Furniture and fixtures	(14,481)			(14,481)
	(4,131,215)	(148,398)	1,555,784	(2,723,829)
Capital assets, net	$ 294,967	$ (148,398)	$ (2,994)	$ 143,575

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

NOTES TO FINANCIAL STATEMENTS
(Continued)

5. CAPITAL ASSETS (Continued)

Capital asset activity for the year ended June 30, 2007 is as follows:

	2007			
	Beginning Balance	Additions	Transfers/ Disposals	Ending Balance
Vehicles	$ 61,181			$ 61,181
Computer equipment	972,989	$ 142,937	$ (58,415)	1,057,511
Computer software	627,661	219,306		846,967
Office equipment	2,469,988		(23,946)	2,446,042
Furniture and fixtures	14,481			14,481
Construction in progress	167,637		(167,637)	
	4,313,937	362,243	(249,998)	4,426,182
Less accumulated depreciation:				
Vehicles	(61,181)			(61,181)
Computer equipment	(939,764)	(58,803)	58,415	(940,152)
Computer software	(605,905)	(75,671)		(681,576)
Office equipment	(2,453,825)	(3,946)	23,946	(2,433,825)
Furniture and fixtures	(14,481)			(14,481)
	(4,075,156)	(138,420)	82,361	(4,131,215)
Capital assets, net	$ 238,781	$ 223,823	$ (167,637)	$ 294,967

6. ADMINISTRATIVE AND PROGRAM FEES

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

The DAF is earned for default aversion activities on delinquent loans at the time lenders request 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 a receivable in the Federal Fund. The net DAF is transferred from the Federal Fund to the Operating Fund on a monthly basis.

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 OPERATING FUND AND FEDERAL FUND OF THE CALIFORNIA STUDENT AID COMMISSION

NOTES TO FINANCIAL STATEMENTS
(Continued)

6. ADMINISTRATIVE AND PROGRAM FEES (Continued)

The AMF is calculated at 0.06 and 0.10 percent of the original principal amount of loans outstanding at federal years ended September 30, 2008 and 2007, respectively. The fee is calculated on an annual basis and was paid by ED in quarterly installments.

As of June 30, 2008 and 2007, the administrative and program fees receivable, which are included in the net amount due from federal government (ED), consisted of the following:

	2008	2007
Operating Fund:		
LPIF receivable	$ 3,946,577	$ 3,236,594
AMF receivable	5,271,854	6,979,472
	$ 9,218,431	$ 10,216,066

For the years ended June 30, 2008 and 2007, total administrative and program fee income recognized is as follows:

	2008	2007
Operating Fund:		
DAF, net of related provision	$ 13,125,681	$ 13,196,309
LPIF	23,180,346	22,174,896
AMF	23,849,597	28,405,648
	$ 60,155,624	$ 63,776,853

Gross DAF income for the years ended June 30, 2008 and 2007 was $22,876,149 and $20,729,358, 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 as of June 30, 2008 and 2007. The allowance for DAF income as of June 30, 2008 and 2007 was $11,636,985 and $10,148,049, respectively. The activity in the allowance for DAF for the years ended June 30, 2008 and 2007 is as follows:

Beginning balance as of July 1, 2006	$ 7,705,724
Provisions	7,533,049
Refunds	(5,090,724)
Ending balance as of June 30, 2007	10,148,049
Provisions	9,750,468
Refunds	(8,261,532)
Ending balance as of June 30, 2008	$ 11,636,985

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

NOTES TO FINANCIAL STATEMENTS
(Continued)

7. VOLUNTARY FLEXIBLE AGREEMENT

The 1998 Amendments established the 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. In January 2001, the Commission entered into a VFA with ED. As a result, three alternative revenue sources were developed:

- Shared claims savings
- Performance based collections
- Early withdrawal fee

The Commission received VFA revenue of $4,911,242 and $7,736,096 in 2008 and 2007, respectively, solely from Early Withdrawal Fee (WAF) funding generated from borrower default prevention counseling efforts. The Operating Fund did not qualify for shared claims savings or performance based collections under the VFA in 2008 and 2007.

At June 30, 2008 and 2007, the Operating Fund has an allowance for WAF refunds in the amount of $3,160,249 and $3,062,314, respectively. The activity in the allowance for WAF for the years ended June 30, 2008 and 2007 is as follows:

Beginning balance as of July 1, 2006	$ 2,180,793
Provisions	1,365,193
Refunds	(483,672)
Ending balance as of June 30, 2007	3,062,314
Provisions	866,690
Refunds	(768,755)
Ending balance as of June 30, 2008	$ 3,160,249

In October 2007, ED enacted the VFA cancellation provision and issued all VFA guaranty agencies termination notices effective January 1, 2008. Subsequently, ED agreed to consider new VFA submissions that complied with cost neutrality standards. In response, EdFund management, on behalf of the Commission, submitted a new VFA proposal as allowed by section 308 of the 2008 Congressional Consolidated Appropriations bill. In March 2008, ED preliminarily accepted the proposal to continue the early withdrawal counseling program and issued a new VFA contract for consideration by the Commission in July 2008. The new contract has not been signed by either party.

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

NOTES TO FINANCIAL STATEMENTS
(Continued)

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 on regular payments was reduced from the 23 percent in effect during fiscal year 2007 down to 16 percent effective October 1, 2007. 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 post-default obligation. Net recoveries on loan defaults for the years ended June 30, 2008 and 2007, are as follows:

	2008	2007
Net regular payment recoveries	$ 20,724,761	$ 24,232,588
Net FFEL consolidation loans		195,197
Net rehabilitation loans	63,701,303	43,063,074
Net federal direct consolidation loans	6,485,550	6,022,950
Total net collection recoveries	$ 90,911,614	$ 73,513,809

9. DUE TO GENERAL FUND

Beginning in 2002-03, the State appropriated funding for portions of the Commission's administrative budget for FFEL Program and outreach and training activities, as well as funding for the California Student Opportunity and Access Program (Cal-SOAP) as a reimbursement from the Operating Fund to the General Fund. The Commission's Cal-SOAP program continued as a reimbursement from the Operating Fund to the General Fund through 2006-07. From 2003-04 through 2006-07, the State appropriated the Commission's entire administrative budget directly from the Operating Fund. For 2007-08, the Commission's administrative budget for grant administration and financial aid awareness programs was funded from the State's General Fund. For the years ending June 30, 2008 and 2007, the Commission grant administrative activities expended from the Operating Fund were $1,712,324 and $14,404,157, respectively. For the years ending June 30, 2008 and 2007, the Commission financial awareness programs expended from the Operating Fund were $2,470,157 and $12,108,924, respectively. The Commission's Operating Fund had a net liability to the General Fund representing outstanding reimbursements of $8,218 and $3,064,942 as of June 30, 2008 and 2007, respectively.

10. FEDERAL RESERVE RECALL

The 1997 Budget Reconciliation Act (ACT) required the return of a total of $1 billion in federal reserves from all FFEL Program guaranty agencies. The Commission made all of the required deposits to a restricted account and remitted payment to ED.

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

NOTES TO FINANCIAL STATEMENTS
(Continued)

10. FEDERAL RESERVE RECALL (Continued)

Interest earned from the restricted fund within the Federal Fund may only be used for performing specific default prevention activities and for early withdrawal fees transferred to the Operating Fund as stipulated in the VFA between the Commission and ED. The restricted account earned a total of $1,356 and $64,422 in interest revenue. Default prevention expenses totaled $2,459,248 for the year ended June 30, 2007. The restricted account balance was $153,000 as of June 30, 2007. No default prevention expenses were incurred and no cash was restricted for the year ended June 30, 2008.

In addition to the $1 billion Federal Reserve return, the 1998 Amendments to the Higher Education Act contain a provision for an additional recall of Federal Reserve funds held by guaranty agencies totaling $250 million nationwide. ED notified the Commission that its share of this recall would be $24,871,909. The first installment of $8,456,449 was remitted to ED in September 2002, with $16,415,460 due in two equal installments of $8,207,730 in September 2006 and 2007, respectively. The remaining final installment was completed in September 2007.

11. LOAN DEFAULT EXPENSES

Loan default expense represents the purchase of defaulted loans, net of lender repurchases and reinsurance received from ED as recorded in the Federal Fund. Effective July 1, 2006, 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 between October 1, 1993 through September 30, 1998	98 percent
Loans guaranteed on or after October 1, 1998	95 percent

Effective July 1, 2006, qualified lenders designated for exceptional performance (EP) receive 99 percent reimbursement on claims submitted for insurance during the 12-month period following the date the lender and its guarantors receive EP designation notification. The EP designation was eliminated effective October 1, 2007. The Federal Fund's reinsurance rate range of 95 percent to 98 percent remains unchanged.

12. FEDERAL DEFAULT FEE AND FEDERAL DEFAULT FEE SUBSIDY

Federal regulations authorized the assessment of an insurance premium as a source of revenue for the Federal Fund. During federal fiscal years 1996 through 2006, the Commission waived assessing the insurance premium.

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

NOTES TO FINANCIAL STATEMENTS
(Continued)

12. FEDERAL DEFAULT FEE AND FEDERAL DEFAULT FEE SUBSIDY (Continued)

The Higher Education Reconciliation Act of 2005 replaced the insurance premium with a Federal Default Fee (FDF). The FDF is assessed on all loans guaranteed on or after July 1, 2006, is equal to 1 percent of the principal amount of the loan, and must be deposited into the Federal Fund within 45 days of disbursement. The FDF shall be deducted and collected from the proceeds of the loan or by payment from other non-federal sources. In keeping with the commitment of waiving the previous insurance premium or FDF to borrowers through the remainder of federal fiscal year 2006, the Commission agreed to pay the FDF on their behalf for loans guaranteed July 1, 2006 through September 30, 2006.

For loans guaranteed on or after October 1, 2006, the FDF was again assessed to borrowers and forwarded by lenders for deposit into the Federal Fund. However, 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 share program effective May 1, 2008. The new FDF strategy partners with certain FFEL program lenders to fund the fee for borrowers attending schools with cohort default rates of 9 percent or less.

13. LENDER PREMIUM FEE

During fiscal year ending June 30, 2007, a contractual relationship was established with a lending partner, which includes a scaled premium fee paid by the lender when purchasing loans qualifying for rehabilitation. Recent Federal legislative changes resulted in this rehabilitation lender cancelling the lender premium fee arrangement effective March 31, 2008.

14. 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, 2007 and 2006.

Through September 30, 2006, while the federal default fee was waived, management opted to subsidize the Federal Fund, when needed, by transferring funds from the Operating Fund to ensure the minimum reserve level was maintained. For the year ended June 30, 2007, the Operating Fund subsidized $9,392,146, to the Federal Fund. For the year ended June 30, 2008 the Operating Fund did not provide a minimum reserve subsidy to the Federal Fund.

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

NOTES TO FINANCIAL STATEMENTS
(Continued)

15. RETIREMENT BENEFITS

As of June 30, 2008 and 2007, 19 and 46, respectively, of the Commission's permanent civil service employees were assigned to EdFund, the Commission's auxiliary, in direct support of FFEL Program activities. As of June 30, 2008 and 2007, 122 and 118, respectively, of the Commission's permanent civil service employees supported the programs administered by the Commission. 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 may be obtained by writing to California Public Employees' Retirement System, 400 P Street, Sacramento, CA 94229-2701.

For the year ended June 30, 2008, budget responsibility for employees in these positions was transferred from the Operating Fund to the State's General Fund.

Civil service employees may participate in PERS at one of three levels; first-tier participants contribute a portion of their salaries to a retirement fund; second-tier employees do not make contributions; and Alternate Retirement Program (ARP) participants contribute to a special retirement account for the first two years of State service. The ARP was established for State of California employees hired on or after August 11, 2004. The Department of Personnel Administration's website (www.dpa.ca.gov) has additional information about this program. As of June 30, 2007, 43 of the employees assigned to EdFund were classified as first-tier and 3 employees were classified as second-tier. As of June 30, 2007, 93 of the Commission's employees who supported the programs administered by the Commission were classified as first-tier and 7 employees were classified as second-tier. As of June 30, 2007, 18 of the Commission employees who supported the programs administered by the Commission were classified as ARP.

All new State civil service employees are automatically enrolled in ARP for the first two years of employment with the State. After two years, employees will have the option of choosing between the first-tier and second-tier. 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. Second-tier employees vest after ten years of State service and may receive retirement benefits at age 55. State records relating to pension benefit obligations and net assets available for benefits are not separately available for the Funds.

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

NOTES TO FINANCIAL STATEMENTS
(Continued)

15. RETIREMENT BENEFITS (Continued)

The Operating Fund paid total pension expense and funded contributions of $347,197 and $483,299 in 2008 and 2007, respectively, for employees supporting loan program activity and assigned to EdFund. The Operating Fund also paid $994,042 in 2007 for Commission employees who supported the grant and outreach programs administered by the Commission. All contributions were paid as of June 30, 2008 and 2007, respectively.

For the year ending June 30, 2008, the Operating Fund recognized an Annual Required Contribution (ARC) of $60,000. 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, 2008, the Commission funded $21,000 and $39,000 was recorded as Net OPEB Obligation (NOO) liability. The California Public Employees' Retirement System website (www.calpers.ca.gov) has additional information about the California Employers' Retiree Benefit Trust (CERBT) Fund and the OPEB model and assumptions used in the actuarial valuation.

16. 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 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 million to EdFund for operating capital. This advance is reported in the Operating Fund as an advance to EdFund. EdFund uses the advance for monthly operating expenses which are subsequently reimbursed in part by the Operating Fund.

As of June 30, 2008 and 2007, the net amount due to EdFund from the Operating Fund was $8,475,721 and $7,412,962, respectively. As of June 30, 2008 and 2007, the net amount due from EdFund to the Federal Fund was $21,537,158 and $22,066,309, respectively.

As of June 30, 2008, the amount due from the Federal Fund to the Operating Fund totaled $40,247,482 due to a deposit delay between funds. As of June 30, 2007, the amount due from the Operating Fund to the Federal Fund totaled $2,004,819.

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

NOTES TO FINANCIAL STATEMENTS
(Continued)

17. LEASES

The Commission and EdFund lease office and storage space under noncancelable operating leases and month-to-month agreements. Total rental expense recorded in the Operating Fund, which includes utilities for one of two major leases, for the years ended June 30, 2008 and 2007 approximated $3,408,000 and $3,573,000, respectively. The future minimum lease payments for the noncancelable EdFund operating leases are as follows (in 000's):

Year Ending June 30,		
2009	$	5,626
2010		4,960
2011		4,998
2012		4,835
2013		4,941
Thereafter		25,863
	$	51,223

18. CONTINGENCIES

During the normal course of business, the loan 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.

19. SUBSEQUENT EVENT

Chapter 132 of the 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 Director of Finance to consummate other transactions to maximize the value of the state's student loan guarantee program. The 2008-09 State budget, signed into law on September 23, 2008, indicates the sale has been postponed due to a variety of factors affecting the student loan guaranty industry. However, the state administration is continuing its efforts, pursuant to Chapter 757 of the statutes of 2008 (Assembly Bill 519) that extends the sale authorization through January 10, 2011.

As a consequence of this proposed transaction, the state budget continues to use General Fund resources to finance the Commission's state operations budget and financial aid awareness programs. However, the state budget shifted $24 million from the General Fund to the Operating Fund to fund a portion of the CalGrant costs in 2008-09. Further detail and information about the 2008-09 budget for the State of California is available through the Department of Finance budget website (www.ebudget.ca.gov).

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, 2008, and have issued our report thereon dated December 30, 2008. 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 control deficiency 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 misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the Commission's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the Commission's financial statements that is more than inconsequential will not be prevented or detected by the Commission's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the Commission's internal control.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be 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.

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

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 no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards.*

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 30, 2008