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Information/Action Item

California Student Aid Commission

Presentation on the October 31, 2010 Operating Fund and Federal Fund Financial Statements for Federal Student Loan Program

Perry Smith LLP has completed their independent audit of the Operating Fund and Federal Fund financial statements for the four months ended October 31, 2010. The auditors will make a formal presentation of 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 four months ended October 31, 2010.

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

Tina Treis, Partner
Perry Smith LLP

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

We are pleased to present this letter related to the conduct of the audit of the financial statements of the Student Loan Operating Fund and the Federal Student Loan Fund (collectively "the Funds") as of and for the four months ended October 31, 2010. This report is intended to inform the Honorable Members of the California Student Aid Commission (the "Commission") about significant matters related to the conduct of the audit so that they can appropriately discharge their FFEL Program responsibility, and that we comply with our professional responsibilities.

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

The Auditor's Responsibility Under Generally Accepted Auditing Standards

Our audit of the financial statements of the Funds of the Commission for the four months ended October 31, 2010 was conducted in accordance with auditing standards generally accepted in the United States of America and *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether caused by error, fraudulent financial reporting or misappropriation of assets. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. Accordingly, the audit was designed to obtain reasonable, rather than absolute, assurance about the financial statements. We believe that our audit accomplished that objective.

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

Accounting Estimates and Management Judgments

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

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

Financial Statement Disclosures

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

Significant 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 Operating Fund's accounting records. The adjustments that were recorded included the recognition of a $700,000 unemployment insurance accrual and the recognition of a $466,444 escheat liability to the State Controller's Office.

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.

Difficulties Encountered in Performing the Audit

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

Material Written Communications Between Management and Our Firm

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

* * * * *

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

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

Perry-Smith LLP

Sacramento, California
May 25, 2011

CALIFORNIA STUDENT AID COMMISSION
OPERATING FUND

SUMMARIZED SCHEDULE OF SIGNIFICANT AUDIT ADJUSTMENTS

OCTOBER 31, 2010

	Effect – Increase (Decrease)				
Description	Assets	Liabilities	Equity	Revenue	Expenses
- Unemployment insurance accrual		$ 700,000			$ 700,000
- Escheat liability		466,444			466,444
Total Effect			$(1,166,444)	$ -	$ 1,166,444
Balance Sheet Effect (Pretax)	$ -	$ 1,166,444	$(1,166,444)		

CALIFORNIA STUDENT AID COMMISSION

May 25, 2011

CALIFORNIA STUDENT AID COMMISSION

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

In connection with your audits of the basic financial statements of the Operating and Federal Funds (collectively the "Funds") of the California Student Aid Commission ("Commission") as of and for the periods ended October 31, 2010 and June 30, 2010, 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 May 25, 2011 the following representations made to you during your audit.

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

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Rancho Cordova, CA 95670 TEL 916/464-8271 FAX 916/464-8033 WEB SITE www.csac.ca.gov

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

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

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

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

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

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

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

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

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

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

    c. For pension obligations, post-retirement benefits other than pensions and deferred compensation agreements attributable to employee services rendered through May 25, 2011.

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

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

18. There are no:

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

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

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

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

20. We have no direct or indirect, legal or moral, obligation for any debt of any organization, public or private, that is not disclosed in the financial statements.
21. We have satisfactory title to all owned assets.
22. We have complied with all aspects of contractual agreements that would have a material effect on the financial statements in the event of noncompliance.
23. Net asset components and fund balance reserves and designations are properly classified and, if applicable, approved.
24. Expenses have been appropriately classified in or allocated to functions and programs in the statement of revenues, expenses and changes in net assets, and allocations have been made on a reasonable basis.
25. Revenues are appropriately classified in the statement of revenues, expenses and changes in net assets within program revenues.
26. Capital assets, including infrastructure assets, are properly capitalized, reported, and depreciated.
27. Required supplementary information is properly measured and presented.
28. Effective November 1, 2010, Educational Credit Management Corporation (ECMC) became the designated guaranty agency for the Commission's FFEL Program portfolio. ECMC is assessing the EdFund personnel, facilities, and other operational expenses and incorporating those deemed useful for administering the FFEL Program activities now under their control. As part of this transition, the U.S. Department of Education (ED) agreed to fund $100 million from the Operating Fund to the 2010-11 State of California budget to support Cal Grant program awards. The $100 million has been transferred from the Operating Fund to the 2010-11 State of California budget to support the Cal Grant program awards.
29. EdFund administered the Federal Family Education Loan (FFEL) Program for the Commission. ED terminated its guaranty agency agreements with the Commission as of October 31, 2010 and transferred the FFEL Program to ECMC effective November 1, 2010. As of December 6, 2010, all EdFund employees had become ECMC employees. Because EdFund does not have any employees at this time, there is no representation from EdFund management regarding the financial statements of the Operating and Federal Funds of the Commission for the periods ended October 31, 2010 and June 30, 2010.
30. Subsequent to October 31, 2010, ECMC's Operating Fund assumed the Operating Fund's allowance for default aversion fees and allowance for early withdrawal fees of $28,801,234 and $1,139,617, respectively. Subsequent to the designation transfer, the Commission has no obligation to ECMC or the Federal Fund for future defaults or early withdrawals.
31. The Commission believes the Operating Fund will not be held accountable to pay interest or penalties on the unclaimed property which was not timely remitted to the State Controller's Office.

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 Administration and External Affairs

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

FINANCIAL STATEMENTS

FOR THE FOUR MONTHS ENDED OCTOBER 31, 2010

AND FOR THE YEAR ENDED JUNE 30, 2010

AND

INDEPENDENT AUDITOR'S REPORT

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

FINANCIAL STATEMENTS

For the Four Months Ended October 31, 2010 and the Year Ended June 30, 2010

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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 October 31, 2010 and June 30, 2010 and for the four months ended October 31, 2010 and the year ended June 30, 2010, as shown in the accompanying table of contents. These financial statements are the responsibility of the Commission's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

As discussed in Note 1, the financial statements present only the Operating Fund and Federal Fund of the Loan Program of the Commission and do not purport to, and do not, present fairly the financial position of the California Student Aid Commission as of October 31, 2010 and June 30, 2010, and the changes in its financial position and its cash flows for the four months ended October 31, 2010 and the year ended June 30, 2010 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 October 31, 2010 and June 30, 2010, and their changes in financial position and their cash flows for the four months ended October 31, 2010 and the year ended June 30, 2010 in conformity with accounting principles generally accepted in the United States of America.

INDEPENDENT AUDITOR'S REPORT
(Continued)

As discussed in Note 18, effective November 1, 2010, Educational Credit Management Corporation became the designated guaranty agency for the Commission's Federal Family Education Loan (FFEL) Program portfolio and the Operating Fund and Federal Fund are no longer under the administration of the Commission. Subsequent to October 31, 2010 the Commission transferred $75,000,000 from the Operating Fund and $25,000,000 received from ECMC's Operating Fund to the State of California's General Fund for 2010-11 Cal Grant program awards. On November 2, 2010, EdFund was directed to remit substantially all excess cash totaling $28,216,702 to the Operating Fund. Part of this cash transfer extinguished EdFund's $20,000,000 liability due to the Operating Fund that was advanced at EdFund's inception for use as operating capital. On November 24, 2010, the Commission remitted $68,145,662 from the Operating Fund to ECMC's Operating Fund. The Commission remitted $103,837 and $11,142 from the Federal Fund to ECMC's Federal Fund on November 18, 2010 and January 14, 2011, respectively. These transactions are recognized as net payables at October 31, 2010 in the balance sheet of the Commission's Operating Fund and Federal Fund. Subsequent to October 31, 2010, ECMC's Operating Fund assumed the Operating Fund's allowance for default aversion fees and allowance for early withdrawal fees of $28,801,234 and $1,139,617, respectively. Other receivables and payables of the Commission's Operating Fund and Federal Fund cleared subsequent to October 31, 2010 by cash settlements in ECMC's Operating Fund and Federal Fund. Per ED's authorization, the Commission retained $885,000 in the Operating Fund for 2010-11 federal policy and programs expenses, November and December 2010 payroll expenses for the 10 civil service employees who previously were assigned to EdFund, and contingencies. Any remaining cash is subject to subsequent transfer to ECMC.

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

In accordance with *Government Auditing Standards*, we have also issued a report dated May 25, 2011 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
May 25, 2011

MANAGEMENT'S DISCUSSION AND ANALYSIS

Effective November 1, 2010, the U.S. Department of Education (ED) terminated its guaranty agency agreements with the California Student Aid Commission (Commission) and transferred the State of California's guarantor designation from the Commission to another guarantor, Educational Credit Management Corporation (ECMC). This section of the Commission's Federal Family Education Loan (FFEL) Program financial audit report presents discussion and analysis of the program's financial performance during the final four month period ended October 31, 2010 and the fiscal years ended June 30, 2010 and 2009.

The FFEL Program, created by the federal government in 1965 as a means of making loans available to students attending college, allows undergraduate and graduate students at eligible postsecondary schools to obtain federally guaranteed loans from private lenders at advantageous interest rates. ED has administrative responsibility over the FFEL Program and designates guaranty agencies to perform the daily operational and oversight functions. Federal legislation governing the FFEL Program established two distinct funds, the Student Loan Operating Fund (Operating Fund) and Federal Student Loan Reserve Fund (Federal Fund), to finance program activities. The information contained in this management discussion and analysis should be read in conjunction with the financial statements following this section.

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

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

The Commission, as a designated guarantor through October 31, 2010, administered the FFEL Program through a contractual arrangement with its auxiliary organization, EdFund. Commission responsibilities also include grant program administration. FFEL Program functions consist of guarantor activities as defined by federal regulations, while the grant program encompasses all activities related to the Commission's administration of the state Cal Grant awards and other specialized programs. The accompanying financial statements present the financial position of the Operating and Federal Funds only, and do not present the financial position or results of operations of any other Commission fund or activity.

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

Financial Highlights

Stafford and PLUS loan disbursement volume was $1.1 billion for the four months ended October 31, 2010 and $8.0 billion for the year ended June 30, 2010. This loan volume reflects disbursements of loans guaranteed prior to the discontinuation of new lending under the FFEL Program effective July 1, 2010.

Effective May 2008, the Ensuring Continued Access to Student Loans Act of 2008 (ECASLA) was enacted in response to the lack of liquidity in the financial markets as FFEL Program lenders were unable to find buyers for their securitized student loan offerings. ECASLA provides avenues for lenders to sell these loans to the federal government. Although these solutions provide the liquidity needed for lenders to continue funding student loans, a negative consequence is that these loans are no longer retained in the guarantor's portfolio. As of October and June 2010, lenders transferred $13.8 million and $8.1 million, respectively, in loan guarantees to ED under the loan purchase program authorized by ECASLA. These loan purchases are a primary cause of the outstanding loan portfolio declining 20.3 percent, from $33.8 billion at June 30, 2010 to $26.9 billion at October 31, 2010.

Operating Fund operating income was $15.6 million for the four months ended October 31, 2010 and $81.5 million for the twelve months ended June 30, 2010. These positive operating performances reflect operating margins of 39.4 percent and 45.4 percent for the periods, respectively. This 6 percent decline in operating margin results from a decrease in administrative fees associated with the elimination of new loan volume and a rise in claim activity from a weak economy, offset somewhat by reductions in personnel and operating costs, and the elimination of the Federal Default Fee (FDF) subsidy.

Gross collection recoveries on loan defaults totaled $170.8 million in the four months ended October 31, 2010, and totaled $522.9 million in the twelve months ended June 30, 2010. Of these amounts, $126.2 million and $386.6 million were remitted to ED in federal share during these two periods, respectively. Similarly, net recoveries on loan defaults of $37.4 million and $112.5 million were retained as revenue to the Operating Fund in the four months ended October 31, 2010 and the twelve months ended June 30, 2010, respectively. Net recoveries as a percent of gross collection recoveries increased slightly to 21.9 percent from 21.5 percent reflecting continued achievements in shifting collection efforts to an emphasis on rehabilitation loan recoveries, an increased defaulted loan portfolio, and improved defaulted loan recovery rates through enhanced automation tools and increased internal and external collection recovery performance.

In the 2010-11 and 2009-10 state fiscal years, the state of California appropriated $100 million and $32 million, respectively, from the Operating Fund to fund Cal Grant program awards. In an agreement with ED and ECMC, $100 million was funded from the Operating Fund. Cal Grant program awards are made to students to help pay the costs for postsecondary education.

Program Overview

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

Program Overview (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 collections on defaulted loans. The Operating Fund also reflects other student financial aid related activities as selected by the guaranty agency, including activities related to administration of state specialized grant programs. Operating Fund revenues are derived principally from collection recoveries on defaulted student loans and performance based fees paid by ED for new loan disbursements, portfolio maintenance and successful default aversion efforts.

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

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

Regulatory changes required by the passage of the Higher Education Reconciliation Act (HERA) in 2007 included a federal requirement that all guaranty agencies deposit a FDF to their Federal Fund equal to 1 percent of the disbursement amount for Stafford and PLUS loans guaranteed on and after July 1, 2006 to cover the cost of insuring the loan. The FDF was the primary source of revenue to the Federal Fund prior to the elimination of new FFEL program lending on July 1, 2010.

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

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

Rehabilitation loans continue to account for the largest portion of collection recoveries and offer benefits to borrowers through improved credit histories and the ability to qualify again for federal student loans. Gross rehabilitation loan volume was $112.8 million for the four months ended October 31, 2010 and $343.3 million for the twelve months ended June 30, 2010, or 66.0 percent and 65.6 percent of gross collections, respectively.

Program Overview (Continued)

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

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

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

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

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

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

MANAGEMENT'S DISCUSSION AND ANALYSIS
(Continued)

Overview of the Financial Statements

The following table provides a summary of the balance sheets and statements of revenues, expenses, and changes in net assets for both the Operating Fund and Federal Fund for the final four month period ended October 31, 2010 and the fiscal years ended June 30, 2010 and 2009.

Summary of Balance Sheets	Operating Fund *Amounts in thousands*			Federal Fund *Amounts in thousands*		
	10/31/2010	2010	2009	10/31/2010	2010	2009
Current assets	$ 177,139	$ 122,445	$ 64,276	$ 144,847	$ 146,777	$ 151,240
Other noncurrent assets	—	1	20,015	—	—	—
Total assets	177,139	122,446	84,291	144,847	146,777	151,240
Current liabilities	173,834	19,920	31,272	13,863	12,941	37,250
Noncurrent liabilities	48	48	39	—	—	—
Total liabilities	173,882	19,968	31,311	13,863	12,941	37,250
Net assets:						
Restricted	—	—	—	130,984	133,836	113,990
Unrestricted	3,257	102,478	52,980	—	—	—
Total net assets	$ 3,257	$ 102,478	$ 52,980	$ 130,984	$ 133,836	$ 113,990

Summary of Revenues, Expenses and Changes in Net Assets	Operating Fund *Amounts in thousands*			Federal Fund *Amounts in thousands*		
	10/31/2010	2010	2009	10/31/2010	2010	2009
Operating revenues:						
Net recoveries on loan defaults	$ 37,380	$ 112,548	$ 108,468	$ —	$ —	$ —
Administrative and program fee income	432	65,668	65,767	—	—	—
Borrower counseling services	1,820	1,206	—	—	—	—
Federal default fee	—	—	—	2,697	71,762	79,418
Claim purchase complement	—	—	—	6,188	18,924	15,811
Other	—	—	—	865	23	27
Operating revenues	39,632	179,422	174,235	9,750	90,709	95,256
Operating expenses:						
Administrative	24,019	87,324	93,314	—	—	—
Fee subsidies	(6)	10,566	64,052	(6,300)	13,873	9,966
Loan default expense	—	—	—	18,846	57,224	51,226
Operating expenses	24,013	97,890	157,366	12,546	71,097	61,192
Operating income (loss)	15,619	81,532	16,869	(2,796)	19,612	34,064
Nonoperating revenues (expenses):						
Interest income	180	363	1,190	59	234	773
Grant administrative costs	(164)	(397)	(596)	—	—	—
Other	73	—	—	—	—	—
Financial aid awareness program	—	—	(124)	—	—	—
Nonoperating revenues (expenses), net	89	(34)	470	59	234	773
Transfers:						
Cal Grant program awards	(75,000)	(32,000)	(24,000)	—	—	—
Other	(39,929)	—	—	(115)	—	—
Change in net assets	(99,221)	49,498	(6,661)	(2,852)	19,846	34,837
Net assets, beginning of year	102,478	52,980	59,641	133,836	113,990	79,153
Net assets, end of year	$ 3,257	$ 102,478	$ 52,980	$ 130,984	$ 133,836	$ 113,990

Financial Analysis of the Operating Fund

At the period ended October 31, 2010 total net assets of the Operating Fund were $3.3 million, a decrease of $99.2 million from $102.5 million at June 30, 2010 compared to a $49.5 million increase from June 30, 2009. Net assets are comprised entirely of unrestricted net assets. This net asset change is primarily due to the items noted below.

Financial Analysis of the Operating Fund (Continued)

- In the four months ended October 31, 2010, total operating revenues were $39.6 million and $179.4 million for the fiscal year ended June 30, 2010. Net recoveries on loan defaults continues as the primary source of operating revenues.

- Net recoveries on loan defaults were $37.4 million for the four month period ended October 31, 2010 and $112.5 million in fiscal period ended June 30, 2010. Rehabilitation loans continue to account for the largest portion of collection recoveries and offer benefits to the defaulted borrower by improving their credit rating while bringing their student loan balances out of default status, and providing increased revenues to the Operating Fund because of higher retention rates on this collection type.

- Administrative and program fee income was $0.4 million for the four month period ended October 31, 2010 and $65.7 million in fiscal 2010. In a letter dated February 28, 2011, ED notified guaranty agencies that as loan disbursements under the FFEL program ended July 1, 2010, ED will no longer calculate LPIF after the quarter ended December 31, 2010. Additionally, ED stated that due to a miscalculation LPIF was overpaid between April and September 2010. As a result, LPIF was reduced by $0.9 million in the period ended October 31, 2010. AMF is also impacted by loans purchased by the federal government under ECASLA. While DAF revenue reflects the successful default aversion programs and counseling provided to borrowers, increases to the DAF and WAF allowances were necessitated by the weak economy.

- Borrower counseling services is a new program added in 2010. The program offers delinquency prevention and default aversion services to students for loans not covered by the traditional FFEL guarantor model. A contract was entered into with an educational institution in February, 2010 and generated $1.8 million and $1.2 million in revenues for the Operating Fund in the four months ended October 31, 2010 and twelve months ended June 30, 2010, respectively. The contract ended on November 4, 2010.

- Administrative operating expenses for loan program personnel and other operating expenses were $24.0 million in the four months ended October 31, 2010 and $87.3 million and $93.3 million in the fiscal years ended June 30, 2010 and 2009, respectively. The decrease in 2010 reflects the change in operations attributable to the elimination of new loan guarantees in the FFEL Program under H.R. 4872 and other expense reduction efforts.

- The federal default fee subsidy program terminated effective July 1, 2009. FDF subsidy paid in 2010 is for loans guaranteed prior to June 30, 2009, but not funded until after that date.

- Transfers from the Operating Fund to the State General Fund for Cal Grant program awards increased by $43 million in the four months ended October 31, 2010. The State appropriated $100 million to help fund Cal Grant program awards in fiscal year 2010-11 and $32.0 million in 2009-10. In an agreement with ED and ECMC, $100 million was funded from the Operating Fund.

Financial Analysis of the Federal Fund

At the period ended October 31, 2010, the total net assets of the Federal Fund decreased from June 30, 2010 by $2.8 million to $131.0 million compared to a $19.8 million increase to $133.8 million at year ended June 30, 2010. Net assets are comprised entirely of restricted balances mandated by federal regulation to meet required minimum reserve levels. This net asset decrease is primarily due to the items noted below.

- Operating revenues were $9.8 million in the four months ended October 31, 2010 and $90.7 million in the twelve months ended June 30, 2010. The federal default fee was the primary source of revenues to the Federal Fund prior to ED's June 30, 2010 deadline to transition new loans from the FFEL Program to direct lending, as required by H.R. 4872. Complement revenues were $6.2 million and $18.9 million for the two periods, respectively.

- Fee subsidies consist of DAF subsidies recorded net of refund allowance estimates. In the four months ended October 31, 2010 the Operating Fund paid the Federal Fund $6.3 million which represented allowance increases in excess of revenues. In fiscal year 2010, the Operating Fund charged the Federal Fund $13.9 million in DAF expenses.

- Loan default expense was $18.8 million in the four months ended October 31, 2010 and $57.2 million in the twelve months ended June 30, 2010.

Significant Known Facts, Decisions, or Conditions

<u>Guaranty Designation Transfer</u>

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

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

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

Significant Known Facts, Decisions, or Conditions (Continued)

Guaranty Designation Transfer (Continued)

On October 29, 2010, ECMC, the Commission and EdFund entered into an operating agreement for the transition of guarantor services from the Commission to ECMC. As directed by ED, this agreement required the Commission to transfer and assign to ECMC the Commission's guarantee portfolio, Federal Fund and Operating Fund. The Commission's Operating Fund included the Student Loan Operating Fund in the State Treasury and EdFund's Auxiliary and Equity accounts. Both EdFund accounts were initially established from transfers from the Commission's Operating Fund in the State Treasury. As such, the funds in these accounts were subject to the federally authorized uses of an Operating Fund.

Effective November 1, 2010, ECMC became the designated guaranty agency for the Commission's FFEL Program portfolio. Between November 1 and December 6, 2010, all EdFund direct hire employees were either employed by ECMC, or separated from EdFund. The 10 civil service employees were reassigned to the Commission. The outside members of the EdFund Board of Directors tendered their resignation effective December 5, 2010. In an action taken December 7, 2010, the Commissioners appointed themselves as members of the EdFund Board of Directors. Future services to be provided by EdFund are still under review by the new EdFund Board of Directors and the Commission.

On November 2, 2010, ED directed EdFund to remit substantially all excess cash totaling $28,216,702 to the Commission's Operating Fund in the State Treasury. Part of this cash transfer extinguished EdFund's $20,000,000 liability due to the Operating Fund that was advanced at EdFund's inception for use as operating capital. In accordance with the transfer of funds to the successor agency, the Commission's Operating Fund remitted $68,145,662 to ECMC's Operating Fund on November 24, 2010 and $103,837 and $11,142 from the Commission's Federal Fund to ECMC's Federal Fund on November 18, 2010 and January 14, 2011, respectively. On January 19, 2011, the Operating Fund received $25,000,000 from ECMC's Operating Fund. The Commission remitted $75,000,000 and $25,000,000 from the Operating Fund to the state's General Fund for Cal Grant program awards on November 8, 2010 and January 19, 2011, respectively. These subsequent transactions are recognized as net payables at October 31, 2010 in the balance sheet of the Commission's Operating Fund and Federal Fund. Subsequent to October 31, 2010, ECMC's Operating Fund assumed the Operating Fund's allowance for default aversion fees and allowance for early withdrawal fees of $28,801,234 and $1,139,617, respectively.

Other receivables and payables of the Commission's Operating Fund and Federal Fund cleared subsequent to October 31, 2010 by cash settlements in ECMC's Operating Fund and Federal Fund. Per ED's authorization, the Commission will retain $885,000 in the Operating Fund for 2010-11 federal policy and programs expenses, payroll expenses in November and December, 2010 for the 10 civil service employees who previously worked at EdFund, and an amount for any contingent liabilities. Any remaining cash is subject to subsequent transfer to ECMC.

Significant Known Facts, Decisions, or Conditions (Continued)

EdFund Lease

On December 16, 2010, ED issued a final program review report to the Commission. The purpose of the review was to determine whether lease payments made by EdFund on an unoccupied building, and subsequently reimbursed by the Commission, were an authorized use of the Guaranty Agency's Operating Fund. The report indicated that ED determined that paying rent on an unoccupied building is an improper use of the Operating Fund under the FFEL Program since the payment of these costs is not in support of a guaranty agency-related activity or for other student financial aid-related activities. Between July 3, 2008 and October 31, 2010, EdFund has made lease payments on the unoccupied building (Building B) totaling $3,920,476. The required action from ED was for the Commission to immediately cease making future lease payments for the unoccupied building using the Operating Fund. The Commission must reimburse the Operating Fund for the lease payments made to date on Building B.

The Commission responded to ED's final program review report. ED has not issued a response, so no action has been taken to reimburse the Operating Fund.

Pending Litigation

In November, 2010, EdFund notified the lessor that it was terminating the main office (Mather) operating lease effective December 31, 2010. While the lessor has not accepted the termination, it has subsequently leased to other parties the two buildings that comprise the Mather premises. The gross obligation per the lease agreement totals $38,137,403 for the two buildings without any offset for the building that has been leased. On January 14, 2011 the lessor filed suit against EdFund and its Board of Directors citing, among other things, breach of contract for the Mather lease and filed a claim with the Victims Compensation and Government Claims Board against the Commission, Department of Finance, and the State Controller for damages related to the EdFund lease. After the statutory time limit had passed for action by the Victims Compensation and Government Claims Board, Mather Development Partners amended their lawsuit against EdFund to include the Commission, Commissioners, and the Department of Finance. It is too early in the legal process to estimate the potential outcome or possibility of loss, but the amount requested by the lessor in the suit is $40,000,000.

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

BALANCE SHEETS

October 31, 2010 and June 30, 2010

	Operating Fund	
	October 31, 2010	June 30, 2010
ASSETS		
Current assets:		
Cash and cash equivalents (Note 4)	$ 115,796,122	$ 77,473,237
Interest receivable	44,564	113,686
Other receivables (Note 12)	1,500,849	1,124,171
Due from EdFund (Note 15)	34,633,851	19,779,584
Due from Federal Fund (Note 15)	13,748,223	12,940,556
Due from Federal government (Note 6)	7,596,074	8,668,839
Due from lending institutions (Note 8)	3,656,984	2,230,112
Due from other funds	162,774	114,573
Total current assets	177,139,441	122,444,758
Noncurrent assets:		
Capital assets, net of accumulated depreciation (Note 5)	214	1,069
Total assets	$ 177,139,655	$ 122,445,827
LIABILITIES AND NET ASSETS		
Current liabilities:		
Accounts payable	$ 281,465	$ 166,449
Due to General Fund (Note 9)	100,000,000	-
Due to Operating Fund at ECMC (Note 18)	43,145,662	-
Due to other government agency	466,444	43,765
Allowance for default aversion fees (Note 6)	28,801,234	18,598,709
Allowance for early withdrawal fees (Note 7)	1,139,617	1,111,138
Total current liabilities	173,834,422	19,920,061
Noncurrent liabilities:		
Post retirement obligation (Note 14)	48,000	48,000
Total liabilities	173,882,422	19,968,061
Net assets:		
Investment in capital assets (Note 5)	214	1,069
Unrestricted	3,257,019	102,476,697
Total net assets	3,257,233	102,477,766
Total liabilities and net assets	$ 177,139,655	$ 122,445,827

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

October 31, 2010 and June 30, 2010

	Federal Fund	
	October 31, 2010	June 30, 2010
ASSETS		
Current assets:		
Cash and cash equivalents (Note 4)	$ 108,610	$ 21,505,138
Interest receivable	11,142	61,246
Due from Federal government (Note 3)	78,446,653	68,187,996
Due from EdFund (Note 15)	24,809,546	29,139,890
Due from lending institutions (Note 8)	11,530,216	8,173,022
Default aversion fees receivable (Note 6)	28,801,234	18,598,709
Early withdrawal fees receivable (Note 7)	1,139,617	1,111,138
Total assets	$ 144,847,018	$ 146,777,139
LIABILITIES AND NET ASSETS		
Current liabilities:		
Due to Operating Fund (Note 15)	$ 13,748,223	$ 12,940,556
Due to Federal Fund at ECMC (Note 18)	114,979	-
Total current liabilities	13,863,202	12,940,556
Net assets:		
Restricted (Note 13)	130,983,816	133,836,583
Total liabilities and net assets	$ 144,847,018	$ 146,777,139

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 Four Months Ended October 31, 2010 and the Year Ended June 30, 2010

	Operating Fund	
	October 31, 2010	June 30, 2010
Operating revenues:		
Net recoveries on loan defaults (Note 8)	$ 37,379,911	$ 112,548,629
Administrative and program fees income (Note 6)	432,090	65,667,707
Borrower counseling services (Note 12)	1,820,538	1,205,966
Total operating revenues	39,632,539	179,422,302
Operating expenses:		
Loan program personnel costs	12,992,976	49,549,319
Operating expenses (Note 16)	5,655,909	20,243,231
Contracted collection costs	5,369,973	17,531,785
Federal default fee subsidy (Note 11)	(5,884)	10,566,219
Total operating expenses	24,012,974	97,890,554
Operating income	15,619,565	81,531,748
Nonoperating revenues (expenses):		
Interest income	180,355	362,749
Grant administrative costs (Note 9)	(164,355)	(396,653)
Gain on liquidation of ELM investment (Note 4)	72,862	-
Total nonoperating revenues (expenses), net	88,862	(33,904)
Transfers:		
Transfer to State of California's General Fund for Cal Grant program awards (Note 9)	(75,000,000)	(32,000,000)
Transfer cash balances from EdFund (Note 18)	28,216,702	-
Transfer of cash balances to the Operating Fund at ECMC (Note 18)	(68,145,662)	-
Total net transfers	(114,928,960)	(32,000,000)
Change in net assets	(99,220,533)	49,497,844
Net assets, beginning of period	102,477,766	52,979,922
Net assets, end of period	$ 3,257,233	$ 102,477,766

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 Four Months Ended October 31, 2010 and the Year Ended June 30, 2010

	Federal Fund	
	October 31, 2010	June 30, 2010
Operating revenues:		
Federal default fee (Note 11)	$ 2,697,111	$ 71,761,555
Claim purchase complement	6,188,015	18,924,171
Other revenues	865,364	23,527
Total operating revenues	9,750,490	90,709,253
Operating expenses:		
Loan default expenses (Note 10)	18,845,969	57,224,196
Default aversion fee (Note 6)	(5,993,631)	13,873,258
Early withdrawal fee (Note 7)	(304,988)	-
Total operating expenses	12,547,350	71,097,454
Operating (loss) income	(2,796,860)	19,611,799
Nonoperating revenues:		
Interest income	59,072	234,419
Transfers:		
Transfer cash balances to the Federal Fund at ECMC	(114,979)	-
Change in net assets	(2,852,767)	19,846,218
Net assets, beginning of period	133,836,583	113,990,365
Net assets, end of period	$ 130,983,816	$ 133,836,583

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 Four Months Ended October 31, 2010 and the Year Ended June 30, 2010

	Operating Fund	
	October 31, 2010	June 30, 2010
Cash flows from operating activities:		
Receipts from:		
Collections	$ 37,337,772	$ 121,843,386
Administrative fees	12,932,209	68,632,273
Other sources	1,620,178	143,096
Payments for:		
General administrative and other expenses	(13,655,170)	(67,717,061)
Federal default fee subsidy	1,867	(13,959,301)
Net cash provided by operating activities	38,236,856	108,942,393
Cash flows from noncapital financing activities:		
Payments for grant administrative costs	(163,500)	(382,648)
Transfer for Cal Grant program awards	-	(32,000,000)
Net cash used in noncapital financing activities	(163,500)	(32,382,648)
Cash flows provided by investing activities:		
Interest received	249,529	322,182
Increase in cash and cash equivalents	38,322,885	76,881,927
Cash and cash equivalents, beginning of year	77,473,237	591,310
Cash and cash equivalents, end of year	$ 115,796,122	$ 77,473,237
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	$ 15,619,565	$ 81,531,748
Adjustments to reconcile operating income to net cash provided by operating activities:		
Change in assets and liabilities:		
Receivables	(303,816)	(1,123,418)
Federal government	1,072,765	3,243,346
Lending institutions	(1,426,872)	12,207,372
EdFund	13,362,383	(10,836,868)
Federal Fund	(807,667)	24,309,068
Other funds	(48,201)	8,087
Accounts payable	115,016	(11,336)
Other government agency	422,679	(65,338)
Allowance for default aversion and early withdrawal fees	10,231,004	(329,268)
Post retirement obligation	-	9,000
Total adjustments	22,617,291	27,410,645
Net cash provided by operating activities	$ 38,236,856	$ 108,942,393

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 Four Months Ended October 31, 2010 and the Year Ended June 30, 2010

	Federal Fund	
	October 31, 2010	June 30, 2010
Cash flows from operating activities:		
Receipts from:		
Reimbursement on default purchases	$ 422,482,039	$ 1,295,439,659
Federal default fee	3,478,245	75,002,386
Other sources	6,177,155	20,863,452
Payments for:		
Purchases of default student loans	(448,830,519)	(1,364,884,599)
Administrative fees	(4,263,371)	(13,594,478)
General administrative and other expenses	(549,256)	(251,332)
Net cash (used in) provided by operating activities	(21,505,707)	12,575,088
Cash flows provided by investing activities:		
Interest received	109,179	272,096
(Decrease) increase in cash and cash equivalents	(21,396,528)	12,847,184
Cash and cash equivalents, beginning of year	21,505,138	8,657,954
Cash and cash equivalents, end of year	$ 108,610	$ 21,505,138
Reconciliation of operating (loss) income to net cash (used in) provided by operating activities:		
Operating (loss) income	$ (2,796,860)	$ 19,611,799
Adjustments to reconcile operating (loss) income to net cash (used in) provided by operating activities:		
Change in assets and liabilities:		
Federal government	(10,258,657)	(20,551,929)
EdFund	4,330,341	(9,744,741)
Operating Fund	807,667	(24,309,068)
Lending institutions	(3,242,215)	47,239,759
Due to Federal Fund at ECMC	(114,979)	-
Allowance for default aversion and early withdrawal fees	(10,231,004)	329,268
Total adjustments	(18,708,847)	(7,036,711)
Net cash (used in) provided by operating activities	$ (21,505,707)	$ 12,575,088

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

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

NOTES TO FINANCIAL STATEMENTS

1. ORGANIZATION AND OPERATIONS

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

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

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

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

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

Adoption of, or Change in, Accounting Policies

The Commission and management have the ultimate responsibility for the appropriateness of the accounting policies used by the Funds. Significant accounting policies are included in Note 2 to the financial statements. Following is a description of the significant accounting policy which was adopted during the period:

Fund Balance Reporting and Governmental Fund Type Definitions

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

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.

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

NOTES TO FINANCIAL STATEMENTS
(Continued)

1. ORGANIZATION AND OPERATIONS (Continued)

On July 20, 2010, ED notified the Commission and the State of California Department of Finance (DOF) that the guaranty agency agreement with the Commission would be terminated no later than the close of business on October 31, 2010. In a subsequent letter dated August 27, 2010, ED clarified that the action to terminate is in accordance with section 428(c)(9)(E) of the Higher Education Act of 1965, as amended. ED also indicated that the U.S. Secretary of Education selected Educational Credit Management Corporation (ECMC) as the successor guaranty agency to assume the Commission's guaranty agency responsibilities effective November 1, 2010. This transfer includes Federal Fund assets and liabilities and the rights, and obligations (including the continuing outstanding FFEL Program loan guarantees) of the Commission's guaranty agency activities and administration of the Operating Fund.

On October 29, 2010, ECMC, the Commission and EdFund (the Commission's nonprofit public benefit auxiliary organization) entered into an operating agreement for the transition of guarantor services from the Commission to ECMC. As directed by ED, this agreement required the Commission to transfer and assign to ECMC the Commission's guarantee portfolio, Federal Fund and Operating Fund.

Effective November 1, 2010 ECMC became the designated guaranty agency for the Commission's FFEL Program portfolio. Remaining Operating Fund assets, except for capital assets net of accumulated depreciation as of October 31, 2010, will ultimately be remitted to the Operating Fund controlled by ECMC.

2. SIGNIFICANT ACCOUNTING POLICIES

(a) Basis of Accounting

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

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

2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(b) Cash and Cash Equivalents

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

(c) Capital Assets

Capital assets are those assets purchased or acquired with an original cost of $5,000 or more. Additions, improvements or other capital outlays that significantly extend the useful life of an asset are capitalized. These assets are reported at historical cost and are depreciated using the straight-line method over estimated useful lives of three to five years. Repair and maintenance costs are expensed as incurred. Depreciation of $855 and $14,005 is included in the Operating Fund's grant administrative costs for the four month period ended October 31, 2010 and the year ended June 30, 2010, respectively.

(d) Net Assets

The Operating Fund's and Federal Fund's net assets are classified as follows:

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

(e) Operating Revenues and Expenses

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

2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(f) Use of Estimates

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

g) Reclassifications

Certain reclassifications have been made to prior year balances for clarification and to conform to classifications used in the financial statements for the four months ended October 31, 2010.

(h) New Financial Accounting Pronouncement

Fund Balance Reporting and Governmental Fund Type Definitions

In February 2009, the Governmental Accounting Standards Board (GASB) issued GASB Codification Section 1300 and 1800, *Fund Balance Reporting and Governmental Fund Type Definitions,* effective for periods beginning after June 15, 2010. The Statement was issued to address a lack of consistency in fund balance reporting by providing clearer fund balance classifications and by clarifying the existing definitions of governmental fund types. The financial statements of the Operating Fund and Federal Fund are proprietary funds and not impacted by GASB Codification Section 1300 and 1800.

3. GUARANTEED LOANS OUTSTANDING

As of October 31, 2010 and June 30, 2010, the Commission was the guarantor of a portfolio of outstanding loans with original principal amounts of approximately $26.9 billion and $33.8 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 October 31, 2010 will go into default status in the future requiring the use of the Federal Fund to purchase these defaulted loans from lenders. The Federal Fund will subsequently be reimbursed by ED at the applicable reinsurance rate associated with these defaulted loans. At October 31, 2010 and June 30, 2010, reinsurance reimbursements on defaulted loan purchases due from the Federal government were $78,446,653 and $68,187,996, respectively.

4. CASH AND CASH EQUIVALENTS

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

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 October 31, 2010 and June 30, 2010 the allocation of the carrying value plus accrued interest purchased of the SMIF investments and cash held by the Operating Fund and Federal Fund are approximated as follows (in 000's):

	October 31, 2010		June 30, 2010	
	Operating Fund	Federal Fund	Operating Fund	Federal Fund
SMIF:				
U.S. Treasury Securities	$ 56,477	$ 53	$ 36,150	$ 10,034
Federal Agency Securities	15,718	15	10,301	2,859
IBRD Debt FR	510	-	335	93
Bank Notes	170	-	447	124
Certificates of Deposit	9,182	9	8,447	2,345
Commercial Paper	12,937	12	8,668	2,406
Corporate Bonds	-	-	140	39
Time Deposits	7,127	7	4,629	1,285
AB 55 and General Fund loans	13,675	13	8,356	2,320
Total	$ 115,796	$ 109	$ 77,473	$ 21,505

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 October 31, 2010 and June 30, 2010, this difference was immaterial to the valuation of the deposits held by the Operating Fund and Federal Fund in the SMIF. The pool is run with "dollar in, dollar out" participation. There are no share-value adjustments to reflect changes in fair value. The Operating Fund and Federal Fund share in the interest earnings of PMIA based on the ratio that their dollar-day contributions bear to the dollar-day investments of the PMIA.

The Operating Fund had an investment in ELM Resources as a jointly governed organization. ELM Resources provided loan processing services for member guarantors, lenders and servicers until the passage of H.R. 4872 which eliminated the need for services provided by ELM. The Operating Fund recognized a gain of $72,862 upon the liquidation of ELM Resources.

5. CAPITAL ASSETS

Capital asset activity for the four months ended October 31, 2010 is as follows:

	October 31, 2010			
	Beginning Balance	Additions	Transfers/ Disposals	Ending Balance
Vehicles	$ 20,559	$ -	$ -	$ 20,559
Computer equipment	309,274	-	-	309,274
Computer software	840,807	-	-	840,807
Office equipment	1,339,645	-	-	1,339,645
	2,510,285	-	-	2,510,285
Less accumulated depreciation:				
Vehicles	(20,559)	-	-	(20,559)
Computer equipment	(309,274)	-	-	(309,274)
Computer software	(840,807)	-	-	(840,807)
Office equipment	(1,338,576)	(855)	-	(1,339,431)
	(2,509,216)	(855)	-	(2,510,071)
Capital assets, net	$ 1,069	$ (855)	$ -	$ 214

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, 2010 is as follows:

	June 30, 2010			
	Beginning Balance	Additions	Transfers/ Disposals	Ending Balance
Vehicles	$ 20,559	$ -	$ -	$ 20,559
Computer equipment	330,468	-	(21,194)	309,274
Computer software	840,807	-	-	840,807
Office equipment	1,346,732	-	(7,087)	1,339,645
	2,538,566	-	(28,281)	2,510,285
Less accumulated depreciation:				
Vehicles	(20,559)	-	-	(20,559)
Computer equipment	(325,168)	(5,300)	21,194	(309,274)
Computer software	(834,666)	(6,141)	-	(840,807)
Office equipment	(1,343,099)	(2,564)	7,087	(1,338,576)
	(2,523,492)	(14,005)	28,281	(2,509,216)
Capital assets, net	$ 15,074	$ (14,005)	$ -	$ 1,069

6. ADMINISTRATIVE AND PROGRAM FEES

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

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

The AMF is calculated annually at 0.06 percent based on the original principal outstanding (OPO) amount of loans at federal year end September 30, 2010 and 2009. Interim quarterly installment payments paid by ED are based on year-end estimates and reconciled each federal fiscal year-end. Beginning December 31, 2009, and quarterly thereafter, ED changed the AMF calculation methodology to quarterly payments paid by ED based on actual quarterly OPO balances divided by 4 and multiplied by 0.06 percent.

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

6. ADMINISTRATIVE AND PROGRAM FEES (Continued)

As of October 31, 2010 and June 30, 2010, the administrative and program fees receivable, which are included in the amount due from Federal government, consisted of the following:

	October 31, 2010	June 30, 2010
Operating Fund:		
AMF receivable	$ 1,782,254	$ 5,123,975
LPIF receivable	5,813,820	3,544,864
	$ 7,596,074	$ 8,668,839

For the four months ended October 31, 2010 and the year ended June 30, 2010, total administrative and program fee revenue recognized is as follows:

	October 31, 2010	June 30, 2010
Operating Fund:		
LPIF	$ 916,889	$ 29,438,583
AMF	5,813,820	22,355,866
DAF, net of related provision	(5,993,631)	13,873,258
WAF provision (Note 7)	(304,988)	-
	$ 432,090	$ 65,667,707

Gross DAF income for the four months ended October 31, 2010 and the year ended June 30, 2010 was $8,006,443 and $25,811,294, respectively. The estimated allowance for DAF refunds is netted against DAF income. Based on current and historical data, management estimated that certain DAF income will have to be refunded from the Operating Fund to the Federal Fund. The dollar amount of the allowance for DAF as of October 31, 2010 and June 30, 2010 was $28,801,234 and $18,598,709, respectively. The activity in the allowance for DAF for the four months ended October 31, 2010 and the year ended June 30, 2010 is as follows:

Ending balance as of July 1, 2009	$ 18,028,082
Provision	11,938,036
Refunds	(11,367,409)
Ending balance as of June 30, 2010	18,598,709
Provision	14,000,075
Refunds	(3,797,550)
Ending balance as of October 31, 2010	$ 28,801,234

7. EARLY WITHDRAWAL FEE PROGRAM

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

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

At October 31, 2010 and June 30, 2010, the Operating Fund has an allowance for WAF refunds of $1,139,617 and $1,111,138, respectively. The remaining allowance balance is an estimate recognizing the inherent risk of future WAF refunds for fees collected prior to VFA termination. The activity in the allowance for WAF for the four months ended October 31, 2010 and the year ended June 30, 2010 is as follows:

Ending balance as of July 1, 2009	$ 2,011,033
Refunds	(899,895)
Ending balance as of June 30, 2010	1,111,138
Provision	304,988
Refunds	(276,509)
Ending balance as of October 31, 2010	$ 1,139,617

8. NET RECOVERIES ON LOAN DEFAULTS

The Commission is required by federal statutes to pursue collections on loans upon default of payment. The collection retention rate retained by the Operating Fund varies depending upon type of collection. For loans that have been rehabilitated (9 on-time payments made by the defaulted borrower in a 10-month period) or consolidated out of default by a third-party refinancing, the Commission is allowed by federal regulation to retain a percentage of the total amount received relating to the retirement of the post-default obligation. Net recoveries on loan defaults for the four months ended October 31, 2010 and the year ended June 30, 2010 are as follows:

8. NET RECOVERIES ON LOAN DEFAULTS (Continued)

	October 31, 2010	June 30, 2010
Net regular payment recoveries	$ 7,900,992	$ 24,977,150
Net rehabilitation loans	25,842,174	77,714,538
Net federal direct consolidation loans	3,636,745	9,856,941
Total net collection recoveries	$ 37,379,911	$ 112,548,629

The Operating Fund and Federal Fund reflect a due from lending institutions receivable of $3,656,984 and $ 11,530,216, respectively, as of October 31, 2010, and $2,230,112 and $8,173,022, respectively, as of June 30, 2010. These amounts represent the collection retention due each fund for rehabilitation loan proceeds from lenders, in accordance with the rehabilitation loan agreement terms. A portion of the Federal Fund due from lending institutions represents the Federal Default Fee receivable as of October 31, 2010 and June 30, 2010.

9. GRANT PROGRAM FUNDING

Since 2003 the State of California has periodically appropriated funding for portions of the Commission's grant administrative budget, outreach and training activities, and Cal Grant program awards as a reimbursement from the Operating Fund to the General Fund. For the four months ended October 31, 2010 and the year ended June 30, 2010, the Commission administrative activities expended from the Operating Fund as nonoperating expenses were $164,355 and $396,653, respectively.

Also, for the year ended June 30, 2010, the Commission transferred $32,000,000 from the Operating Fund to the State of California's General Fund to support Cal Grant program awards. Subsequent to October 31, 2010 the Commission transferred $75,000,000 from the Operating Fund and $25,000,000 received from ECMC's Operating Fund to the State of California's General Fund for 2010-11 Cal Grant program awards. Cal Grant program awards are made to students to help pay the costs for postsecondary education.

10. LOAN DEFAULT EXPENSES

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

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

11. FEDERAL DEFAULT FEE AND FEDERAL DEFAULT FEE SUBSIDY

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

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

12. BORROWER COUNSELING SERVICES

On February 4, 2010, EdFund entered into a contract with a school to provide borrower counseling (delinquency prevention and default aversion) services to its students for loans not covered by the traditional FFEL guarantor model. The Department of Finance approved the new line of business pursuant to provisions of SB 89 on March 24, 2010. The contract was terminated effective November 4, 2010. For the four months ended October 31, 2010 and the year ended June 30, 2010, the Operating Fund reported revenues of $ 1,820,538 and $1,205,966, respectively, for borrower counseling services, for which a receivable of $1,325,714 and $1,122,784, respectively, is included in other receivables.

13. RESERVE FOR LOAN DEFAULTS

Pursuant to the 1998 Amendments, Section 428(c)(9), a guaranty agency is required to maintain a minimum Federal Fund reserve level of at least 0.25 percent of the total original principal amount of all outstanding loans guaranteed by such agency. The purpose of the reserve is to ensure the Commission is able to fulfill obligations relative to the overall outstanding portfolio. The minimum reserve is calculated as of the Federal Fiscal Year End date of September 30. The Federal Fund was in compliance with the required minimum reserve calculation at September 30, 2010 and 2009.

14. RETIREMENT BENEFITS

As of October 31, 2010 and June 30, 2010, 10 of the Commission's permanent civil service employees were assigned to EdFund, the Commission's auxiliary (see Note 15), in direct support of FFEL Program activities and, 1 and 2 employees, respectively, of the Commission's non-assigned employees functioned in a FFEL Program oversight capacity that was funded from the Operating Fund. Full-time civil service employees participate in the California Public Employees' Retirement System (PERS). PERS, a multiple-employer defined benefit retirement plan, is administered by a Board of Administration composed of individuals (1) elected by PERS membership; (2) appointed by elected State of California officials; and (3) elected State of California officials. PERS provides retirement, disability, and death benefits. Such benefits are based on the employee's years of service, age, and final compensation. PERS issues a publicly available financial report that includes financial statements and required supplementary information, which is available on the California Public Employees' Retirement System website (www.calpers.ca.gov), 400 P Street, Sacramento, CA 94229-2701.

Civil service employees may participate in PERS at one of three levels. As of October 31, 2010 and June 30, 2010, all 10 of the employees, respectively, assigned to EdFund were classified as first-tier. As of October 31, 2010 and June 30, 2010, 1 and 2 employees, respectively, of the Commission FFEL Program oversight employees are classified as first-tier. First-tier participants contribute a portion of their salaries to a retirement fund. The Department of Personnel Administration's website (www.dpa.ca.gov) has additional information about civil service retirement programs.

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

The Operating Fund paid total pension expense and funded contributions of $36,706 and $96,931 for the four months ended October 31, 2010 and for the year ended June 30, 2010, respectively, for employees assigned to EdFund. The Operating Fund also paid $3,838 during the four months ended October 31, 2010 and $19,411 during the year ended June 30 2010, for Commission FFEL Program oversight employees. All contributions were paid as of October 31, 2010 and June 30, 2010, respectively.

The actuarial valuation is determined annually for the state's fiscal year ended June 30. For the four months ended October 31, 2010, the Operating Fund did not recognize an Annual Required Contribution (ARC). For the year ended June 30, 2010, the Operating Fund was not required to recognize additional ARC. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal costs each year and amortize any unfunded actuarial liabilities or funding excess. There was no funded, or unfunded, requirement recognized at October 31, 2010. There was no additional funding requirement at June 30, 2010. The Net OPEB Obligation (NOO) liability at October 31, 2010 and June 30, 2010 was $48,000. Additional information about the California Employers' Retiree Benefit Trust (CERBT) Fund, and the OPEB model and assumptions used in the actuarial valuation, is available as the California Public Employees' Retirement System website (www.calpers.ca.gov).

15. RELATED PARTY TRANSACTIONS

The Commission established EdFund effective January 2, 1997. EdFund is governed by a 13-member Board of Directors who are nominated and appointed by the Commission. The current Board bylaws require at least one commissioner, one EdFund employee and one student enrolled in a California postsecondary educational institution serving as directors at all times. The President of EdFund and the Executive Director of the Commission serve as ex-officio members of the Board. The outside members of the EdFund Board of Directors tendered their resignation effective December 5, 2010. In an action taken December 7, 2010, the Commissioners appointed themselves as members of the EdFund Board of Directors.

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

On January 2, 1997, the Commission advanced $20,000,000 to EdFund for operating capital. This advance is reported in the Operating Fund net of amounts owed EdFund for reimbursement of operating expenses. As of October 31, 2010 and June 30, 2010, the net amount due from EdFund from the Operating Fund was $34,633,851 and $19,779,584, respectively. As of October 31, 2010 and June 30, 2010, the net amount due from EdFund to the Federal Fund was $24,809,546 and $29,139,890, respectively.

As of October 31, 2010 and June 30, 2010, the amount due from the Federal Fund to the Operating Fund totaled $13,748,223 and $12,940,556, respectively, due to deposit delays between funds.

The Commission denies the reimbursement of expenses to EdFund from the Operating Fund when EdFund does not provide the Commission with requested backup documentation of a product or service or when the Commission determines the expense to be a gift of California state funds, a waste of public funds or not allowable under Federal regulations. Denied expenses for the four months ended October 31, 2010 and the year ended June 30, 2010 were $37,984 and $463,673, respectively.

16. LEASES

The Commission, through EdFund, maintains various operating leases for EdFund's main office, data center, warehouse and storage facility. Subsequent to October 31, 2010, three of the four operating leases were assigned to ECMC. Rental expense recorded in the Operating Fund, which includes utilities for one of two major leases, for the four months ended October 31, 2010 and the year ended June 30, 2010 approximated $1,752,000 and $5,053,000, respectively. The future minimum lease payments for the noncancelable operating leases are as follows (in 000's):

16. LEASES (Continued)

Year Ending June 30,	
2011	$ 3,400,000
2012	4,888,000
2013	4,950,000
2014	4,995,000
2015	5,070,000
Thereafter	15,384,000
	38,687,000
Less: reduction for leases assigned to ECMC	(541,000)
	$ 38,146,000

EdFund Lease

As an auxiliary organization of the Commission, EdFund made lease payments on an unoccupied building (Building B) of $576,852 between July 1 and October 31, 2010 and $3,343,624 from the inception of the lease on July 3, 2008 through June 30, 2010. On December 16, 2010, ED issued a final program review report to the Commission which determined that paying rent on an unoccupied building is an improper use of the Operating Fund under the FFEL Program since the payment of these costs is not in support of a guaranty agency-related activity or for other student financial aid-related activities. The required action from ED is for the Commission to immediately cease making future lease payments for the unoccupied building through the Operating Fund. In addition, the Commission must reimburse the Operating Fund for the lease payments made to date on Building B. The source of repayment has not yet been determined and as a result, the amount receivable and impact to the related statements of revenues, expenses and changes in net assets has not been reflected in these financial statements.

Pending EdFund Litigation

In November 2010, EdFund notified the lessor that it was terminating the main office (Mather) operating lease effective December 31, 2010. While the lessor has not accepted the termination, it has subsequently leased to other parties the two buildings that comprise the Mather premise. On January 14, 2011 the lessor filed suit against EdFund and its Board of Directors citing, among other things, breach of contract for the Mather lease and filed a claim with the Victims Compensation and Government Claims Board against the Commission, Department of Finance, and the State Controller for damages related to the Mather lease. After the statutory time limit had passed for action by the Victims Compensation and Government Claims Board, Mather Development Partners amended their lawsuit against EdFund to include the Commission, Commissioners, and the Department of Finance. It is too early in the legal process to estimate the potential outcome or possibility of loss, but the amount requested by the lessor in the suit is $40 million.

17. CONTINGENCIES

During the normal course of business, the FFEL Program is involved in various legal proceedings and investigations of its operations and activities. While these proceedings and investigations may lead to a possible liability, in the opinion of the Commission's management, these possible liabilities will not have a material adverse effect on the financial position or operations of the Operating Fund or Federal Fund. See pending EdFund litigation at Note 16.

EdFund, as a 501(c)(3) nonprofit organization, elected the reimbursable method to pay unemployment insurance (UI) obligations. This method requires payment to the UI fund on a dollar-for-dollar basis for all unemployment benefits paid to former employees. As of October 31, 2010, the Operating Fund included a $700,000 accrued expense estimate for future unemployment obligations to former EdFund employees. This estimate is based upon 2010 actual payments from prior employee claims and the expected eligibility expiration date for each of these individuals.

18. SUBSEQUENT EVENTS

Guaranty Designation Transfer

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

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

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

18. SUBSEQUENT EVENTS (Continued)

Guaranty Designation Transfer (Continued)

On October 29, 2010, ECMC, the Commission and EdFund entered into an operating agreement for the transition of guarantor services from the Commission to ECMC as directed by ED. Effective November 1, 2010, ECMC became the designated guaranty agency for the Commission's FFEL Program portfolio. Between November 1 and December 6, 2010, all EdFund direct hire employees were either employed by ECMC, or separated from EdFund. The 10 civil service employees were reassigned to the Commission. The outside members of the EdFund Board of Directors tendered their resignation effective December 5, 2010. In an action taken December 7, 2010, the Commissioners appointed themselves as members of the EdFund Board of Directors.

Subsequent to October 31, 2010 the Commission transferred $75,000,000 from the Operating Fund and $25,000,000 received from ECMC's Operating Fund to the State of California's General Fund for 2010-11 Cal Grant program awards. On November 2, 2010, EdFund was directed to remit substantially all excess cash totaling $28,216,702 to the Operating Fund. Part of this cash transfer extinguished EdFund's $20,000,000 liability due to the Operating Fund that was advanced at EdFund's inception for use as operating capital. On November 24, 2010, the Commission remitted $68,145,662 from the Operating Fund to ECMC's Operating Fund. The Commission remitted $103,837 and $11,142 from the Federal Fund to ECMC's Federal Fund on November 18, 2010 and January 14, 2011, respectively. These transactions are recognized as net payables at October 31, 2010 in the balance sheet of the Commission's Operating Fund and Federal Fund. Subsequent to October 31, 2010, ECMC's Operating Fund assumed the Operating Fund's allowance for default aversion fees and allowance for early withdrawal fees of $28,801,234 and $1,139,617, respectively.

Other receivables and payables of the Commission's Operating Fund and Federal Fund cleared subsequent to October 31, 2010 by cash settlements in ECMC's Operating Fund and Federal Fund. Per ED's authorization, the Commission retained $885,000 in the Operating Fund for 2010-11 federal policy and programs expenses, November and December 2010 payroll expenses for the 10 civil service employees who previously were assigned to EdFund, and contingencies. Any remaining cash is subject to subsequent transfer to ECMC.

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 four months ended October 31, 2010, and have issued our report thereon dated May 25, 2011. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

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

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

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

Compliance and Other Matters

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

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

(Continued)

In accordance with the Federal Unclaimed Property Act, unclaimed property is required to be remitted to the State Controller's Office (SCO). Between 2000 and 2006, the Operating Fund received approximately $466,000 in unclaimed property from EdFund that has not been remitted to SCO.

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
May 25, 2011