

**CALIFORNIA HEALTH FACILITIES
FINANCING AUTHORITY
BOND FINANCING PROGRAM FUND**

PERFORMANCE AUDIT

JUNE 30, 2011

California Health Facilities Financing Authority
Bond Financing Program Fund

PERFORMANCE AUDIT

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TRANSMITTAL LETTER

Members of the Board
California Health Facilities Financing Authority
Bond Financing Program Fund

The following is the final report on the performance audit we conducted of the Bond Financing Program Fund of the California Health Facilities Financing Authority (the Authority or CHFFA) as of and for the year ended June 30, 2011. We conducted the performance audit in accordance with generally accepted government auditing standards promulgated by the Comptroller General of the United States of America. The scope of the performance audit focused on assessing the Authority's internal controls surrounding the Bond Financing Program Fund (Program). Our report provides recommendations for improving efficiencies and effectiveness of the Program.

We provided a draft version of the report for review and comment by the Authority. Their responses are included in this final report.



Sacramento, California
February 18, 2013

California Health Facilities Financing Authority
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GENERAL BACKGROUND AND OVERVIEW

In August 2010, the Authority requested a performance audit of the Bond Financing Program over the internal controls and operational procedures of the Program. We issued a performance report for the prior year which mainly focused on the internal control and administrative procedures and our recommendations formulated in prior year are summarized at pages 17 and 18 of this report. This current report will focus in addition to the timing of the major steps for processing the files from receipt of the applications through the issuance of the bonds. The purpose of the performance audit is to provide the Authority recommendations in order to improve the operating effectiveness and efficiencies of the Program.

The Authority

The California Health Facilities Financing Authority (CHFFA) was created in 1979 pursuant to the CHFFA Act (codified in Government Code sections 15430-15462.5). CHFFA is a public instrumentality of the State of California, authorized and empowered by the provisions of the CHFFA Act for the purpose of providing financial assistance to eligible and creditworthy non-profit and public health facilities through loans, grants and tax-exempt financings. The Authority was created to be the State of California's vehicle for providing financial assistance to public and non-profit health care providers in California through loans funded by the issuance of tax-exempt bonds, low-cost loans, and direct grant programs to promote important California health access, healthcare improvement and cost containment objectives. The diverse nature of the facilities funded by the Authority reflects the changing health care needs of California. From rural community-based organizations to large multi-hospital systems, the Authority has financed a wide range of providers and programs throughout California.

The Act authorizes CHFFA to charge fees relating to the administrative costs and expenses incurred in obtaining tax-exempt financing. This self-funding structure allows CHFFA to provide assistance to eligible borrowers without cost to the State's General Fund. All fees are deposited into the CHFFA Fund ("the Fund") and all expenses are paid from the Fund. In addition, interest earnings from the investment of the fund in the State's Surplus Money Investment Fund are deposited directly to the Fund.

The Tax Exempt Bond Financing Program

The Bond Financing Program (the Program) provides a borrower with access to low interest rate capital markets through the issuance of tax-exempt revenue bonds. Proceeds from the loan may be used by eligible borrowers to fund construction/renovation projects, land acquisition for

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future projects, acquisition of existing health facilities, refinancing of existing debt, working capital for start-up facilities and pay costs of issuance. Given the cost of issuing bonds, this is the option usually pursued by borrowers with capital projects in excess of \$5 million.

Over the years, CHFFA has served as a conduit issuer for a wide range of providers and systems throughout the State of California, from rural community-based organizations to stand alone and large multi-hospital systems. CHFFA's enabling legislation guides the specific types of eligible entities, covering a wide range of entities, including acute care hospitals, specialty centers, intermediate and skilled nursing care facilities, clinics and adult day health centers. The legislation also addresses project eligibility (including without limitation, construction, expansion, remodeling, renovation, and refinances), in addition to the make-up and responsibility of the nine member board. The borrowers are categorized under the following bond financing programs:

Standard Bond Financing Program - This program provides borrowers with access to low interest rate capital markets through the issuance of tax-exempt revenue bonds. Proceeds from the bonds may be used to fund construction/renovation projects, land acquisition for future projects, acquisition of existing health facilities, refinancing of existing debt, working capital for start-up facilities, and costs of issuance.

Pooled Bond Financing Program - This program provides borrowers, with more modest financing needs, the option to group or "pool" into a single bond financing, where bond issuance costs are shared by other participants. This type of financing will generally allow a borrower to finance an eligible project with a minimum loan of \$500,000.

Tax Exempt Equipment Financing Program - This program provides health facilities with access to tax-exempt fixed rate financing for equipment purchases. A borrower under the program can fund qualifying equipment purchases of \$500,000 or more. The maturity of the loan must be related to the useful life of the equipment to be financed. Notes issued through the program are collateralized by the equipment that is purchased. Funds may be used to purchase or reimburse all types of qualifying equipment by an eligible health facility, including but not limited to, medical and diagnostic equipment, computers, and telecommunications equipment. Funds can also be used to finance minor equipment installation costs.

THE ELIGIBILITY REQUIREMENTS

The regulations specify that in order for an institution to be eligible for the Program it must be a public hospital, a private non-profit corporation, or an association authorized by the laws of

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California to provide or operate a health facility and undertake the financing or refinancing of a project. Section 15432(d) of the California Government Code defines the health facilities eligible for the Program by CHFFA.

HISTORICAL SUMMARY OF ACTIVITY

Since the inception of the Program, the Program benefited a large number of health provider networks. As of June 30, 2011, CHFFA served as the issuer for \$25.8 billion in conduit revenue bond of which \$10.1 billion are outstanding.

The schedule below summarizes the health provider networks that most used the program:

Significant Networks Participating in the Program	Bonds issued	Percentage of total	Outstanding at 06/30/2011	Percentage of total
Adventist Health System-West	949,500,000	4%	623,940,000	6%
Catholic Healthcare West	4,496,960,000	17%	1,886,205,000	19%
Cedars-Sinai Medical Center	1,879,330,000	7%	1,170,415,000	12%
Kaiser Permanente	2,398,090,000	9%	910,544,308	9%
Providence Health System	601,095,000	2%	430,325,000	4%
Scripps Health	1,259,775,000	5%	558,755,000	6%
St. Joseph Health System	765,575,000	3%	420,760,000	4%
Stanford Hospital and Clinics	1,526,225,000	6%	803,150,000	8%
Sutter Health	2,751,090,000	11%	1,886,265,000	19%
Sub-total for nine largest networks	16,627,640,000	64%	8,690,359,308	86%
Others	9,171,437,017	36%	1,455,124,378	14%
Total	25,799,077,017	100%	10,145,483,686	100%

The nine largest networks represent 64% of the total bonds issued since the inception of the Program and 86% of the outstanding debt as of June 30, 2011.

MEASUREMENT

Goals and Monitoring

The goals of the Program are to provide low interest financing to public and non-profit health care providers in California through loans funded by the issuance of tax-exempt bonds in order to expand the availability and improve the quality of healthcare available in California.

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Inputs

The inputs used to measure are the proceeds from the issuance of bonds. The Authority does not have any obligation to repay the bonds as the financing is secured by the full faith and credit of the health facility receiving the financing.

Outputs

The outputs are the expanded health care available through the expansion of facilities and upgraded equipment.

Outcomes

The outcomes are the increased quality of care and availability of healthcare to the public and non-profit healthcare facilities in major areas as well as rural areas of California.

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PERFORMANCE AUDIT STANDARDS AND METHODOLOGY

Performance Audit Standards

We conducted the performance audit in accordance with generally accepted government auditing standards promulgated by the Comptroller General of the United States of America. These standards pertain to the auditor's professional qualifications, the quality of the audit effort and the characteristics of professional and meaningful audit reports. The standards ensure the independence and objectivity of the audit team, the analysis and the resulting findings and recommendations presented in the report. We limited our procedures to those specified in the scope of this performance audit.

Methodology

Our approach for conducting the performance audit involved interviewing different levels of staff, reviewing policies and procedures surrounding the application process through bond issuance and reviewing a sample of bond files that are in various stages of the application process during the period July 1, 2010 through June 30, 2011.

To gain an understanding of the program requirements, we performed the following procedures:

- We obtained and reviewed the regulations which created the Authority and the Bond Program.
- We interviewed management and the Authority staff.
- We reviewed the relevant documents such as the bond application and instructions.

To gain an understanding of the process for receiving and processing applications to ensure they are awarded in accordance with the regulations we performed the following:

- We reviewed the regulations for the requirements and eligibility of the Program.
- We interviewed management and the Authority staff to gain an understanding of the processes and procedures for reviewing applications for eligibility and approval.
- We reviewed the bond files and followed through the various stages of the processing timeline and gathered information regarding the time spent at each major stage.

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To ensure the bond proceeds were being used in accordance with the regulations and program requirements we performed the following procedures:

- We selected a sample of 7 files during the period July 1, 2010 through June 30, 2011. The selection consisted of 4 files for which the bonds were issued during the year ended June 30, 2011 and 3 files for which the Board approved the applications received but no bonds were yet issued as of June 30, 2011. We performed detailed procedures on the 7 files for compliance with the policies and procedures of CHFFA.
- We reviewed CHFFA's due diligence process and procedures and the length of time each stage has taken during the application process.
- We reviewed the approval process and the submission process to the Board for approval.
- We reviewed the ongoing monitoring requirements and process in place by CHFFA.

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PERFORMANCE AUDIT RESULTS

- We conducted interviews of the staff working on the Program to update our understanding of the process and procedures. During these interviews we noted that there are no written policies and procedures that explain the process and procedures for each type of bond funding, i.e. new applicant, refunding. However, there is a checklist which documents the steps taken to approve the bond funding.
- Our review of CHFFA’s due diligence process and procedures and the length of time to complete each stage resulted in the following observations:
 - The Authority uses two checklists to document the processes and procedures of the application review. The first checklist is used during the initial review of the file and the second is used after the bond documents are received from the legal counsel.
 - The checklists are very detailed and provide a manner to organize the significant number of documents and calculations performed.
 - In addition CHFFA utilizes an outside firm to perform an independent financial review of the applications.
 - We compared the date stamp of the receipt of the application to the date the bond was issued. A summary of the bond files reviewed is as follows:

Borrower	Series	Application received	Bond issued
Adventist Health System/West	2011 Series A	4/1/2011	6/1/2011
Beacon House Association of San Pedro		12/30/2010	not issued as of 6/30/11
Community Programs for Persons with Developmental Disabilities	2011 Series A/B	9/23/2010	2/17/2011
Kaiser Permanente	2011 Series A/B	3/14/2011	5/3/2011
St. Joseph Health System		6/14/2011	not issued as of 6/30/11
Sutter Health	2011 Series A/B/C/D	12/2/2010	2/10/2011
TLC Child and Family Services		10/27/2010	not issued as of 6/30/11

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- The following chart summarizes the time that elapsed in days from the date the application was received through the date the bonds were issued.

Borrower	Series	Application received	Bond issuance	Total days
Adventist Health System/West Community Programs for Persons with Developmental Disabilities	2011 Series A	4/1/2011	6/1/2011	61
Kaiser Permanente	2011 Series A/B	9/23/2010	2/17/2011	147
Sutter Health	2011 Series A/B	3/14/2011	5/3/2011	50
	2011 Series A/B/C/D	12/2/2010	2/10/2011	70
Average days from application receipt to bond issuance				99
Median days from application receipt to bond issuance				66

The longest time that elapsed from receipt of the application to the issuance of the bonds was 147 days and the shortest was 50 days.

- The following chart summarizes the time that elapsed in days from the date the application was received through the date the initial fee was collected.

Borrower	Series	Application received	Date initial fee Received	Total Days
Adventist Health System/West Beacon House Association of San Pedro	Series 2011A	4/1/2011	6/15/2011	75
Community Programs for Persons with Developmental Disabilities		12/30/2010	waived	
Kaiser Permanente	2011 Series A/B	9/23/2010	6/6/2011	256
St. Joseph Health System	2011 Series A/B	3/14/2011	5/12/2011	59
Sutter Health		6/14/2011	9/21/2011	99
TLC Child and Family Services	2011 Series A/B/C/D	12/2/2010	2/18/2011	78
		10/27/2010	10/7/2011	345
Average days from receipt of application to receipt of the initial fee				152
Median days from receipt of application to receipt of the initial fee				89

The initial fee was collected between approximately 2 months from the date the application was received and just under one year.

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- The following chart summarizes the time that elapsed in days from the date the application was received through the date a public hearing was held, for those bond issuances which required a public hearing to be held.

Borrower	Series	Application received	Public Hearing Held - Date	Total Days
Adventist Health System/West Community Programs for Persons with Developmental Disabilities	Series 2011A	4/1/2011	4/27/2011	26
St. Joseph Health System	2011 Series A/B	9/23/2010	10/27/2010	34
Sutter Health	2011 Series A/B/C/D	6/14/2011	6/29/2011	15
TLC Child and Family Services		12/2/2010	12/7/2010	5
		10/27/2010	12/22/2010	56
Average days from receipt of application to public hearing				27
Median days from receipt of application to public hearing				26

A public hearing was held between 5 days from the date the application was received and approximately 2 months from the receipt of the application.

- The following chart summarizes the time involved in the legal review process for those applications requiring legal review.

Borrower	Series	Application received	Date Sent to Legal Review	Date Legal Review Completed	Days to send for legal review	Days to complete legal review
Kaiser Permanente	2011 Series A/B	3/14/2011	3/29/2011	4/5/2011	15	7
St. Joseph Health System		6/14/2011	6/17/2011	6/27/2011	3	10
Sutter Health	2011 Series A/B/C/D	12/2/2010	12/22/2010	12/27/2010	20	5
Average days					13	7
Median days					15	7

The legal review process happens relatively quickly from the application receipt date, usually within three weeks. The legal department averaged a one week turnaround time from the date a file was sent for review.

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- We compared the date stamp of the receipt of the application to the date the Board approved the application. We noted that the average time to process the application from receipt to Board approval is approximately 42 days. The schedule below summarizes the bond approval timeframe:

Borrower	Series	Application received	Board approval	Total days
Adventist Health System/West	Series 2011A	4/1/2011	4/28/2011	27
Beacon House Association of San Pedro		12/30/2010	4/28/2011	119
Community Programs for Persons with Developmental Disabilities	2011 Series A/B	9/23/2010	10/28/2010	35
Kaiser Permanente	2011 Series A/B	3/14/2011	4/11/2011	28
St. Joseph Health System		6/14/2011	6/30/2011	16
Sutter Health	2011 Series A/B/C/D	12/2/2010	1/6/2011	35
TLC Child and Family Services		10/27/2010	12/2/2010	36
Median days from application receipt to board approval				42
Average days from application receipt to board approval				35

- We also reviewed the time that elapsed from the date of Board approval through the date of issuance of the bonds. We noted that the average time to process the application from Board approval to issuance is approximately 51 days. The schedule below summarizes the bond approval timeline:

Borrower	Series	Board approval	Bond issuance	Total days
Adventist Health System/West	Series 2011A	4/28/2011	6/1/2011	34
Community Programs for Persons with Developmental Disabilities	2011 Series A/B	10/28/2010	2/17/2011	112
Kaiser Permanente	2011 Series A/B	4/11/2011	5/3/2011	22
Sutter Health	2011 Series A/B/C/D	1/6/2011	2/10/2011	35
Average days from board approval to issuance				51
Median days from board approval to issuance				35

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- The following chart summarizes the length of time that elapsed in the due diligence process starting from the date of receipt of the application for the bonds not yet issued as of June 30, 2011:

Borrower	Application received	Fiscal Year End	Total days
Beacon House Association of San Pedro	12/30/2010	6/30/2011	182
St. Joseph Health System	6/14/2011	6/30/2011	16
TLC Child and Family Services	10/27/2010	6/30/2011	246
Average days from receipt of application to the end of the fiscal year			148
Median days from receipt of application to the end of the fiscal year			182

- Our review of the approval process and the submission process to the Board for approval resulted in the following observations:
 - Prior to the package being sent to the Board for approval, there are a multitude of reviews by various levels to ensure that each application includes all of the supporting documentation needed for the determination of funding the bonds.
 - The documentation files did not always contain the cover page with the reviewers' signoffs. As the Authority moves toward an electronic process, procedures should be in place to maintain a process to ensure that all of the approvals and documentation are accounted for. It was noted that when applications were submitted electronically, the cover pages showing the review and approvals were missing from the files.
- During our review of the resolutions by the Authority's Board to ensure that the financing was approved we noted the following:
 - A detailed summary of the project and results of the due diligence were provided to the Board for review.
 - The resolution from the Board approving the project and bond financing is maintained in the file and also in the Board minutes online in the Authority's website.

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- Our review of the ongoing monitoring requirements and process in place by CHFFA resulted in the following observations:
 - The borrowers are required to submit the following documents annually:
 - Annual audited financial statements
 - Debt service coverage ratio
 - Statement regarding the use of proceeds

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RECOMMENDATIONS

CURRENT YEAR RECOMMENDATIONS

- During the performance audit, we noticed that the borrowers are required to submit annual audited financial statements and a summary for potential use of the proceeds. However, we found that no actions are performed on the monitoring of financial performance after the bonds are issued or any follow up actions by the Authority to ensure those bond proceeds are used as planned. Regarding such, we have the following recommendations:
 - We recommend that the Authority perform and document its review and analysis of the borrower's annual audited financial statements received to ensure the borrower is a viable entity on a yearly basis. Such review could also include a checklist developed by the Authority to be completed by the borrower at the time it submits the annual financial information. The checklist will contain the key financial and operational information needed by the Authority and will help facilitate the Authority's review of the overall documentation received.
 - We also recommend that the Authority obtain a report from the borrower that is certified by the borrower's executive director or chief financial officer as to the use of the bond proceeds after the funds are expended and an explanation of any departure from the original plan submit with the application. Once those items are obtained, we recommend the Authority review such documents for any indication of potential noncompliance of usage of proceeds. If noncompliance is indicated, the Authority will take the proper course of action that is necessary in the specific circumstance.
 - We also recommend that the Authority review and update the outstanding bond balances on an ongoing basis, at least twice a year to ensure the outstanding bond balances on the Automated Bond System (bond tracking database system) are up-to-date.
- Based upon our review of the timing of the major activities from the receipt of the application through the bond issuance, we noted that the median number of days is approximately 65 days based on the files tested for the fiscal year. However, the median number of days to receive payment of the initial fee from the application date is approximately 88 days. Also, some initial fees are collected after bond issuance. Our

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recommendation is for the Authority to review the invoicing and collection procedures to improve the timing for collection of the initial fee and to collect the initial fee prior to bond issuance.

- We also recommend that the Authority review the average time that elapsed for the different stages of processing. Improved efficiencies may be gained by having a monitoring process that looks at how long the files are in process prior to board approval. It may help identify early on a file that may need additional resources to review.

PRIOR YEAR RECOMMENDATIONS

The June 30, 2010 performance audit was issued June 5, 2012 and therefore, the Authority has not had an opportunity to fully implement the recommendations based on the prior year's performance audit. Those recommendations are summarized below to serve as guidelines in assessing the status of their implementation.

Procedures and Documentation

- The checklist used during the file review was last updated in 2005 and there is only one checklist. The checklist is modified by lining out certain criteria and writing in the criteria being used. Currently there is not an audit trail to indicate why items are lined out and replaced with other items indicating that required documentation is excluded. It is recommended that a separate checklist be created for each type of funding so that the staff can choose the correct checklist. This would eliminate any possible errors and missing items and it would increase the efficiency of the staff as they would not have to determine what document may or may not be needed.

In addition, the Authority should develop a process for updating the checklists so that they are always the most current listing of information to analyze and include in the file. By reviewing the checklists on an annual basis and updating them as needed, it would help to ensure that as the processes and procedures are updated there is a mechanism to ensure compliance.

- The electronic application submissions do not consistently include a form of signature, either through the PDF of the application emailed to the Authority or the documentation maintained from the receipt of the email. The recommendation is that formal procedures are developed so that all of the documentation is obtained and included in the file.

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- The checklists also include a section for analyst and manager approval in the form of a signature on the cover page. Of the 21 files reviewed, 12 of the files were missing the checklist. The response received is that the files were submitted electronically and the paper files could not be found. A recommendation is to have a central location where files should be kept so that the proper trail of documentation is maintained throughout the bond analysis and approval process.
- During our discussions it was noted that during the year the processes included obtaining an independent analysis for approval of the application from a third party financial analysis. However, of the applications received after the policy was implemented, 4 of the files did not have an analysis performed and 2 additional files had a note that the independent analysis was obtained verbally. It is recommended that all support be in the form of written documentation and included in the file to support the decision.
- Of the 21 files reviewed it was noted that 3 of the files did not include supporting documentation that the initial fee was collected. It is recommended that this item be added to the checklist to ensure that documentation of revenue collection be included in the file.

Measurement

- There were no specific measurement tools and mechanism in place to gather data and assess the impacts of the Program with respect to the target participants (smaller networks versus larger networks) and the geography (rural versus urban areas).
- The Authority should assess the need to implement procedures and mechanism to gather data and assess the impact of the Program in the community and how the goals and expected outcomes of the Program are being achieved.

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MANAGEMENT RESPONSE TO THE PERFORMANCE AUDIT

For each recommendation included in the audit report, the following is our corrective action(s) taken or proposed. For recommendations where corrective action has not been taken or proposed, we have included the following explanations.

Recommendations:

1. Perform and document its review and analysis of the borrower's annual audited financial statements received to ensure the borrower is a viable entity on a yearly basis. Such review could also include a checklist developed by the Authority to be completed by the borrower at the time it submits the annual financial information. The checklist will contain the key financial and operational information needed by the Authority and will help facilitate the Authority's review of the overall documentation received.

Response: Agree. Management created a new Compliance Officer position to monitor the post issuance process which will include the review of annual audited financial statements and other key documentation. The Compliance Officer will also utilize EMMA and the internet to monitor any material events, rating changes, and continuing disclosure matters. We are in the process of interviewing candidates and hope to fill the position by the end of the year.

2. Obtain a report from the borrower that is certified by the borrower's executive director or chief financial officer as to the use of the bond proceeds after the funds are expended and an explanation of any departure from the original plan submit with the application. Once those items are obtained, we recommend the Authority review such documents for any indication of potential noncompliance of usage of proceeds. If noncompliance is indicated, the Authority will take the proper course of action that is necessary in the specific circumstance.

Response: Agree. The new Compliance Officer will review such documents on a regular basis for any indication of potential noncompliance use of proceeds.

3. Review and update the outstanding bond balances on an ongoing basis, at least twice a year to ensure the outstanding bond balances on the Automated Bond System (bond tracking database system) are up to- date.

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Response: Agree. We will review and update the outstanding bond balances twice a year.

4. Review the invoicing and collection procedures to improve the timing for collection of the initial fee and to collect the initial fee prior to bond issuance.

Response: Disagree. We cannot collect the initial fee prior to bond issuance. The initial fee is part of the cost of issuance fees that are paid at the time of bond closing. It depends on a number of factors on how long the process is from application date to bond closing. The factors may include legal issues, market conditions and ongoing negotiations on the terms of the transaction.

5. Review the average time that elapsed for the different stage of processing and consider improved efficiencies that may be gained by having a monitoring process that looks at how long the files are in process prior to board approval. It may help identify early on a file that may need additional resources to review.

Response: Disagree. While we work and will continue to work to ensure we do not contribute to delays in the application review process, the timing is largely out of our hands. The time between application date, board approval, and bond issuance varies and depends on a number of factors. There may be legal issues, ongoing negotiations on the terms of the transaction, and market conditions that require more time for review and analysis. The financing team mainly the borrower, bond counsel, and the underwriter are continuously working on these issues with the Authority before and after board approval.