

Information/Action Item

Joint Meeting of the CSAC and EDFUND Audit Committees

Perry-Smith Audit Approach Presentation

The Commission and EDFUND's independent external auditor, Perry-Smith, will present their approach to conducting the annual financial statement audits during 2008 of the Operating Fund and Federal Fund, EDFUND, and the EDFUND 401(k) Plan.

Staff Recommendation: Approve

Sample Motion: "I move to accept the independent auditor's audit approach for the audits conducted during 2008."

Responsible Staff: Tina Treis, Partner
Perry-Smith

Jeff Jensen, Vice President
Perry-Smith

**CALIFORNIA STUDENT AID COMMISSION – OPERATING AND FEDERAL FUNDS
EDFUND 401 (K) AND EDFUND
AUDIT PLAN FOR THE YEARS ENDING
December 31, 2007, June 30, 2008 and September 30, 2008**

Agenda

- The Auditors' Responsibility Under Generally Accepted Auditing Standards
- Required Communications
- Our Reporting Requirements to You
- Current Accounting Standards
- Audit Timing and Reporting Calendar
- Auditor Independence
- Fraud Risk Discussion

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The Auditors' Responsibility Under Generally Accepted Auditing Standards

- Conduct our audits in accordance with auditing standards generally accepted in the United States of America.
- Our audits are designed 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 audits are designed to obtain reasonable, rather than absolute, assurance about the financial statements. We believe that our audits will accomplish that objective.

Required Communication

Communication

Effective two-way communication between our Firm and the Audit Committee is important to understanding matters related to the audit and in developing a constructive working relationship.

Your insights may assist us in understanding the Operating and Federal Funds of the California Student Aid Commission and EDFUND and its environment, in identifying appropriate sources of audit evidence, and in providing information about specific transactions or events. We will discuss with the Audit Committee your oversight of the effectiveness of internal control and any areas where you request additional procedures to be undertaken. We understand that communication with us regarding any matters you consider relevant to the audit will be timely. Such matters might include strategic decisions that may significantly affect the nature, timing, and extent of audit procedures, your suspicion or detection of fraud, or any concerns you may have about the integrity or competence of senior management.

We will promptly communicate to you any fraud involving senior management and other fraud that causes a material misstatement of the financial statements, illegal acts that come to our attention (unless they are clearly inconsequential), and disagreements with management and other serious difficulties encountered in performing the audit. We also will communicate to you and to management any significant deficiencies or material weaknesses in internal control that become known to us during the course of the audit. Other matters arising from the audit that are, in our professional judgment, significant and relevant to them in their oversight of the financial reporting process will be communicated to them in writing after the completion of the audit.

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Required Communication (Continued)

The Audit Planning Process

Our audit approach places a strong emphasis on obtaining an understanding of how the Commission and EdFUND and the Plan functions. This enables us to identify key audit components and tailor our procedures to the unique aspects of your business. The development of a specific audit plan begins by meeting with management to obtain an understanding of business objectives, strategies, risks, and performance.

We will obtain an understanding of internal control to assess the impact of internal control on determining the nature, timing and extent of audit procedures, and we will establish an overall materiality limit for audit purposes. We will conduct formal discussions among engagement team members to consider how and where your financial statements might be susceptible to material misstatement due to fraud or error.

We will use this knowledge and understanding, together with other factors, to first assess the risk that errors or fraud may cause a material misstatement at the financial statement level. The assessment of the risks of material misstatement at the financial statement level provides us with parameters within which to design the audit procedures for specific account balances and classes of transactions. Our risk assessment process at the account-balance or class-of-transactions level consists of:

- An assessment of inherent risk (the susceptibility of an assertion relating to an account balance or class of transactions to a material misstatement, assuming there are no related controls); and
- An evaluation of the design effectiveness of internal control over financial reporting and our assessment of control risk (the risk that a material misstatement could occur in an assertion and not be prevented or detected on a timely basis by the company's internal control).

We will then determine the nature, timing and extent of tests of controls and substantive procedures necessary given the risks identified and the controls as we understand them.

The Concept of Materiality in Planning and Executing the Audit

In planning the audit, the materiality limit is viewed as the maximum aggregate amount of misstatements, which if detected and not corrected, would cause us to modify our opinion on the financial statements. The materiality limit is an allowance not only for misstatements that will be detected and not corrected but also for misstatements that may not be detected by the audit. Our assessment of materiality throughout the audit will be based on both quantitative and qualitative considerations. Because of the interaction of quantitative and qualitative considerations, misstatements of a relatively small amount could have a material effect on the current financial statements as well as financial statements of future periods. At the end of the audit, we will inform the audit committee of all individual unrecorded misstatements aggregated by us in connection with our evaluation of our audit test results.

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Required Communication (Continued)

Using the Work of Internal Auditors

As part of our understanding of internal control, we will obtain and document an understanding of your internal audit function. We will read relevant internal audit reports issued during the year to determine whether such reports indicate a source of potential error or fraud that would require a response when designing our audit procedures. Because internal auditors are employees, they are not independent and their work can never be substituted for the work of the external auditor. We may, however, alter the nature, timing and extent of our audit procedures based upon the results of the internal auditor's work or use them to provide direct assistance to us during the performance of our audit.

Our Reporting Requirements to You

- Audit opinions on the financial statements of the Operating Fund and Federal Fund, EDFUND and EDFUND 401(k).
- Letter confirming auditor independence.
- Required communications to the audit committee.
- A management letter.

New Statements on Auditing Standards

- SAS 104: *Amendment to SAS No. 1, Codification of Accounting Standards and Procedures*
- SAS 105: *Amendment to SAS 95, Generally Accepted Auditing Standards*
- SAS 106: *Audit Evidence*
- SAS 107: *Audit Risk and Materiality*
- SAS 108: *Planning and Supervision*
- SAS 109: *Understanding the Entity and its Environment and Assessing the Risks of Material Misstatement*
- SAS 110: *Performing Audit Procedures in Response to Assessed Risk and Evaluating the Audit Evidence Obtained*
- SAS 111: *Amendment to SAS 39, Audit Sampling*

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New Statements on Auditing Standards (Continued)

SAS 104: *Amendment to SAS No. 1, Codification of Accounting Standards and Procedures*

Expands the definition of “reasonable assurance” as “high level of assurance”.

SAS 105: *Amendment to SAS 95, Generally Accepted Auditing Standards*

Expands the level of understanding required about an entity and its internal control.

SAS 106: *Audit Evidence*

Expands audit procedures to include risk assessment procedures and further audit procedures. Also expands the assertions to categorize into classes of transactions, account balances, and presentation and disclosure.

SAS 107: *Audit Risk and Materiality*

Requires auditor to consider audit risk at both the overall financial statement level (fraud, management competence, related party transactions) as well as assertion level. Requires materiality determination to perform risk assessment procedures, identify risk of material misstatement, and design further audit procedures. Further breaks down materiality into tolerable misstatement by line item. Requires a more rigorous evaluation of audit differences.

SAS 108: *Planning and Supervision*

Further defines documentation of audit strategy and use of specialists.

SAS 109: *Understanding the Entity and its Environment and Assessing the Risks of Material Misstatement*

Requires additional procedures specifically focused on assessing risks at the entity, including analytical procedures, inquiries and observation and inspection.

SAS 110: *Performing Audit Procedures in Response to Assessed Risk and Evaluating the Audit Evidence Obtained*

Requires that procedures provide a clear linkage between the risk assessments and further audit procedures considering the nature, timing and extent of procedures. Also requires testing of controls.

SAS 111: *Amendment to SAS 39, Audit Sampling*

Provides enhanced guidance on tolerable misstatement and sampling.

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Current Accounting Standards

- GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*
- GASB Statement No. 48, *Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues*
- GASB Statement No. 50, *Pension Disclosures, An Amendment of GASB Statements No. 25 and 27*

GASB Statement No. 45, Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions

This statement addresses how state and local governments should account for and report their costs and obligations related to postemployment healthcare and other nonpension benefits. Collectively, these benefits are commonly referred to as *other postemployment benefits*, or *OPEB*.

The statement generally requires that state and local governmental employers account for and report the annual cost of OPEB and the outstanding obligations and commitments related to OPEB in essentially the same manner as they currently do for pensions. Annual OPEB cost for most employers will be based on actuarially determined amounts that, if paid on an ongoing basis, generally would provide sufficient resources to pay benefits as they come due. The provisions of Statement 45 may be applied prospectively and do not require governments to fund their OPEB plans. An employer may establish its OPEB liability at zero as of the beginning of the initial year of implementation; however, the unfunded actuarial liability is required to be amortized over future periods.

Statement 45 also establishes disclosure requirements for information about the plans in which an employer participates, the funding policy followed, the actuarial valuation process and assumptions, and, for certain employers, the extent to which the plan has been funded over time.

Statement 45 is effective in three phases based on a government's total annual revenues. The largest employers would be required to implement the requirements of Statement 45 for periods beginning after December 15, 2006. Medium-sized employers have one additional year to implement the standards, and the smallest employers have two additional years. Earlier implementation is encouraged.

GASB Statement No. 48, Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues

This Statement establishes criteria that governments will use to ascertain whether certain transactions should be regarded as a sale or a collateralized borrowing. Such transactions are likely to comprise the sale of delinquent taxes, certain mortgages, student loans, or future revenues such as those arising from tobacco settlement agreements.

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Current Accounting Standards (Continued)

GASB Statement No. 48, Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues (Continued)

This Statement also includes a provision that stipulates that governments should not revalue assets that are transferred between financial reporting entity components.

In addition to clarifying guidance on accounting for sales and pledges of receivables and future revenues, the Statement:

- Requires enhanced disclosures pertaining to future revenues that have been pledged or sold.
- Provides guidance on sales of receivables and future revenues within the same financial reporting entity.
- Provides guidance on recognizing other assets and liabilities arising from the sale of specific receivables or future revenues.

The requirements of this Statement are effective for financial statements for periods beginning after December 15, 2006.

GASB Statement No. 50, Pension Disclosures, an Amendment of GASB Statements No. 25 and 27

This statement amends GASB Statements No. 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans*, and No. 27, *Accounting for Pensions by State and Local Governmental Employers*, by requiring:

- Disclosure in the notes to the financial statements of pension plans and certain employer governments of the current funded status of the plan—in other words, the degree to which the actuarial accrued liabilities for benefits are covered by assets that have been set aside to pay the benefits—as of the most recent actuarial valuation date.
- Governments that use the aggregate actuarial cost method to disclose the funded status and present a multi-year schedule of funding progress using the entry age actuarial cost method as a surrogate; these governments previously were not required to provide this information.
- Disclosure by governments participating in multi-employer cost-sharing pension plans of how the contractually required contribution rate is determined.

The provisions of Statement 50 generally are effective for periods beginning after June 15, 2007, with early implementation encouraged. The requirements relating to governments using the aggregate actuarial cost method are effective for financial statements and required supplementary information that contains information from actuarial valuations as of June 15, 2007, or later.

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Audit Timing and Reporting Calendar

EdFUND 401(k) Plan Audit Procedures (May / June 2008) (Fieldwork in Progress)

- Test contributions from EdFUND and disbursements to participants from the 401(k) plan.
- Test eligibility of participants and employees of EdFUND in the 401(k) plan.
- Complete the audit of the 401(k) plan's financial statements and review the Form 5500.
- Deliver audit communications to the Audit Committee in October 2008, including required communications, letter on independence and management letter.

Operating Fund and Federal Fund Planning Procedures (June 2008)

- Update our understanding of the Operating Fund and Federal Fund's strategies, objectives, and operating environment.
- Develop overall audit plan and integrate new auditing standards into audit documentation.
- Document and perform testing of the Operating Fund and Federal Fund's internal control processes.
- Information systems control update.

Operating Fund and Federal Fund Year-End Procedures (August 4 – August 22, 2008)

- Complete the audit of the Operating Fund and Federal Fund balance sheet and income statement.
- Obtain management's financial statements.
- Complete engagement administration including subsequent events review, board minute review and other matters.
- Obtain management's representations.
- Deliver audit communications to the Audit Committee in September 2008, including required communications, letter on independence and management letter.

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Audit Timing and Reporting Calendar (Continued)

EDFUND Planning Procedures (Week of September 15)

- Document and perform testing of EDFUND's internal control processes.
- Perform a preliminary analytical review of EDFUND financial statements.
- Evaluation of the control environment and risk assessment of EDFUND.

EDFUND Year-End Procedures (November 10 – November 21, 2008)

- Complete the audit of EDFUND's balance sheet and income statement.
- Obtain management's financial statements.
- Complete engagement administration including subsequent events review, board minute review and other matters.
- Obtain management's representations.
- Deliver audit communications to the Audit Committee in January 2009, including required communications, letter on independence and management letter.
- Review the draft Form 990 (upon completion by EDFUND's management).

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Auditor Independence

Auditor independence ensures that the auditor is free to carry out his or her responsibilities to audit committees, shareholders and the marketplace.

Certain independence matters have been addressed including their potential effect on our services related to the Operating Fund and Federal Fund of California Student Aid Commission and EdFUND are described below.

Personal Impairments – *In compliance with Government Auditing Standards (GAS) we confirm the following types of personal impairments have been evaluated for all Firm employees:*

- a. No immediate family member (spouse, spousal equivalent, or dependent) or a close family member (parent, sibling, or nondependent child) is a director or officer of the Operating Fund and Federal Fund or EdFUND, or is an employee of Operating Fund and Federal Fund or EdFUND in a position to exert direct and significant influence over Operating Fund and Federal Fund or EdFUND or the program under audit.
- b. No financial interest that is direct, or is significant/material though indirect, in the Operating Fund and Federal Fund or EdFUND.
- c. There is no responsibility for managing an entity or decision-making that could affect operations of the Operating Fund and Federal Fund or EdFUND, for example as a director, officer, or other senior position of the entity, activity, or program being audited, or as a member of management in any decision-making, supervisory, or ongoing monitoring function for the Operating Fund and Federal Fund or EdFUND.
- d. There is no concurrent or subsequent performance of an audit by the same individual who maintained the official accounting records when such services involved preparing source documents or originating data, in electronic or other form; posting transactions (whether coded by management or not coded); authorizing, executing, or consummating transactions (for example, approving invoices, payrolls, claims, or other payments of the Operating Fund and Federal Fund or EdFUND), maintaining the Operating Fund and Federal Fund or EdFUND bank account or otherwise having custody of the Operating Fund and Federal Fund or EdFUND funds; or otherwise exercising authority on behalf of the entity, or having authority to do so,
- e. There are no preconceived ideas toward individuals, groups, organizations, or objectives of a particular program that could bias the audit,
- f. Biases, including those induced by political or social convictions, that result from employment in, or loyalty to, a particular group, organization, or level of government, and
- g. Seeking employment with the Operating Fund and Federal Fund or EdFUND during the conduct of the audit.

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Auditor Independence (Continued)

Prohibited Services – we do not provide any services that are prohibited under independence rules.

Pre-approval of non-audit services – the respective Audit Committees pre-approve all non-audit services performed by Perry-Smith LLP.

Fraud Risk Discussion

- Auditor assessment of risks of fraud in the Operating Fund and Federal Fund of CSAC and EdFUND
- Oversight of fraud risk by Audit Committee
- Audit Committee awareness of any fraud or suspected fraud
- Level of communication desired by Audit Committee from management