

REPORT BY THE  
AUDITOR GENERAL  
OF CALIFORNIA

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**CALIFORNIA STUDENT AID COMMISSION  
STATE GUARANTEED LOAN RESERVE FUND  
FINANCIAL AUDIT REPORT  
YEAR ENDED JUNE 30, 1984**

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F-450

CALIFORNIA STUDENT AID COMMISSION  
STATE GUARANTEED LOAN RESERVE FUND  
FINANCIAL AUDIT REPORT  
YEAR ENDED JUNE 30, 1984

NOVEMBER 1984



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Auditor General

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**Office of the Auditor General**  
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SACRAMENTO, CALIFORNIA 95814

November 9, 1984

F-450

Honorable Art Agnos, Chairman  
Members, Joint Legislative  
Audit Committee  
State Capitol, Room 3151  
Sacramento, California 95814

Dear Mr. Chairman and Members:

The Office of the Auditor General presents its report concerning the California Student Aid Commission's State Guaranteed Loan Reserve Fund for the year ended June 30, 1984. We prepared the report to meet the commission's obligation to provide audited financial statements of the loan program to lenders participating in the program.

The report shows that the student loan programs have accumulated a fund balance of \$72 million as of June 30, 1984. This represents an increase of approximately \$20 million since the end of the previous fiscal year. Loan defaults during the year amounted to approximately \$95 million. However, the State's share of the loan defaults amounted to only \$2.35 million, since the U. S. Department of Education reimburses the Student Aid Commission for most of the defaulted loans.

Respectfully submitted,

  
THOMAS W. HAYES  
Auditor General

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## INTRODUCTION

We have conducted a financial audit of the California Student Aid Commission's State Guaranteed Loan Reserve Fund. The California Student Aid Commission (commission) requested this audit to meet its obligation to provide audited financial statements to lenders participating in the California Educational Loan Programs.

The State Guaranteed Loan Reserve Fund reflects the financial activities of three programs: (1) the Guaranteed Loan Program, (2) the State Guaranteed Loan Program, and (3) the California Loans to Assist Students Program. Because the Guaranteed Loan Program has been replaced by the State Guaranteed Loan Program, the Guaranteed Loan Program no longer provides loans and contains only residual activity. The State Guaranteed Loan Program and the California Loans to Assist Students Program are collectively known as the California Educational Loan Programs.

Chapter 1201, Statutes of 1977, established the State Guaranteed Loan Program and authorized the commission to serve as a guarantee agency for student loans. This program carries out the provisions of the federal Guaranteed Student Loan Program instituted within the federal Higher Education Act of 1965, as amended (P.L. 94-482). Also by authority of Chapter 1201, Statutes of 1977, the commission in 1982 established the California Loans to Assist Students Program. The commission is responsible for guaranteeing

federally reinsured loans issued to students and parents for postsecondary education expenses.

The commission has contracted with the E.D.S. Corporation, to provide administrative support services from January 3, 1983, to February 28, 1986. These services include processing and approving all student loan applications, collecting insurance premiums, maintaining and managing the loan portfolio, processing claims from lenders, pursuing collections, and preparing reports required by the United States Department of Education.

The State Guaranteed Loan Reserve Fund is supported by federal funds, investment earnings, and insurance premiums paid by student borrowers.

We conducted this audit under the authority vested in the Auditor General by Section 10500 et seq. of the Government Code.



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Members of the Joint Legislative Audit Committee  
State of California

We have examined the balance sheet of the California Student Aid Commission's State Guaranteed Loan Reserve Fund as of June 30, 1984, and the related statement of revenues, expenditures, and changes in fund balance for the year then ended. We made our examination in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the financial statements referred to above present fairly the financial position of the California Student Aid Commission's State Guaranteed Loan Reserve Fund at June 30, 1984, and the results of its operations and the changes in fund balance for the year then ended, in conformity with generally accepted accounting principles applied on a consistent basis.

OFFICE OF THE AUDITOR GENERAL

A handwritten signature in cursive script, appearing to read "Karl W. Dolk".

KARL W. DOLK, CPA  
Assistant Auditor General

September 28, 1984

Staff: Ulrich Pelz, CPA, Audit Manager  
Harriet Kiyon, CPA  
Marianne L. Pulli-Otis  
Wendy T. Rodriguez

**CALIFORNIA STUDENT AID COMMISSION  
STATE GUARANTEED LOAN RESERVE FUND  
BALANCE SHEET  
AS OF JUNE 30, 1984**

ASSETS

Cash	\$ 20,603
Insurance premiums receivable	1,017,242
Due from other funds	68,339,356
Due from federal government	10,049,039
Equipment	<u>102,943</u>
Total Assets	<u>\$79,529,183</u>

LIABILITIES AND FUND EQUITY

Liabilities	
Due to General Fund	\$ 6,485,191
Due to federal government	<u>594,018</u>
Total Liabilities	<u>7,079,209</u>
Fund Equity	
Investments in fixed assets	<u>102,943</u>
Fund balance	
Reserved for loan defaults	42,054,471
Designated for federal advances	9,126,687
Undesignated	<u>21,165,873</u>
Total Fund Balance	<u>72,347,031</u>
Total Fund Equity	<u>72,449,974</u>
Total Liabilities and Fund Equity	<u>\$79,529,183</u>

See the notes accompanying the financial statements.



**CALIFORNIA STUDENT AID COMMISSION  
STATE GUARANTEED LOAN RESERVE FUND  
STATEMENT OF REVENUES, EXPENDITURES,  
AND CHANGES IN FUND BALANCE  
FOR THE FISCAL YEAR ENDED JUNE 30, 1984**

REVENUES

Insurance premiums	\$13,891,270
Intergovernmental	6,863,217
Interest	3,725,832
Collection fees	2,212,490
Miscellaneous	<u>40,430</u>
Total Revenues	<u>26,733,239</u>

EXPENDITURES

Personal services	1,068,100
Operating expenses and equipment	1,069,838
Contract fees	5,186,032
State share of loan defaults	<u>2,350,774</u>
Total Expenditures	<u>9,674,744</u>
Excess of Revenues Over Expenditures	17,058,495

OTHER FINANCING SOURCES

Federal advance	<u>3,648,524</u>
Excess of Revenues and Other Financing Sources Over Expenditures	20,707,019
Beginning Fund Balance, July 1, 1983	<u>51,640,012</u>
Ending Fund Balance, June 30, 1984	<u><u>\$72,347,031</u></u>

See the notes accompanying the financial statements.

## NOTES TO THE FINANCIAL STATEMENTS

### 1. Definition of Reporting Entity

The State Guaranteed Loan Reserve Fund accounts for the activities of the California Educational Loan Programs, which comprise the State Guaranteed Loan Program and the California Loans to Assist Students Program, plus the residual activities of the Guaranteed Loan Program, which ceased to provide loans in 1967. The Guaranteed Loan Program had a fund balance of \$565,685, revenues of \$93,929, and expenditures of \$41,649 as of and for the year ended June 30, 1984. In previous years, the California Student Aid Commission (commission) has issued financial reports only on the California Educational Loan Programs and the State Guaranteed Loan Program. The California Loans to Assist Students Program began in fiscal year 1982-83.

### 2. Summary of Significant Accounting Policies

The accompanying financial statements reflect the financial position and results of operations of the State Guaranteed Loan Reserve Fund. The financial statements have been prepared in conformity with generally accepted accounting principles applicable to state and local governments. Below is a summary of the more significant accounting policies.

#### A. Fund Accounting

The State Guaranteed Loan Reserve Fund is accounted for as an Expendable Trust Fund. Expendable Trust Funds account for assets held in a trustee capacity, and both principal and income may be expended in the course of the fund's designated operations.

#### B. Basis of Accounting

The State Guaranteed Loan Reserve Fund is accounted for on the modified accrual basis of accounting except for vacation and sick leave accruals. Under the modified accrual basis of accounting, revenues are recognized in the accounting period in which they become measurable and available and expenditures are recognized, if measurable, in the accounting period in which the liability is incurred. The commission charges the costs of vacation and sick leave when these benefits are used rather than when they are earned.

3. Due From Other Funds

Most of the amount in this account reflects the fund's share of the Surplus Money Investment Fund (SMIF). This amount is available upon demand. The account also includes amounts due from the General Fund for recoveries of defaulted loans collected by the General Fund but not remitted to the State Guaranteed Loan Reserve Fund as of June 30. The following schedule summarizes the account balances as of June 30, 1984:

Investment in SMIF	\$67,031,469
General Fund	<u>1,307,887</u>
Total	<u>\$68,339,356</u>

4. Due From Federal Government

This account represents the June 30, 1984, balance due from the United States Secretary of Education for amounts billed that are to be reimbursed in the subsequent fiscal year. Included in this account are amounts due for administrative costs that the commission billed the United States Secretary of Education for reimbursement of either one percent of the balance of loans guaranteed or the actual administrative costs, whichever is less. This account also includes balances due from the United States Secretary of Education for amounts billed for defaulted loans that the commission purchased under a federal reinsurance agreement. (See also Note 15.) The following schedule summarizes the amounts due from the federal government as of June 30, 1984:

Administrative costs	\$ 4,524,840
Defaulted loans purchased	<u>5,524,199</u>
Total	<u>\$10,049,039</u>

5. Due to General Fund

This account represents the operating costs and the loan default purchases made by the General Fund on behalf of the State Guaranteed Loan Reserve Fund during May and June 1984.

6. Reserved for Loan Defaults

The California Administrative Code Title V, Chapter 1, Part IV, Section 30108 requires the commission to maintain a reserve for the purchase of defaulted loans. The commission must deposit to this reserve at least 80 percent of the insurance premium revenue and the interest earnings from federal advances received under Section 422 (c) of the Higher Education Act of 1965. Funds in this reserve can be used only for the purchase of defaulted loans.

## 7. Designated for Federal Advances

The United States Secretary of Education made advances to the commission to establish or strengthen the State Guaranteed Loan Reserve Fund. These advances may be used only to purchase defaulted loans. An agreement between the commission and the United States Secretary of Education also states that the Secretary, under specified conditions, may call upon the commission to repay part or all of any advanced monies when the Secretary determines that the fund no longer needs the advanced monies.

## 8. Lenders' Agreements

The commission's agreements with lending institutions require that it maintain a guarantee reserve fund. This fund must be represented by cash and marketable securities, and it must have a total market value of not less than one percent of the total amount of unpaid principal and interest of all approved notes that are covered by federal reinsurance under the agreement between the commission and the United States Secretary of Education. At June 30, 1984, the commission had a cash investment of \$67,031,469 in the Surplus Money Investment Fund. This amount is readily available upon demand. Under the agreement with the lenders, the required balance for the principal portion was \$24,151,307 at June 30, 1984. The required amount for the unpaid interest is unknown, since the lenders do not report to the commission information on unpaid interest.

In January 1983, the commission also entered into a guarantee reserve agreement with the California Student Loan Authority, which was established to provide a secondary market for loans to students and parents. This agreement requires that the commission maintain a fund balance reserved for loan defaults in the California Educational Loan Programs. This fund balance must be equal to at least one percent of the unpaid principal amount of all loans guaranteed by the commission. At June 30, 1984, the commission maintained a reserve for loan defaults of \$42,054,471. Under the agreement, the required reserve was \$24,524,721.

## 9. Retirement Commitments

Regular employees of the commission are members of the Public Employees' Retirement System (PERS), which is a defined benefit, contributory retirement plan. The amount that the commission and its employees contribute to the PERS is determined actuarially under a program in which contributions plus retirement system earnings provide the necessary funds to pay retirement costs as they are accrued. The State Guaranteed Loan Reserve Fund's share of retirement contributions for the fiscal year ended June 30, 1984, was \$140,718.

10. Compensated Absences

At June 30, 1984, the State Guaranteed Loan Reserve Fund's liability for accumulated vacation, compensated time off, and personal holidays was approximately \$61,000. Payments for these accumulated compensated absences will be made to employees as absences occur in future periods. Employees may receive cash payments for vacation, compensated time off, and personal holidays when they leave state service. Accumulated sick leave may be exchanged upon retirement for service credits in an employee's retirement account.

11. Insurance Premiums

Student borrowers pay insurance premiums when the lending institutions make loan disbursements. The commission must use at least 80 percent of these premiums to underwrite defaulted loans. The remainder may be used to cover costs that the commission incurs in administering the loan program.

12. Intergovernmental Revenue

This amount represents federally reimbursed administrative costs.

13. Collection Fees

The federal government allows guarantee agencies to retain up to 30 percent of loan default recoveries for collection efforts.

14. Contract Fees

This amount represents payments to E.D.S. Corporation for administrative support services. Under the contract with E.D.S. Corporation, the fees are calculated at various percentages, depending on whether the loan amount is classified as guaranteed during the month, as outstanding at the end of the month, or as a defaulted loan purchased during the month.

15. State Share of Loan Defaults

The agreements between the California Student Aid Commission and the lenders participating in the loan program require that the commission purchase guaranteed loans that have been defaulted if the lender has exercised due diligence in making, servicing, and collecting the loan. Likewise, the agreement between the commission and the United States Secretary of Education requires the Secretary of Education to purchase from the commission a percentage of those defaulted loans that the commission purchases. Through federal fiscal year ended September 30, 1983, the United States Secretary of Education purchased 100 percent of the amount of defaulted loans. However, beginning with the 1983-84 federal fiscal year, the percentage of defaulted loans that the United States Secretary of Education purchases may vary. During each

federal fiscal year, the federal government will purchase 100 percent of the amount of defaulted loans until the total amount of the defaulted loans purchased reaches 5 percent of the amount of loans in repayment at the end of the preceding federal fiscal year. After the amount of defaulted loans purchased reaches 5 percent of the amount of loans that were in repayment, the federal government will purchase 90 percent of the amounts of defaulted loans. When the amount of the defaulted loans purchased reaches 9 percent of the amount of loans that were in repayment, the federal government will purchase 80 percent of the amounts of defaulted loans.

During the year ended June 30, 1984, the federal government purchased \$86.9 million of the \$88.7 million of defaulted loans. The amount of \$88.7 million does not include \$6.1 million in defaulted loans that the federal government had not yet purchased at June 30, 1984.

16. Subsequent Events

As described in Note 15, the percentage of the amount of defaulted loans that the United States Secretary of Education will purchase varies according to the ratio of the total amount of the defaulted loans purchased to the amount of loans in repayment at the end of the preceding federal fiscal year. In late July 1984, the amount of defaulted loans purchased reached 9 percent of the amount of loans in repayment on September 30, 1983. During August and September, therefore, the federal government purchased 80 percent of most defaulted loans. On October 1, 1984, the purchase percentage will return to 100 percent.

### OTHER COMMENTS

As an integral part of our examination, we reviewed the accounting procedures of the California Student Aid Commission and its related system of internal accounting control to the extent we considered necessary to form an opinion on the fairness with which the financial statements of the State Guaranteed Loan Reserve Fund present the fund's financial position and the results of the operations in accordance with generally accepted accounting principles consistently applied. As part of our review, we are issuing a management letter to the commission suggesting action that it should take to improve its administration of the State Guaranteed Loan Reserve Fund.

cc: Members of the Legislature  
Office of the Governor  
Office of the Lieutenant Governor  
State Controller  
Legislative Analyst  
Assembly Office of Research  
Senate Office of Research  
Assembly Majority/Minority Consultants  
Senate Majority/Minority Consultants  
Capitol Press Corps