

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

PERFORMANCE AUDIT

JUNE 30, 2010

California Health Facilities Financing Authority
Bond Financing Program Fund

PERFORMANCE AUDIT

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TRANSMITTAL REPORT

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, 2010. The scope of the audit focused on assessing the Authority's internal controls surrounding the Bond Financing Program Fund. Our report provides recommendations for improving efficiencies and effectiveness.

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



Sacramento, California
June 5, 2012

California Health Facilities Financing Authority
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AUDIT SCOPE AND OBJECTIVES

In August 2010, the Authority requested a performance audit of the Bond Financing Fund program over the internal controls in relation to the Program. The purpose of the performance audit is to provide the Authority recommendations in order to improve the operating effectiveness and efficiencies of the Program.

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 all of the bond files which closed during the period July 1, 2009 through June 30, 2010.

GENERAL BACKGROUND

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.

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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 bonds may be used by eligible borrowers 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 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, 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 notes 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.

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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 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, 2010, CHFFA served as the issuer for \$24.9 billion in conduit revenue bond of which \$9.5 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 6-30-2010	Percentage of total
Adventist Health System-West	\$ 819,500,000	3%	\$ 506,080,000	5%
Catholic Healthcare West	4,496,960,000	18%	1,922,825,000	20%
Cedars-Sinai Medical Center	1,879,330,000	8%	1,197,650,000	13%
Kaiser Permanente	2,193,545,000	9%	708,999,226	7%
Providence Health System	601,095,000	2%	436,195,000	5%
Scripps Health	1,259,775,000	5%	569,520,000	6%
St. Joseph Health System	765,575,000	3%	421,100,000	4%
Stanford Hospital and Clinics	1,526,225,000	6%	807,955,000	9%
Sutter Health	2,276,090,000	9%	1,468,560,000	15%
Sub-total for nine largest networks	15,818,095,000	64%	8,038,884,226	85%
Other	9,092,097,017	36%	1,459,968,722	15%
	<u>\$24,910,192,017</u>	<u>100%</u>	<u>\$ 9,498,852,948</u>	<u>100%</u>

The nine largest networks represent 64% of the total bonds issued since the inception of the Program and 85% of the outstanding debt as of June 30, 2010.

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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.

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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AUDIT STANDARDS AND METHODOLOGY

Audit Standards

We conducted the 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

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 relevant documents such as the checklists used by the Authority to process the applications and document the approval process in order to gain an understanding of the level of review performed by the Authority.

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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 files for all the bonds issued during the period July 1, 2009 through June 30, 2010. This consisted of 21 bond files. We performed detailed procedures on the 21 files for compliance with the policies and procedures of CHFFA.
- We reviewed the availability of the applications and the process an applicant follows to submit the application to CHFFA.
- We reviewed the fee schedule and process CHFFA utilizes for collecting the fees.
- We reviewed CHFFA's due diligence process and procedures.
- We reviewed the bond documents to ensure they contained information required by the regulations.
- 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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AUDIT RESULTS

- We conducted interviews of the staff working on the Program to gain an 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 the availability of the applications and the process an applicant follows to submit the application to CHFFA resulted in the following observations:
 - The applications and the application process are available on the internet and can be downloaded and printed. The Authority accepts both paper applications and electronic applications. Two copies of the application are required to be submitted. The electronic files are printed twice and distributed to the program manager, staff, Public Finance Division, Public Financial Management, Inc., Macias Gini & O'Connell, LLP, and Attorney General's Office. This process is helpful as the application can be reviewed for different aspects and is intended to increase the efficiency of the process.
 - The applications solicit the basic information needed and also provide a detailed listing of exhibits to be attached to the application, such items included in the listing of exhibits are as follows:
 - Most recent three years audited financial statements
 - Appendix A or Borrower's information from most recent official statement
 - Description of project to be financed at each facility
 - Details of the bond structure, credit enhancement, funding capitalized interest, reimbursement
 - Estimated sources and uses of the bond proceeds
 - Estimated amortization schedule
 - Distribution list for the financing team

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- Financing timeline
 - Expected ratings on bonds
 - Application Certification
 - California Environment Quality Act (CEQA) Review
 - Pass-through Savings Certification - this certification demonstrates compliance with the requirement that all health facilities obtaining tax-exempt bond financing will perform “significant community service” such as a written policy regarding providing charity care, soliciting input regarding the need for care from the community.
 - Legal Status Questionnaire
 - Religious Affiliation Due Diligence
 - Seismic Upgrades (applies to Acute Care Hospitals)
 - Community Service Obligation
- Our review of the fee schedule and process CHFFA utilizes for collecting the fees resulted in the following observations:
 - The fee schedule is easy to find on CHFFA’s website homepage and all of the fees are posted.
 - The nonrefundable application fees are to be sent in along with the application package. In the event that an application fee is not received the fee can be paid out of cost of issuance. Since not all applications are guaranteed to be approved, a recommendation is for the Authority to obtain the nonrefundable fee prior to reviewing the application in an effort to ensure that all nonrefundable fees are received.

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- Our review of CHFFA's due diligence process and procedures resulted in the following observations:
 - The Authority uses two checklists in order 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 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 application received and compared it to the date the bond was issued. We noted that the time to process the application from receipt to issuances is approximately 60-90 days. In addition, we noted that if the application was received electronically the paper file including the stamped application was unable to be located.
- During our review of the bond documents to ensure they contained information required by the regulations, we found that the files are complete and contain the appropriate information.
- 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 the application includes all of the supporting documentation and 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 file.

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- 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.
- 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
 - Certificate of Compliance

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RECOMMENDATIONS

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.
- 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.

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- 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 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.

Audit Recommendations:

1. Create a checklist for each type of funding so that staff can choose the correct checklist
2. Establish a process for updating the checklist so that staff can use the most current listing of information to analyze and include in the file.
3. Develop formal procedures so that all documentation is obtained and included in the file.
4. Create a central location where files should be kept so that the proper trail of documents is maintained throughout the bond analysis and approval process.
5. Clarify the policy as to what documentation should be included in the file to support the decision to not receive a formal written analysis if the Authority wishes to maintain this requirement.
6. Add to the checklist that the initial fee was collected.
7. Create measurements to gather data and assess the impacts of the program with respect to target participants.
8. Implement procedures and mechanisms to gather data and assess the impact of the program in the comments and how the goals and expected outcomes of the programs are being achieved.

Implementation Plan of Actions:

- Staff is in the midst of revising a 2000 bond manual to assist staff in processing bond transactions. The current bond manual includes current checklists, but these checklists will be updated right along with the revision to the 2000 manual. Management will ensure the bond manual includes items #1, 2, 3, 5 and 6 outlined above.

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- For item #4 listed above, each analyst is assigned to a bond transaction and is responsible for the maintenance of the file which includes ensuring all of the proper documentation, such as the staff report, the quick ratio analysis, the independent audit report and correspondence, is included in the file. Since the analyst works on the bond transaction daily, it would be unproductive to move the files to a central location. In addition, there is limited amount of office space to create a central location to maintain the files during the review, approval and closing process. After the bond transaction closes, the analyst closes out the file and the file is maintained in a central location.

A bond manual is currently being updated and management plans to have it updated annually. The bond manual provides the analyst a step by step process on how to analyze an application and to how to close a bond transaction. There is a checklist for every bond transaction that must be completed by the analyst and reviewed by management. The checklist is placed in the completed file.

In addition, management intends to provide continuous training to staff which includes formal classroom training on various aspects of a bond transaction to informal training such as “open forums” which are bi-weekly open discussions with staff on alternating subject matters such as closing procedures and quick ratio analysis.

- Items #7 and #8 refer to ways to gather data and assess the impact of the program. As a conduit issuer, CHFFA has little control over who chooses to do business with the Authority as it is typically the bankers and the bond counsel who recommend the conduit to use for a particular bond transaction. However, the Authority has a database which collects information regarding the bond transaction including the financing team, the bond amount and the bond structure. Management is assessing the current database to determine what additional information can be accessed or added. Additional data that may be collected include counties, facility types, savings on refunding and whether the projects are in urban or rural areas.