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Information Item

California Student Aid Commission

Presentation of the June 30, 2009 Operating Fund and Federal Fund financial statements for federal student loan program

Perry-Smith LLP has completed their independent audit of the Operating Fund and Federal Fund financial statements for the year ended June 30, 2009. The auditors will make a formal presentation on the financial statements, related correspondence, and the results of the audit.

Recommended Action: Accept the Operating Fund and Federal Fund audited financial statements for the year ended June 30, 2009.

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

Tina Treis
Perry-Smith Partner

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

FINANCIAL STATEMENTS

FOR THE YEARS ENDED JUNE 30, 2009 AND 2008

AND

INDEPENDENT AUDITOR'S REPORT

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

FINANCIAL STATEMENTS

For the Years Ended June 30, 2009 and 2008

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PERRY-SMITH
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Perry-Smith LLP
400 Capitol Mall | Suite 1200
Sacramento, CA 95814
www.perry-smith.com
916.441.1000

INDEPENDENT AUDITOR'S REPORT

The Honorable Members
California Student Aid Commission
Rancho Cordova, California

We have audited the accompanying financial statements of the Student Loan Operating Fund (Operating Fund) and Federal Student Loan Reserve Fund (Federal Fund) of the California Student Aid Commission (the "Commission") as of and for the years ended June 30, 2009 and 2008, as shown in the accompanying table of contents. These financial statements are the responsibility of the Commission's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

As discussed in Note 1, the financial statements present only the Operating Fund and Federal Fund of the Loan Program of the Commission and do not purport to, and do not, present fairly the financial position of the California Student Aid Commission as of June 30, 2009 and 2008, and the changes in its financial position and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial positions of the Operating Fund and Federal Fund of the California Student Aid Commission as of June 30, 2009 and 2008, and their changes in financial position and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

INDEPENDENT AUDITOR'S REPORT
(Continued)

The accompanying management's discussion and analysis on pages 3 through 10 is not a required part of the financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

In accordance with *Government Auditing Standards*, we have also issued a report dated October 9, 2009 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
October 9, 2009

MANAGEMENT'S DISCUSSION AND ANALYSIS

This section of the California Student Aid Commission's (Commission) Federal Family Education Loan (FFEL) Program financial audit report presents discussion and analysis of the program's financial performance during fiscal years ended June 30, 2009, 2008 and 2007. The FFEL Program, created by the federal government in 1965 as a means of making loans available to students attending college, allows undergraduate and graduate students at eligible postsecondary schools to obtain federally guaranteed loans from private lenders at advantageous interest rates. The U.S. Department of Education (ED) has administrative responsibility over the FFEL Program and designates guaranty agencies to perform the daily administration 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's discussion and analysis should be read in conjunction with the financial statements following this section.

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 Financial Statements*, which explain in further detail information contained in the financial statements.

The Commission, as a designated guarantor, administers the FFEL Program through a contractual arrangement with its auxiliary organization, EdFund. Commission responsibilities also include grant program administration. FFEL Program functions consist of guarantor activities as defined by federal regulations, while the grant program encompasses all activities related to the Commission's administration of the state Cal Grant program 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.

Financial Highlights

Loan volume reached $10.5 billion for the year ended June 30, 2009 in new Stafford and PLUS loans guaranteed. Despite disruptions in the financial markets this past year, loan volume grew 43.8 percent from the $7.3 billion loans guaranteed for the year ended June 30, 2008. This loan volume increase reflects the competitiveness of the federal default fee (FDF) strategy implemented with certain lenders and paying the 1 percent FDF on behalf of students. While benefiting borrowers, the FDF strategy also helped preserve the outstanding loan portfolio as noted by the healthy annual growth of 14.5 percent, from $31.7 billion in 2008 to $36.3 billion in 2009.

FDF subsidy paid from the Operating Fund was $64.1 million for the year ended June 30, 2009, or 146.5 percent higher than the $26.0 million paid in 2008. These FDF strategies have helped maintain market share and cumulatively saved borrowers approximately $420.8 million since the FDF and insurance premiums (the FDF predecessor) were first waived in 1996.

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

Operating Fund operating income of $16.9 million in 2009 is $21.0 million lower than the $37.9 million generated in 2008 and was influenced by the FDF subsidy. These positive operating performances generated operating margins of 9.7 percent and 24.0 percent in 2009 and 2008, respectively.

Federal Fund operating income of $34.1 million in 2009 is $27.6 million higher than the $6.5 million generated in 2008 due to growth in federal default fee and complement revenue. These positive operating performances reflect operating margins of 35.8 percent and 9.4 percent in 2009 and 2008, respectively.

Gross collection recoveries on loan defaults reached $447.1 million in 2009 compared to $327.1 million in 2008. Of these amounts, $327.3 million was remitted to ED in federal share during 2009, resulting in a 38.8 percent increase from the $235.8 million remitted the previous year. Similarly, net recoveries on loan defaults of $108.5 million and $90.9 million were retained as revenue to the Operating Fund in 2009 and 2008, respectively. This collection performance reflects a 36.7 percent improvement from 2008 signifying EdFund's 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 October 2007, ED enacted the Voluntary Flexible Agreement (VFA) cancellation provision and issued all VFA guaranty agencies termination notices effective January 1, 2008. As such, there were no VFA revenues in 2009. In 2008 the Commission, via the performance based features of the VFA, received $4.9 million from Early Withdrawal Fee funding generated from borrower default prevention counseling efforts.

From 2003 through 2007 the state appropriated funding for the Commission's grant administrative budget from the Operating Fund, but returned funding to the state's General Fund for the year ended June 30, 2008. In 2009 the state appropriated $24 million towards its Cal Grant program from the Operating Fund.

Program Overview

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

The Operating Fund, a state fund within the custody and control of the Commission, reflects transactions related to guarantor activities as specified by law. These activities include loan origination and guaranty processing, default aversion and default collection. The Operating Fund also reflects other student financial aid related activities as selected by the guaranty agency, including activities related to administration of state specialized grant programs.

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

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

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

To help mitigate education costs for students and remain competitive in the market, on September 7, 2006 the Commission approved a 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.

During 2008 the FFEL Program faced several changes due to the passage of H.R. 2669, the College Cost Reduction and Access Act (CCRAA). CCRAA reflected the position of many in Congress that the margins for private lenders in the FFEL Program were too great and that savings to the federal government could only be achieved by reducing program subsidies. The result was an estimated $16 billion in cuts to lender subsidies and $4.5 billion in cuts to guarantor subsidies over five years. Effective October 1, 2007, the act reduced guarantor collection retention rates on defaulted loan recoveries from 23 percent down to 16 percent, and the account maintenance fee payment to guarantors from 0.10 percent down to 0.06 percent. Additionally, the exceptional performer program was repealed resulting in reduced lender insurance rates for lenders whose default claims were funded under this program.

Net recoveries on loan defaults are the primary source of revenue to the Operating Fund. After a loan defaults, the Commission continues its collection efforts and is allowed to retain as revenue to the Operating Fund up to 16 percent of the amount collected, down from 23 percent retained prior to October 1, 2007. For loans that have been rehabilitated (9 on-time payments made by the defaulted borrower in a 10-month period) or consolidated by a third-party refinancing, the Commission is allowed by federal regulation to retain a percentage of the total amount received relating to the retirement of the default obligation. The remaining amounts are returned to the federal government.

Rehabilitation loans 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. Disruption in the financial markets and the lack of liquidity forced lenders to suspend purchasing rehabilitation loans and prompted EdFund's rehabilitation lender to rescind its rehabilitation loan agreement on November 21, 2008. However, as the financial markets began stabilizing, EdFund was able to secure new rehabilitation lender contracts for implementation in April and June, 2009 thereby enabling gross rehabilitation loan volume to increase 42.1 percent for the fiscal year ending June 30, 2009. Additionally, improved collection rates in regular collections, wage garnishment, and federal direct consolidation collections also contributed to the $17.6 million growth in net collection recoveries from the prior year.

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

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

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

During 2007 a new lender premium fee revenue source was added to the Operating Fund. Based on a contractual relationship with a lending partner, this fee included a scaled premium paid by the lender when purchasing loans qualifying for rehabilitation. However, disruptions in the financial markets and the lack of liquidity resulted in this rehabilitation lender cancelling the lender premium fee arrangement effective March 31, 2008.

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 the 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.

Overview of the Financial Statements

The following table provides a summary of the balance sheets and statements of revenues, expenses, and changes in net assets for both the Operating Fund and Federal Fund for fiscal years ended June 30, 2009, 2008 and 2007.

	Operating Fund *Amounts in thousands*			Federal Fund *Amounts in thousands*		
Summary of Balance Sheets	**2009**	**2008**	**2007**	**2009**	**2008**	**2007**
Current assets	$ 64,276	$ 62,985	$ 31,034	$ 151,240	$ 119,400	$ 102,622
Other noncurrent assets	20,015	20,143	20,295	—	—	—
Total assets	84,291	83,128	51,329	151,240	119,400	102,622
Current liabilities	31,272	23,448	27,322	37,250	40,247	31,325
Noncurrent liabilities	39	39	—	—	—	—
Total liabilities	31,311	23,487	27,322	37,250	40,247	31,325
Net assets:						
Restricted	—	—	—	113,990	79,153	71,297
Unrestricted	52,980	59,641	24,007	—	—	—
Total net assets	$ 52,980	$ 59,641	$ 24,007	$ 113,990	$ 79,153	$ 71,297

	Operating Fund *Amounts in thousands*			Federal Fund *Amounts in thousands*		
Summary of Revenues, Expenses and Changes in Net Assets	**2009**	**2008**	**2007**	**2009**	**2008**	**2007**
Operating revenues:						
Net recoveries on loan defaults	$ 108,468	$ 90,911	$ 73,514	$ —	$ —	$ —
Administrative and program fee income	65,767	60,156	63,777	—	—	—
VFA revenue	—	4,911	7,736	—	—	—
Lender premium fees	—	1,683	1,323	—	—	—
Federal default fee	—	—	—	79,418	57,431	47,238
Minimum reserve subsidy	—	—	—	—	—	9,392
Claim purchase complement	—	—	—	15,811	11,021	7,767
Other	—	4	607	27	10	720
Operating revenues	174,235	157,665	146,957	95,256	68,462	65,117
Operating expenses:						
Administrative	93,314	93,787	88,252	—	—	—
Minimum reserve subsidy	—	—	9,392	—	—	—
Fee subsidies	64,052	26,014	25,513	9,966	18,037	20,932
Loan default expense	—	—	—	51,226	43,964	28,556
Other	—	—	—	—	2	2,691
Operating expenses	157,366	119,801	123,157	61,192	62,003	52,179
Operating income	16,869	37,864	23,800	34,064	6,459	12,938
Nonoperating revenues (expenses)						
Interest income	1,190	1,952	1,691	773	1,397	1,215
Cal Grant program awards	(24,000)	—	—	—	—	—
Grant administrative costs	(596)	(1,712)	(14,404)	—	—	—
Financial aid awareness program	(124)	(2,470)	(12,110)	—	—	—
	(23,530)	(2,230)	(24,823)	773	1,397	1,215
Change in net assets	$ (6,661)	$ 35,634	$ (1,023)	$ 34,837	$ 7,856	$ 14,153

Financial Analysis of the Operating Fund

- At fiscal year ended June 30, 2009, total net assets of the Operating Fund reflect a decrease from the prior year of $6.7 million to $53.0 million compared to a $35.6 million increase to $59.6 million at June 30, 2008. Net assets are comprised entirely of unrestricted net assets. This net asset change is primarily due to the items noted below.

- In fiscal year ended June 30, 2009, total operating revenues increased by $16.6 million (or 10.5 percent from 2008) to $174.2 million, primarily in net recoveries on loan defaults. Though the economy has weakened as indicated by the rise in unemployment rates, from 5.5 percent in July 2008 to 9.5 percent in June 2009, the collection recovery rates continue increasing, from 29.2 percent in 2008 to 32.3 percent in 2009, signifying the positive returns from EdFund's collection strategy.
- Net recoveries on loan defaults increased to $108.5 million in 2009 from $90.9 million in 2008, most notably in rehabilitation loan recoveries. Rehabilitation loans offer benefits to the defaulted borrower by improving their credit rating while bringing their student loan balances out of default status, and providing increased revenues to the Operating Fund because of higher retention rates on this collection type.
- Administrative and program fee income increased to $65.8 million in 2009 from $60.2 million in 2008 due predominantly to the significant increase in guarantee loan volume. Guarantee loan volume has increased in all school-types reflecting the competitiveness of the FDF strategy to retain and grow market share and assist the borrower in funding their education by paying the 1 percent FDF on the student's behalf.
- Lender premium fee was not earned in 2009 compared to $1.7 million generated in 2008. This decrease is due to disruptions in the financial markets and the lack of liquidity which resulted in the rehabilitation lender cancelling the lender premium fee arrangement on March 31, 2008.
- Administrative operating expenses decreased $0.5 million in 2009 while 2008 administrative operating expenses increased $5.5 million, or 6.3 percent, over 2007 as a result of increased collection agency costs associated with the significant increase in net recoveries performance on loan defaults. The 2009 expenses remained relatively constant to 2008 due to staffing decreases, ongoing expense reductions from process optimization efforts, shifting additional collection efforts internally which is more cost effective and revising the external agency fees.
- The significant federal default fee subsidy increase in 2009 is attributable to an increase in both loan volume and lender participation rates resulting in $64.1 million and $26.0 million funded from the Operating Fund on the behalf of student borrowers during 2009 and 2008, respectively.
- Nonoperating revenues (expenses) increased by $21.3 million to a deficit $23.5 million in 2009 compared to a deficit $2.2 million in 2008. The increase is due primarily to the State's appropriation of $24.0 million for the Cal Grant program awards in 2009.

Financial Analysis of the Federal Fund

At June 30, 2009, the total net assets of the Federal Fund increased from the prior year by $34.8 million to $114.0 million compared to a $7.9 million increase to $79.2 million at June 30, 2008. Net assets are comprised entirely of restricted balances mandated by federal regulation to meet required minimum reserve levels. This net asset increase is primarily due to the items noted below.

- In fiscal year ended June 30, 2009, total operating revenues increased $26.8 million to $95.3 million as federal default fee and complement revenues continue to improve significantly over prior year eliminating the need for a minimum reserve subsidy. FDF revenue increased $22.0 million, or 38.3 percent, in 2009 due to the 43.8 percent increase in guarantee loan volume over the prior year, while complement revenue increases $4.8 million during this same period due to the increases noted in collection recoveries.
- Fee subsidies consist of DAF and WAF subsidies associated with the VFA and are recorded net of refund allowance estimates. In fiscal years 2009 and 2008, the Operating Fund charged the Federal Fund $10.0 million and $13.1 million in DAF expenses, respectively. Effective January 1, 2008 ED canceled the VFA contract resulting in no WAF expenses during the current year in contrast to $4.9 million received the prior year.
- Loan default expense increased by $7.3 million in 2009 due to a rise in the rate of default claims across all school types and increases in the overall size of the outstanding portfolio.

Significant Known Facts, Decisions, or Conditions

Sale of the Commission's Loan Guarantee Function

Chapter 132 of the Statutes of 2007 (Senate Bill 89) authorized the sale or other transaction of the Commission's student loan guarantee portfolio and certain related assets and liabilities of the student loan program. Senate Bill 89 also authorized the Director of Finance to consummate other transactions to maximize the value of the state's student loan guarantee program. The 2008-09 State budget, signed into law on September 23, 2008, noted the sale had been postponed due to a variety of factors affecting the student loan guaranty industry. However, the State administration is continuing its efforts, pursuant to Chapter 757 of the statutes of 2008 (Assembly Bill 519) that extends the sale authorization through January 10, 2011. A State sale-side advisor has been retained and the Department of Finance (DOF) issued a Request for Qualifications (RFQ) with interested party responses due by August 10, 2009. DOF completed the first phase of the RFQ evaluation process and published the list of six qualified purchasers on September 24, 2009. Further details and information about the sale is available on the DOF website at www.dof.ca.gov, word search "EdFund".

California 2009-10 State Budget

As a consequence of this proposed sale transaction, the State budget continues using General Fund resources to finance the Commission's grant administration budget and associated financial awareness programs. However, the State's budgets shifted $32 million from the General Fund to the Operating Fund to fund a portion of the Cal Grant program award costs in 2009-10. Further detail and information about the 2009-10 budget for the State of California is available through the Department of Finance budget website (www.ebudget.ca.gov).

Additionally, in the revised 2009-10 State Budget the Governor reduced the Commission's operations support item by $6.3 million. A small portion of the Commission's operations budget is used for FFEL Program administrative functions. The Governor noted in his veto message that $4.3 million was set aside to be restored contingent upon enactment of legislation that authorizes the decentralization of the Cal Grant Program and other financial aid programs as warranted. Near the close of the 2009 Legislative session, Assembly Bill 187 was amended to establish a pilot alternative delivery system for the Cal Grant Program that restores $4.3 million to the Commission's operating budget. The bill has not yet been approved but will be considered when the Legislature reconvenes in January 2010. If the restoration of the Commission's operations budget is delayed or not approved, the Commission's FFEL Program administrative functions may be disrupted.

FFEL Program Pending Federal Legislation

In February 2009, President Obama issued a general outline to Congress of his budget proposal that included eliminating the FFEL Program and shifting all new student loan funding to the Federal Direct Lending Program (DL). This plan would remove private banks from student lending and expand the role of government contractors in administering student loans. In response to the President's budget proposal, the House Education and Labor Committee proposed H.R. 3221, the Student Aid and Fiscal Responsibility Act of 2009. The bill advances the President's budget proposal to eliminate guaranteed student loans under the FFEL Program by requiring all new federal student loans be originated through the DL by July 1, 2010.

On September 17, 2009, H.R. 3221 was voted on and passed by the House of Representatives. The bill includes an amendment clarifying that borrower services, including delinquency prevention, default aversion, and loan counseling, are allowable uses of grant funds. The amendment includes an option for the Secretary of Education to contract directly with guaranty agencies for these borrower support services. The Senate Health, Education, Labor and Pensions Committee is working on a companion bill, but a timeline for bill consideration in the Senate remains uncertain.

Once final legislation is passed, it is anticipated that any FFEL Program changes would not be effective until July 1, 2010. However, should a mandatory shift to DL be included it is anticipated that FFEL guarantee loan volume would decline in the months prior to enactment as schools shift their guarantee loan processing to DL in preparation for the final implementation date.

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

BALANCE SHEETS

June 30, 2009 and 2008

	Operating Fund	
	2009	**2008**
ASSETS		
Current assets:		
Cash and cash equivalents (Note 4)	$ 591,310	$ 13,256,921
Interest receivable	71,465	259,873
Other receivables	753	1,890
Due from Federal government (Note 6)	11,912,185	9,218,431
Due from other funds	13,557	-
Due from lending institutions (Note 8)	14,437,484	-
Due from Federal Fund (Note 15)	37,249,624	40,247,482
Total current assets	64,276,378	62,984,597
Noncurrent assets:		
Capital assets, net of accumulated depreciation (Note 5)	15,074	143,575
Advance to EdFund (Note 15)	20,000,000	20,000,000
Total noncurrent assets	20,015,074	20,143,575
Total assets	$ 84,291,452	$ 83,128,172
LIABILITIES AND NET ASSETS		
Current liabilities:		
Accounts payable	$ 177,785	$ 167,165
Due to EdFund (Note 15)	11,055,630	8,475,721
Due to General Fund	-	8,218
Allowance for default aversion fees (Note 6)	18,028,082	11,636,985
Allowance for early withdrawal fees (Note 7)	2,011,033	3,160,249
Total current liabilities	31,272,530	23,448,338
Noncurrent liabilities:		
Post retirement obligation (Note 14)	39,000	39,000
Total liabilities	31,311,530	23,487,338
Net assets:		
Investment in capital assets (Note 5)	15,074	143,575
Unrestricted	52,964,848	59,497,259
Total net assets	52,979,922	59,640,834
Total liabilities and net assets	$ 84,291,452	$ 83,128,172

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

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

BALANCE SHEETS

June 30, 2009 and 2008

	Federal Fund	
	2009	**2008**
ASSETS		
Current assets:		
Cash and cash equivalents (Note 4)	$ 8,657,954	$ 13,674,267
Interest receivable	98,072	75,351
Due from Federal government	47,636,067	69,316,380
Due from EdFund (Note 15)	19,396,000	21,537,158
Due from lending institutions (Note 8)	55,412,781	-
Default aversion fees receivable (Note 6)	18,028,082	11,636,985
Early withdrawal fees receivable (Note 7)	2,011,033	3,160,249
Total assets	$ 151,239,989	$ 119,400,390
LIABILITIES AND NET ASSETS		
Current liabilities:		
Due to Operating Fund (Note 15)	$ 37,249,624	$ 40,247,482
Net assets:		
Restricted (Note 13)	113,990,365	79,152,908
Total liabilities and net assets	$ 151,239,989	$ 119,400,390

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

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

STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS

For the Years Ended June 30, 2009 and 2008

	Operating Fund	
	2009	**2008**
Operating revenues:		
Net recoveries on loan defaults (Note 8)	$ 108,467,923	$ 90,911,614
Administrative and program fees (Note 6)	65,766,602	60,155,624
VFA revenue (Note 7)	-	4,911,242
Lender premium fee (Note 12)	-	1,682,647
Other revenues	-	3,707
Total operating revenues	174,234,525	157,664,834
Operating expenses:		
Loan program personnel costs (Note 14)	51,840,024	54,137,811
Operating expenses (Note 16)	23,606,453	21,897,948
Federal default fee subsidy (Note 11)	64,052,318	26,014,316
Contracted collection costs	17,866,972	17,751,349
Total operating expenses	157,365,767	119,801,424
Operating income	16,868,758	37,863,410
Nonoperating revenues (expenses):		
Interest income (Note 4)	1,190,503	1,952,485
Grant administrative costs (Notes 9 and 14)	(595,991)	(1,712,324)
Financial aid awareness programs (Note 9)	(124,182)	(2,470,157)
Total nonoperating revenues (expenses)	470,330	(2,229,996)
Transfers:		
Transfer to State of California's General Fund for Cal Grant program awards (Note 9)	(24,000,000)	-
Change in net assets	(6,660,912)	35,633,414
Net assets, beginning of year	59,640,834	24,007,420
Net assets, end of year	$ 52,979,922	$ 59,640,834

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

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

STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS

For the Years Ended June 30, 2009 and 2008

	Federal Fund	
	2009	**2008**
Operating revenues:		
Federal default fee (Note 11)	$ 79,418,299	$ 57,431,072
Claim purchase complement	15,811,337	11,020,962
Other revenues	26,541	9,955
Total operating revenues	95,256,177	68,461,989
Operating expenses:		
Loan default expenses (Note 10)	51,225,989	43,964,354
Default aversion fee (Note 6)	9,966,087	13,125,681
Early withdrawal fee (Note 7)	-	4,911,242
Other operating expenses	-	1,356
Total operating expenses	61,192,076	62,002,633
Operating income	34,064,101	6,459,356
Nonoperating revenues:		
Interest income (Note 4)	773,356	1,396,968
Change in net assets	34,837,457	7,856,324
Net assets, beginning of year	79,152,908	71,296,584
Net assets, end of year	$ 113,990,365	$ 79,152,908

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

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

STATEMENTS OF CASH FLOWS

For the Years Ended June 30, 2009 and 2008

	Operating Fund	
	2009	**2008**
Cash flows from operating activities:		
Receipts from:		
Collections	$ 95,757,377	$ 91,350,962
Administrative fees	69,592,762	61,493,332
Voluntary flexible agreement	-	4,911,242
Lender premium fee	-	1,682,647
Other sources	-	3,707
Payments for:		
General administrative and other expenses	(92,079,253)	(137,629,686)
Federal default fee subsidy	(62,749,868)	(23,978,477)
Minimum reserve subsidy	-	(3,002,002)
Net cash provided by (used in) operating activities	10,521,018	(5,168,275)
Cash flows from noncapital financing activities:		
Payments for grant administrative costs	(467,490)	(1,560,932)
Financial aid awareness programs	(124,182)	(2,470,157)
Transfer for Cal Grant program awards	(24,000,000)	-
Net cash used in noncapital financing activities	(24,591,672)	(4,031,089)
Cash flows provided by investing activities:		
Interest received	1,405,043	1,937,307
Decrease in cash and cash equivalents	(12,665,611)	(7,262,057)
Cash and cash equivalents, beginning of year	13,256,921	20,518,978
Cash and cash equivalents, end of year	$ 591,310	$ 13,256,921
Reconciliation of operating income to net cash provided by (used in) operating activities:		
Operating income	$ 16,868,758	$ 37,863,410
Adjustments to reconcile operating income to net cash provided by (used in) operating activities:		
Change in assets and liabilities:		
Receivables	1,137	72,690
Federal government	(2,693,754)	997,635
General Fund	(21,775)	(3,056,724)
Lending institution	(14,437,484)	-
EdFund	2,553,777	1,042,831
Federal Fund	2,997,858	(42,252,301)
Accounts payable	10,620	(1,461,687)
Allowance for default aversion and early withdrawal fees	5,241,881	1,586,871
Post retirement obligation	-	39,000
Total adjustments	(6,347,740)	(43,031,685)
Net cash provided by (used in) operating activities	$ 10,521,018	$ (5,168,275)

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

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

STATEMENTS OF CASH FLOWS

For the Years Ended June 30, 2009 and 2008

	Federal Fund	
	2009	2008
Cash flows from operating activities:		
Receipts from:		
Reimbursement on default purchases	$ 1,163,201,497	$ 924,248,105
Federal default fee	79,539,874	58,937,540
Minimum reserve subsidy	-	3,002,002
Other sources	13,179,471	10,856,028
Payments for:		
Administrative fees	(16,786,001)	21,662,346
Purchases of default student loans	(1,244,926,062)	(1,037,270,019)
General administrative and other expenses	(1,392)	(358,233)
Net cash used in operating activities	(5,792,613)	(18,922,231)
Cash flows provided by investing activities:		
Interest received	776,300	1,553,664
Decrease in cash and cash equivalents	(5,016,313)	(17,368,567)
Cash and cash equivalents, beginning of year	13,674,267	31,042,834
Cash and cash equivalents, end of year	$ 8,657,954	$ 13,674,267
Reconciliation of operating income to net cash used in operating activities:		
Operating income	$ 34,064,101	$ 6,459,356
Adjustments to reconcile operating income to net cash used in operating activities:		
Change in assets and liabilities:		
Federal government	21,680,313	(43,430,764)
EdFund	2,115,493	501,388
Operating Fund	(2,997,858)	42,252,301
Due to lending institutions	(55,412,781)	(23,117,641)
Allowance for default aversion and early withdrawal fees	(5,241,881)	(1,586,871)
Total adjustments	(39,856,714)	(25,381,587)
Net cash used in operating activities	$ (5,792,613)	$ (18,922,231)

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

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

NOTES TO FINANCIAL STATEMENTS

1. ORGANIZATION AND OPERATIONS

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

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

The 1998 Reauthorization of the Higher Education Act (1998 Amendments) were enacted on October 6, 1998 and changed the manner in which the FFEL Program is administered. Under the 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.

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.

2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(a) Basis of Accounting (Continued)

The FFEL Program consists of the Federal Fund and the Operating Fund. 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. The two funds are accounted for as business-type activities using the flow of economic resources measurement focus and the accrual basis of accounting. Revenues are recognized when earned and expenses are recognized when the liability is incurred regardless of the timing of the related cash flow.

In accordance with Government Accounting Standards Board (GASB) Statement Number 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that Use Proprietary Fund Accounting*, the Operating and Federal Funds apply all applicable GASB pronouncements as well as Financial Accounting Standards Board (FASB) pronouncements and Accounting Principles Board (APB) opinions, issued on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements. These Funds have not applied accounting standards issued after November 30, 1989 by the FASB.

(b) Cash and Cash Equivalents

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

(c) 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 $128,501 and $148,398 is included in the Operating Fund's grant administrative costs for the years ended June 30, 2009 and 2008, respectively.

2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(d) Net Assets

The Commission's net assets are classified as follows:

- Invested in capital assets – This represents the Commission's total net investment in capital assets.
- Restricted net assets–expendable – Restricted expendable net assets include resources that the Commission is legally or contractually obligated to spend in accordance with restrictions imposed by external third parties.
- Unrestricted net assets – Unrestricted net assets represent resources derived from and expended on behalf of the 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 nonoperating revenues and expenses, including a portion of grant program administrative costs and grant disbursements.

(f) Use of Estimates

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

(g) Reclassifications

Certain reclassifications have been made to prior year balances for clarification and to conform to classifications used in 2009.

2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(h) New Financial Accounting Pronouncement

Fund Balance Reporting and Governmental Fund Type Definitions

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

3. GUARANTEED LOANS OUTSTANDING

As of June 30, 2009 and 2008, the Commission was the guarantor of a portfolio of outstanding loans with original principal amounts of approximately \$36.3 billion and \$31.7 billion, respectively. These loans were made to students by participating lenders and are guaranteed by ED.

Management anticipates that a certain portion of the FFEL Program loans outstanding as of June 30, 2009 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.

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).

4. CASH AND CASH EQUIVALENTS (Continued)

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

At June 30, 2009 and 2008 the allocation of the carrying value plus accrued interest purchased of the SMIF investments and cash held by the Operating Fund and Federal Fund are approximated as follows (in 000's):

	June 30, 2009		June 30, 2008	
	Operating Fund	Federal Fund	Operating Fund	Federal Fund
SMIF:				
U.S. Treasury Securities	$ 156	$ 2,285	$ 779	$ 829
Federal Agency Securities	117	1,716	3,969	4,224
IBRD Debt FR	3	51	-	-
Bank Notes	-	-	164	175
Certificates of Deposit	53	781	2,623	2,792
Commercial Paper	25	361	1,737	1,848
Corporate Bonds	4	52	48	51
Time Deposits	65	948	1,754	1,867
AB 55 and General Fund loans	168	2,464	1,991	2,119
Other	-	-	192	(231)
Total	$ 591	$ 8,658	$ 13,257	$ 13,674

The value of the deposits in the State Treasurer's pooled investment program (program), including the SMIF, is equal to the dollars deposited in the program. The fair value of the position in the program may be greater or less than the value of the deposits, with the difference representing the unrealized gain or loss. As of June 30, 2009 and 2008, 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 Commission has an investment in ELM Resources as a jointly governed organization. ELM Resources provides loan processing services for member guarantors, lenders and servicers. This investment has nominal value and no ongoing financial interest or ongoing financial responsibility for the Commission.

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

NOTES TO FINANCIAL STATEMENTS
(Continued)

5. CAPITAL ASSETS

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

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

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

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

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

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 a receivable in the Federal Fund. The net DAF is transferred from the Federal Fund to the Operating Fund on a monthly basis.

As of June 30, 2009 and 2008, the administrative and program fees receivable, which are included in the amount due from federal government, consisted of the following:

	2009	2008
Operating Fund:		
LPIF receivable	$ 6,133,062	$ 3,946,577
AMF receivable	5,779,123	5,271,854
	$ 11,912,185	$ 9,218,431

For the years ended June 30, 2009 and 2008, total administrative and program fee revenue recognized is as follows:

	2009	2008
Operating Fund:		
LPIF	$ 32,575,421	$ 23,180,346
AMF	23,225,094	23,849,597
DAF, net of related provision	9,966,087	13,125,681
	$ 65,766,602	$ 60,155,624

6. ADMINISTRATIVE AND PROGRAM FEES (Continued)

Gross DAF income for the years ended June 30, 2009 and 2008 was $26,081,919 and $22,876,149, respectively. The estimated allowance for DAF refunds is netted against DAF income. Based on current and historical data, management estimated that certain DAF income will have to be refunded from the Operating Fund to the Federal Fund. The dollar amount of the allowance for DAF as of June 30, 2009 and 2008 was $18,028,082 and $11,636,985, respectively. The activity in the allowance for DAF for the years ended June 30, 2009 and 2008 is as follows:

Beginning balance as of July 1, 2007	$ 10,148,049
Provision	9,750,469
Refunds	(8,261,533)
Ending balance as of June 30, 2008	11,636,985
Provision	16,115,832
Refunds	(9,724,735)
Ending balance as of June 30, 2009	$ 18,028,082

7. VOLUNTARY FLEXIBLE AGREEMENT

The 1998 Amendments established the Voluntary Flexible Agreement (VFA) as a pilot program allowing selected guaranty agencies to negotiate alternative fee structures and implement other default prevention initiatives and programs. The Commission entered into a VFA with ED in January 2001 consistent with the 1998 Amendment's provision.

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, there was no VFA revenue in 2009. In 2008, the Commission received VFA revenue of $4,911,242 in Early Withdrawal Fee (WAF) funding generated from borrower default prevention counseling efforts.

At June 30, 2009 and 2008, the Operating Fund has an allowance for WAF refunds in the amount of $2,011,033 and $3,160,249, respectively. The remaining allowance recognizes inherent risk of refund against WAF collected prior to the termination of the VFA. The activity in the allowance for WAF for the years ended June 30, 2009 and 2008 is as follows:

Beginning balance as of July 1, 2007	$ 3,062,314
Provision	866,690
Refunds	(768,755)
Ending balance as of June 30, 2008	3,160,249
Provision	-
Refunds	(1,149,216)
Ending balance as of June 30, 2009	$ 2,011,033

8. NET RECOVERIES ON LOAN DEFAULTS

The Commission is required by federal statutes to pursue collections on loans upon default of payment. The collection retention rate retained by the Operating Fund on regular payments was reduced from the 23 percent in effect during 2007 down to 16 percent effective October 1, 2007. For loans that have been rehabilitated (9 on-time payments made by the defaulted borrower in a 10-month period) or consolidated out of default by a third-party refinancing, the Commission is allowed by federal regulation to retain a percentage of the total amount received relating to the retirement of the post-default obligation. Net recoveries on loan defaults for the years ended June 30, 2009 and 2008 are as follows:

	2009	2008
Net regular payment recoveries	$ 23,564,068	$ 20,724,761
Net rehabilitation loans	75,737,540	63,701,303
Net federal direct consolidation loans	9,166,315	6,485,550
Total net collection recoveries	$ 108,467,923	$ 90,911,614

Disruption in the financial markets and the lack of liquidity from the weakened economy forced lenders to suspend purchasing rehabilitation loans and prompted EdFund's rehabilitation lender to rescind its rehabilitation loan agreement in November 2008. As the financial markets began stabilizing, EdFund negotiated new agreements with other rehabilitation lenders that were implemented in April and June, 2009. Consistent with the terms of these new agreements, the Operating Fund and Federal Fund reflect a due from lending institutions receivable of $14,437,484 and $55,412,781, respectively, as of June 30, 2009 for rehabilitation loan recoveries and no receivable in either Fund as of June 30, 2008.

9. DUE TO GENERAL FUND

Since 2003 the state has periodically appropriated funding for portions of the Commission's grant administrative budget, outreach and training activities, and Cal Grant program awards as a reimbursement from the Operating Fund to the General Fund. For the years ended June 30, 2009 and 2008, the Commission administrative activities expended from the Operating Fund were $595,991 and $1,712,324, respectively. For the years ended June 30, 2009 and 2008, the Commission financial aid awareness programs expended from the Operating Fund were $124,182 and $2,470,157, respectively. Also, for the year ended June 30, 2009, the Commission remitted $24,000,000 from the Operating Fund to the State of California's General Fund to support Cal Grant program awards and no transfer to the Operating Fund for the year ended June 30, 2008. These 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

For the first quarter of fiscal year 2008 qualified lenders designated for exceptional performance (EP) received 99 percent reimbursement on claims. The EP designation was eliminated effective October 1, 2007.

11. FEDERAL DEFAULT FEE AND FEDERAL DEFAULT FEE SUBSIDY

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

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

12. LENDER PREMIUM FEE

During fiscal year ending June 30, 2007, a contractual relationship was established with a lending partner, which included a scaled premium fee paid by the lender when purchasing loans qualifying for rehabilitation. Beginning in late 2007, disruptions in the financial markets and the lack of liquidity resulted in this rehabilitation lender cancelling the lender premium fee arrangement effective March 31, 2008.

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, 2008 and 2007.

14. RETIREMENT BENEFITS

As of June 30, 2009 and 2008, 12 and 19 of the Commission's permanent civil service employees, respectively, were assigned to EdFund, the Commission's auxiliary (see Note 15), in direct support of FFEL Program activities and 2 and -0- of the Commission's non-assigned employees functioned in a FFEL Program oversight capacity that was funded from the Operating Fund. For the year ended June 30, 2008, budget responsibility for the FFEL Program oversight positions was transferred from the Operating Fund to the General Fund, but reverted back to the Operating Fund for the 2009 year. Full-time civil service employees participate in the California Public Employees' Retirement System (PERS). PERS, a multiple-employer defined benefit retirement plan, is administered by a Board of Administration composed of individuals (1) elected by PERS membership; (2) appointed by elected State of California officials; and (3) elected State of California officials. PERS provides retirement, disability, and death benefits. Such benefits are based on the employee's years of service, age, and final compensation. PERS issues a publicly available financial report that includes financial statements and required supplementary information, which is available on the California Public Employees' Retirement System website (www.calpers.ca.gov), 400 P Street, Sacramento, CA 94229-2701.

Civil service employees may participate in PERS at one of three levels. As of June 30, 2009 and 2008, all 12 and 19 of the employees, respectively, assigned to EdFund were classified as first-tier. As of June 30, 2009, the 2 Commission FFEL Program oversight employees are classified as first-tier. First-tier participants contribute a portion of their salaries to a retirement fund. The Department of Personnel Administration's website (www.dpa.ca.gov) has additional information about civil service retirement programs.

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 $143,693 and $347,197 in 2009 and 2008, respectively, for employees assigned to EdFund. The Operating Fund also paid $32,557 in 2009, for Commission FFEL Program oversight employees. All contributions were paid as of June 30, 2009 and 2008, respectively.

14. RETIREMENT BENEFITS (Continued)

For the year ended June 30, 2009, the Operating Fund was not required to recognize additional Annual Required Contribution (ARC); for the year ended June 30, 2008, the Operating Fund recognized an ARC of $60,000. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal costs each year and amortize any unfunded actuarial liabilities or funding excess. The Commission had no additional funding requirements at June 30, 2009 and $21,000 at June 30, 2008. The Net OPEB Obligation (NOO) liability at June 30, 2009 and 2008 was $39,000. The California Public Employees' Retirement System website (www.calpers.ca.gov) has additional information about the California Employers' Retiree Benefit Trust (CERBT) Fund and the OPEB model and assumptions used in the actuarial valuation.

15. RELATED PARTY TRANSACTIONS

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

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

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

As of June 30, 2009 and 2008, the net amount due to EdFund from the Operating Fund was $11,055,630 and $8,475,721, respectively. As of June 30, 2009 and 2008, the net amount due from EdFund to the Federal Fund was $19,396,000 and $21,537,158, respectively.

As of June 30, 2009 and 2008, the amount due from the Federal Fund to the Operating Fund totaled $37,249,624 and $40,247,482, respectively, due to deposit delays between funds.

16. LEASES

The Commission and EdFund lease office and storage space under noncancelable operating leases and month-to-month agreements. Total rental expense recorded in the Operating Fund, which includes utilities for one of two major leases, for the years ended June 30, 2009 and 2008 approximated $5,546,000 and $3,408,000, respectively. The future minimum lease payments for the noncancelable operating leases are as follows (in 000's):

Year Ending June 30,	
2010	$ 5,088
2011	5,124
2012	4,888
2013	4,950
2014	4,995
Thereafter	20,454
	$ 45,499

17. CONTINGENCIES

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

18. SUBSEQUENT EVENTS

Sale of the Commission's Loan Guarantee Function

Chapter 132 of the Statutes of 2007 (Senate Bill 89) authorized the sale or other transaction of the Commission's student loan guarantee portfolio and certain related assets and liabilities of the student loan program. Senate Bill 89 also authorized the Director of Finance to consummate other transactions to maximize the value of the state's student loan guarantee program. The 2008-09 State budget, signed into law on September 23, 2008, noted the sale had been postponed due to a variety of factors affecting the student loan guaranty industry. However, the State administration is continuing its efforts, pursuant to Chapter 757 of the statutes of 2008 (Assembly Bill 519) that extends the sale authorization through January 10, 2011. A State sale-side advisor has been retained and the Department of Finance (DOF) issued a Request for Qualifications (RFQ) with interested party responses due by August 10, 2009. DOF has completed the first phase of the RFQ evaluation process and published the list of six qualified purchasers on September 24, 2009. Further details and information about the sale is available on the DOF website at www.dof.ca.gov, word search "EdFund".

18. SUBSEQUENT EVENTS (Continued)

California 2009-10 State Budget

As a consequence of this proposed sale transaction, the State budget continues using General Fund resources to finance the Commission's grant administration budget and associated financial awareness programs. However, the State's budgets shifted $32.0 million from the General Fund to the Operating Fund to fund a portion of the Cal Grant program award costs in 2009-10. Further detail and information about the 2009-10 budget for the State of California is available through the Department of Finance budget website (www.ebudget.ca.gov).

Additionally, in the revised 2009-10 State Budget the Governor reduced the Commission's operations support item by $6.3 million. A small portion of the Commission's operations budget is used for FFEL Program administrative functions. The Governor noted in his veto message that $4.3 million was set aside to be restored contingent upon enactment of legislation that authorizes the decentralization of the Cal Grant Program and other financial aid programs as warranted. Near the close of the 2009 Legislative session, Assembly Bill 187 was amended to establish a pilot alternative delivery system for the Cal Grant Program that restores $4.3 million to the Commission's operating budget. The bill has not yet been approved but will be considered when the Legislature reconvenes in January 2010. If the restoration of the Commission's operations budget is delayed or not approved, the Commission's FFEL Program administrative functions may be disrupted.

FFEL Program Pending Federal Legislation

In February 2009, President Obama issued a general outline to Congress of his budget proposal that included eliminating the FFEL Program and shifting all new student loan funding to the Federal Direct Lending Program (DL). This plan would remove private banks from student lending and expand the role of government contractors in administering student loans. In response to the President's budget proposal, the House Education and Labor Committee proposed H.R. 3221, the Student Aid and Fiscal Responsibility Act of 2009. The bill advances the President's budget proposal to eliminate guaranteed student loans under the FFEL Program by requiring all new federal student loans be originated through the DL by July 1, 2010.

On September 17, 2009, H.R. 3221 was voted on and passed by the House of Representatives. The bill includes an amendment clarifying that borrower services, including delinquency prevention, default aversion, and loan counseling, are allowable uses of grant funds. The amendment explicitly authorizes the Department of Education to contract directly with guaranty agencies for such funded services. The Senate Health, Education, Labor and Pensions Committee is working on a companion bill, but a timeline for bill consideration in the Senate remains uncertain. Once final legislation is passed, it is anticipated that any FFEL Program changes would not be effective until July 1, 2010. However, should a mandatory shift to DL be included it is anticipated that FFEL guarantee loan volume would decline in the months prior to enactment as schools shift their guarantee loan processing to DL in preparation for the final implementation date.

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

The Honorable Members
California Student Aid Commission
Rancho Cordova, California

We have audited the financial statements of the Student Loan Operating Fund (Operating Fund) and Federal Student Loan Reserve Fund (Federal Fund) of the California Student Aid Commission (the "Commission"), as of and for the year ended June 30, 2009, and have issued our report thereon dated October 9, 2009. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

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

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the Commission's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the Commission's financial statements that is more than inconsequential will not be prevented or detected by the Commission's internal control.

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

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

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

(Continued)

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Operating Fund and Federal Fund of the Commission's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards.*

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

Perry-Smith LLP

Sacramento, California
October 9, 2009