



Children's Hospital Program

The California Health Facilities Financing Authority
Has Generally Complied With Laws and Regulations
and Resolved Its Issue Related to High Fund Balances

Report 2015-042

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September 15, 2015

2015-042

The Governor of California
President pro Tempore of the Senate
Speaker of the Assembly
State Capitol
Sacramento, California 95814

Dear Governor and Legislative Leaders:

As authorized by California Health and Safety Code, sections 1179.25 and 1179.58, the California State Auditor presents this audit report concerning the Children's Hospital Program (program).

This report concludes that the California Health Facilities Financing Authority (authority), which administers the program, has awarded and disbursed most of the bond proceeds from the Children's Hospital Bond Acts of 2004 (2004 act) and 2008. The authority's activities related to awarding grants generally complied with laws and regulations. Further, the authority has a process for monitoring grants and has made payments to grantees in accordance with the law. Additionally, the authority established a process to ensure that its requests for, and the subsequent sale of, general obligation bonds to finance the program are reasonable and appropriate, resolving the high fund balance issue discussed in our previous report.

On the other hand, the authority adopted amendments to its program regulations that directly conflict with provisions in the act. The 2004 act gives each grantee hospital until June 30, 2014, to apply for funds until the hospital reaches its grant limitation. After this date, if funds remain, the 2004 act allows any of the eligible hospitals to apply for them and the authority is required to make the remaining funds available for this purpose. In May 2014 the authority adopted amendments to the program regulations to extend the application deadline to June 30, 2018. However, the amended regulations prohibit eligible hospitals that already received awards up to the grant limit from submitting any applications for additional funding until July 1, 2018. As a result, the authority's amendments to the program regulations effectively reserve \$67.9 million in remaining 2004 act funds for Loma Linda—the only hospital awaiting a 2004 act award as of June 30, 2014.

Respectfully submitted,



ELAINE M. HOWLE, CPA
State Auditor

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Summary

Results in Brief

In accordance with the Children's Hospital Bond Acts of 2004 (2004 act) and 2008 (2008 act), the California Health Facilities Financing Authority (authority) administers the Children's Hospital Program (program), which provides grants for eligible hospitals to construct or improve children's facilities. As of February 2015 the authority had awarded and disbursed most of the 2004 and 2008 acts' bond proceeds. Of the \$750 million authorized by the 2004 act, the authority had awarded \$674.1 million in program grants and disbursed approximately \$672.8 million to grantees. Of the \$980 million authorized by the 2008 act, the authority had awarded \$675.6 million and disbursed \$607.1 million to grantees. The 2004 act gave each grantee hospital until June 30, 2014, to apply for funds until it reached a grant award limit. After this date, however, the 2004 act allows any of the eligible hospitals to apply for the remaining funds. In May 2014 the authority adopted amendments to program regulations to extend the application deadline to June 30, 2018—four years later than specified in the 2004 act. By adopting these amendments, the authority effectively set aside \$67.9 million of funds not awarded as of June 30, 2014, for grants to Loma Linda University Children's Hospital and prevented other eligible hospitals from applying for these funds.

The authority's activities related to awarding grants generally complied with laws and regulations. Further, the authority has a process for monitoring grants and has made payments to grantees in accordance with the law. Finally, the authority established a process to ensure that its requests for, and the subsequent sale of, general obligation bonds to finance the program are reasonable and appropriate, resolving the high fund balance issue discussed in our July 2012 report titled *Children's Hospital Program: Fund Disbursements Are Appropriate, but Estimates of Cash Needs Have Been Consistently High* (Report 2012-042). The authority's cash balance for the program as of February 28, 2015, was \$36.3 million, down from \$355 million in January 2012.

Recommendation

The authority should amend its regulations so that they comply with the 2004 act, thus allowing any eligible hospital to apply for funds related to the 2004 act that remained as of June 30, 2014.

Audit Highlights . . .

Our audit of the Children's Hospital Program (program) highlighted the following:

- » *The California Health Facilities Financing Authority (authority) had awarded and disbursed most of the proceeds from the Children's Hospital Bond Acts of 2004 (2004 act) and 2008 as of February 2015.*
- » *Contrary to the 2004 act, the authority amended regulations to extend the grants application deadline to June 30, 2018—effectively setting aside \$67.9 million for grants to a single hospital.*
- » *The authority's activities related to awarding grants generally complied with laws and regulations.*

Agency Comments

The authority disagrees with our recommendation and stated that it will not implement it.

Introduction

Background

In November 2004 California voters approved Proposition 61, the Children’s Hospital Bond Act of 2004 (2004 act), establishing the Children’s Hospital Program (program) and authorizing the State to sell \$750 million in general obligation bonds to fund the program. In November 2008 California voters approved Proposition 3, the Children’s Hospital Bond Act of 2008 (2008 act), which authorized an additional \$980 million in general obligation bonds for the program. The purpose of the program is to improve the health and welfare of California’s critically ill children by providing funds for capital improvement projects for qualifying children’s hospitals. (See the text box for hospitals’ eligibility requirements.) Eligible projects include those to construct, expand, improve, or finance children’s hospitals, including their furnishings and equipment.

Under both the 2004 and 2008 acts, two groups of general acute care hospitals are eligible for the program: five enumerated University of California (UC) hospitals and eight non-UC hospitals that the California Health Facilities Financing Authority (authority) identified by applying the acts’ eligibility criteria. Of the total funds available under both acts, 20 percent is earmarked for grants to the five UC hospitals. Each of these hospitals may receive more than one grant, but the total for all grants awarded to each UC hospital is limited to \$30 million for the 2004 act and \$39.2 million for the 2008 act, for a total of \$69.2 million per UC hospital. The remaining 80 percent of the total bond funds is earmarked for the eight other hospitals that are eligible for the program based on the eligibility requirements in the 2004 and 2008 acts. These hospitals may also receive more than one grant, but the total for all grants awarded to each hospital is limited to \$74 million for the 2004 act and \$98 million for the 2008 act, for a total of \$172 million per hospital. The 2004 act allowed each grantee hospital to apply for funds up to the grant award limit by June 30, 2014. The 2008 act has a similar provision, but its cutoff date for applying for earmarked funds is June 30, 2018.

The 2004 and 2008 acts authorize the authority to award grants for the purpose of funding eligible projects. Established in 1979, the authority administers the State’s programs to provide loans

Specific Hospital Eligibility Requirements for Grants Under the Children’s Hospital Program

A general acute care hospital is eligible for program grants if it is, or is an operating entity of, a California nonprofit corporation established before January 1, 2003, and if it demonstrates the following:

- A mission of clinical care, teaching, research, and advocacy that focuses on children.
- Comprehensive pediatric services to a high volume of children eligible for government programs and with special health care needs eligible for the California Children’s Services program—a combined federal-, state-, and county-funded program to treat children with certain chronic medical conditions.
- Evidence of the following, based on information hospitals reported to the Office of Statewide Health Planning and Development on or before July 1, 2003, for their fiscal year ending between June 30, 2001, and June 29, 2002:
 - At least 160 licensed beds for pediatric acute care, pediatric intensive care, and neonatal intensive care.
 - More than 30,000 total pediatric patient days, excluding nursery acute days.
 - Medical education of staff to include at least eight full-time equivalent pediatric or pediatric subspecialty residents.

Sources: [The California Health and Safety Code and the California Department of Health Care Services.](#)

and grants, funded through the issuance of tax-exempt bonds, to public and nonprofit health care providers. The authority employs a process to review applications for grants, evaluate proposed projects, and make recommendations to its governing board for approval or rejection of grant applications.

In addition to the program requirements contained in the 2004 and 2008 acts, regulations also govern the program. These regulations include more specific requirements related to eligibility, applying for funding, and closing out grants. To carry out program activities, the authority uses commercial paper—short-term unsecured promissory notes—to meet its short-term cash needs, and the Public Finance Division of the State Treasurer’s Office issues bonds when market conditions are favorable.

Scope and Methodology

The 2004 and 2008 acts state that the California State Auditor (state auditor) may conduct periodic audits to ensure that bond proceeds are awarded in a timely fashion and in a manner consistent with the requirements of the acts. These periodic audits also make certain that grantees of bond proceeds are using funds in compliance with applicable provisions. The state auditor previously conducted two reviews of the program and issued related audit reports in May 2009 and July 2012. This current review constitutes our third review of the program. Table 1 summarizes the audit objectives and the methods used to address the requirements of the 2004 and 2008 acts.

Table 1
Audit Objectives and the Methods Used to Address Them

AUDIT OBJECTIVE	METHOD
1 Review and evaluate the laws, regulations, and rules significant to the audit objectives.	<ul style="list-style-type: none"> • Reviewed the laws and regulations relevant to the Children’s Hospital Program (program). • Interviewed key management and staff of the California Health Facilities Financing Authority (authority).
2 Determine the current status of the program and any other relevant information on the program.	<ul style="list-style-type: none"> • Interviewed authority management. • Obtained and reviewed the authority’s master grant and disbursement spreadsheets for the Children’s Hospital Bond Acts of 2004 and 2008. • Determined the total number of grant applications submitted since our last review in January 2012 through February 28, 2015. • Reviewed minutes of the authority’s board meetings for evidence of approvals of grant applications. • Determined the total number of grants awarded and the total amounts awarded and disbursed as of February 28, 2015.

AUDIT OBJECTIVE	METHOD
<p>3 Determine whether the authority awards bond proceeds in a manner consistent with applicable laws and regulations.</p>	<ul style="list-style-type: none"> • Interviewed the authority's key management and reviewed relevant documents to identify and assess the controls for awarding bond proceeds. • For a selection of five grant applications, we did the following: <ul style="list-style-type: none"> – Determined whether the hospitals applying for grants were eligible to receive bond funds. – Determined whether the authority processed the applications within 60 days. – Determined whether the authority addressed the eligibility requirements when processing the applications by tracing items from the completed checklists to the applications and supporting documentation. – Determined whether the information in the staff reports regarding project evaluations presented to the authority's board was consistent with the information in the applications. – Determined whether the authority's board approved the grants and created grant agreements that contain elements required by regulation.
<p>4 Determine whether disbursements for program projects agree with the approved grant.</p>	<ul style="list-style-type: none"> • Interviewed the authority's key management to obtain an understanding of the disbursement process and the process that the authority uses to ensure adherence to the funding thresholds of the acts. • Calculated the total disbursement for 10 selected grants to ensure that the amounts disbursed did not exceed the maximum allowable for the hospitals. • Selected a disbursement from each of the 10 selected grants. For nine of these grants, we reviewed the largest two invoices along with their related grant agreements and contracts. For the tenth grant, we reviewed the sole invoice for the entire project plus the related grant agreement and contract. • From the 10 grants selected for disbursement testing, identified and selected hospitals with equipment disbursements for site visits. • Performed site visits at four hospitals to determine whether equipment purchased with program funds exists and was put to its intended use, as stipulated in the statutes and award agreements.
<p>5 Determine the effectiveness of the monitoring and closeout procedures for grants.</p>	<ul style="list-style-type: none"> • Interviewed the authority's key management and obtained supporting documentation to gain an understanding of the monitoring and closeout procedures for grants. • For a selection of four projects completed since our last review, we did the following: <ul style="list-style-type: none"> – Reviewed dates of grant disbursements for evidence that the projects finished on schedule. – Determined whether the authority received certifications from hospitals that the projects had been completed. – Determined whether the authority took appropriate action when projects did not finish on schedule. – Determined whether hospitals' requests for funds included offsets for investment earnings on advance payments, if any.
<p>6 Determine whether the authority maintains a reasonable and appropriate fund balance to pay for project disbursements.</p>	<ul style="list-style-type: none"> • Interviewed the authority's key management and obtained relevant documentation to gain an understanding of the authority's process for estimating cash needs. • Verified the authority's fund balance as of February 28, 2015.

Source: California State Auditor's analysis of information and documentation identified in the table column titled *Method*.

Assessment of Data Reliability

In performing this audit, we relied on electronic data files extracted from the information systems listed in Table 2 on the following page. The U.S. Government Accountability Office, whose standards we are statutorily required to follow, requires us to assess the sufficiency and appropriateness of computer-processed information that we use to support our findings, conclusions, or

recommendations. Table 2 describes the analyses we conducted using data from these information systems, our methodology for testing them, and the conclusions we reached as to the reliability of the data.

Table 2
Methods Used to Assess Data Reliability

INFORMATION SYSTEM	PURPOSE	METHOD AND RESULT	CONCLUSION
California Health Facilities Financing Authority (authority) Master grant and disbursement spreadsheets for the Children's Hospital Bond Acts of 2004 and 2008 Authority's spreadsheets containing all grant awards and disbursements it has made as of February 28, 2015, under each bond act	To identify the grant awards and disbursements the authority has made as of February 28, 2015.	<ul style="list-style-type: none"> • To test the accuracy of the authority's grant award and disbursement data, we traced key data elements for a selection of 29 grant awards and disbursements to supporting documentation and found no errors. • To test the completeness of the disbursement data, we traced 29 haphazardly selected disbursement request forms to the disbursement data and found no errors. 	Sufficiently reliable for the purposes of this audit.

Source: California State Auditor's analysis of various documents, interviews, and data obtained from the authority.

Audit Results

The California Health Facilities Financing Authority Has Awarded and Disbursed Most of the Hospital Bond Funds

The California Health Facilities Financing Authority (authority) has awarded 78 percent and disbursed 74 percent of the bond proceeds authorized by the Children's Hospital Bond Acts of 2004 (2004 act) and 2008 (2008 act). As of February 2015, in the three-year period since our last review, the authority has awarded \$346 million in 17 new grants and made 37 disbursements amounting to \$395 million for 20 grants. Since the inception of the Children's Hospital Program (program), the number of grants awarded totals 55, consisting of 32 grants funded by the 2004 act and 23 funded by the 2008 act.

As of February 28, 2015, the authority had awarded \$674.1 million in program grants from the \$750 million authorized by the 2004 act, including \$1.3 million for administrative and bond issuance costs, and the authority had disbursed \$672.8 million to grantees. In addition, the authority had awarded \$675.6 million of the \$980 million authorized by the 2008 act, including \$3.5 million for administrative and bond issuance costs, and it had disbursed \$607.1 million to grantees. Table 3 on the following page depicts the total awards, disbursements to grantees, and administrative and issuance costs under the 2004 and 2008 acts as of February 28, 2015, by grantee.

As Table 3 shows, two University of California (UC) hospitals and three non-UC hospitals have received the maximum funding available to them under the 2004 and 2008 acts for various projects. Projects completed at these hospitals include construction and renovation of medical facilities as well as the purchase of medical equipment. For example, the Lucile Packard Children's Hospital Stanford used one of its grants to fund construction of a 20-bed cardiovascular pediatric intensive care unit and a surgical suite. The hospital also purchased equipment, such as digital X-ray systems and an ultrasound machine, with grant funds. In another instance, a grant awarded to UC San Francisco Children's Hospital contributed to the construction of a children's hospital building that houses 183 pediatrics beds and a pediatric emergency department.

The University Children's Hospital at UC Irvine (UC Irvine) has yet to receive any of the \$39.2 million in funding available to it under the 2008 act. According to the authority's program manager, UC Irvine submitted an application in January 2015 but subsequently withdrew it. As of August 2015, according to the authority's operations manager, UC Irvine had not yet submitted another application.

Table 3
Total Awards, Disbursements, and Administrative and Issuance Costs for the Children's Hospital Bond Acts
of 2004 and 2008 as of February 2015
(In Millions)

GRANTEE HOSPITAL	MAXIMUM FUNDING AVAILABLE*	BOND ACTIVITY		FUNDS AWAITING AWARD OR DISBURSEMENT	
		AMOUNT AWARDED	ADMINISTRATIVE AND BOND ISSUANCE COSTS†		AMOUNT DISBURSED
CHILDREN'S HOSPITAL BOND ACT OF 2004					
University of California Hospitals Specifically Identified as Eligible for Funds					
University of California, Davis, Children's Hospital	\$30.00	\$30.00	\$ 0.17	\$29.83	-
University Children's Hospital at University of California, Irvine	30.00	30.00	0.17	29.83	-
Mattel Children's Hospital at University of California, Los Angeles	30.00	30.00	0.17	29.83	-
University of California, San Diego, Children's Hospital	30.00	30.00	0.17	29.83	-
University of California, San Francisco, Children's Hospital	30.00	30.00	0.17	29.83	-
Hospitals Eligible for Funds Under Specific Requirements of the Children's Hospital Bond Act of 2004					
Children's Hospital and Research Center Oakland	\$74.00	\$74.00	\$0.06	\$73.94	-
Children's Hospital Central California	74.00	74.00	0.06	73.94	-
Children's Hospital Los Angeles	74.00	74.00	0.06	73.94	-
Children's Hospital of Orange County	74.00	74.00	0.06	73.94	-
Loma Linda University Children's Hospital‡	74.00	6.10	0.01	6.09	\$67.90
Lucile Packard Children's Hospital Stanford	74.00	74.00	0.06	73.94	-
Miller Children's Hospital (Long Beach Memorial)	74.00	74.00	0.06	73.94	-
Rady Children's Hospital—San Diego	74.00	74.00	0.06	73.94	-
Totals	\$742.00	\$674.10	\$1.28	\$672.82	\$67.90
CHILDREN'S HOSPITAL BOND ACT OF 2008					
University of California Hospitals Specifically Identified as Eligible for Funds					
University of California, Davis, Children's Hospital	\$39.20	\$18.81	\$0.11	\$18.70	\$20.39
University Children's Hospital at University of California, Irvine	39.20	-	-	-	39.20
Mattel Children's Hospital at University of California, Los Angeles	39.20	25.00	0.14	24.86	14.20
University of California, San Diego, Children's Hospital	39.20	39.20	0.23	38.97	-
University of California, San Francisco, Children's Hospital	39.20	39.20	0.23	38.97	-
Hospitals Eligible for Funds Under Specific Requirements of the Children's Hospital Bond Act of 2008					
Children's Hospital and Research Center Oakland	\$98.00	\$94.69	\$0.54	\$94.03	\$3.43
Children's Hospital Central California	98.00	32.79	0.19	32.60	65.21
Children's Hospital Los Angeles	98.00	98.00	0.56	97.44	-
Children's Hospital of Orange County	98.00	98.00	0.56	97.44	-
Loma Linda University Children's Hospital	98.00	-	-	-	98.00
Lucile Packard Children's Hospital Stanford	98.00	98.00	0.56	97.44	-
Miller Children's Hospital (Long Beach Memorial)	98.00	42.61	0.08	13.06	84.86
Rady Children's Hospital—San Diego	98.00	89.33	0.31	53.60	44.09
Totals	\$980.00	\$675.63	\$3.51	\$607.11	\$369.38

Sources: California Health and Safety Code and the California Health Facilities Financing Authority (authority).

* Under the Children's Hospital Bond Act of 2004 (2004 act), 80 percent of the \$750 million in authorized bond proceeds was allocated to eligible nonprofit private hospitals. However, the act limits each of these hospitals to \$74 million in grants, leaving \$8 million in funds that are not earmarked for any hospital. According to the program manager for the authority, it deducted administrative costs for the eligible nonprofit private hospitals from this \$8 million and will make the remaining balance available to all of the eligible nonprofit private hospitals for further grants after June 30, 2018.

† For the 2004 act, the authority elected to withhold only bond issuance costs from grant awards to eligible nonprofit private hospitals. For the Children's Hospital Bond Act of 2008, the authority withheld both administrative and bond issuance fees from grant awards to these hospitals.

‡ On pages 9 and 10 of this report, we discuss 2004 act funds awaiting award or disbursement to Loma Linda University Children's Hospital.

Recent Regulations Affecting the Grant Application Process Conflict With the 2004 Act

Like UC Irvine, Loma Linda University Children's Hospital (Loma Linda) has been slow to apply for funds, leading the authority to amend program regulations in a way that conflicts with the 2004 act. Loma Linda has not received most of the \$74 million in funding that was available to it from the 2004 act. As Table 3 indicates, Loma Linda has received a combined total of only about \$6.1 million. This funding related to two separate grants for equipment that were awarded in 2009 and 2010. The authority found issues with Loma Linda's subsequent draft applications for grants; therefore, as of July 2015, the authority had not approved any additional grants for Loma Linda.

As noted in the Introduction, the 2004 act gives every eligible hospital approximately 10 years to apply for funds up to the applicable grant award limit, until June 30, 2014. Once a hospital reaches the limit during this period, it may not apply for further funding and the authority may not award it additional grants. After this period ends, however, the grant award limits lift. If funds remain after June 30, 2014, any eligible hospital may then apply for them and the authority is required to make the remaining funds available for this purpose.

In May 2014, however, to address Loma Linda's situation, the authority adopted amendments to its program regulations that directly conflict with these provisions of the act. The authority amended the regulations so eligible hospitals that had not received the maximum allowable funds by June 30, 2014, would get an additional four years to apply for grant funds up to a limit of \$74 million. However, an eligible hospital that already received awards up to the grant limit continues to be prohibited from submitting any applications for the entire period. The next opportunity for it to apply, assuming funds remain, will not be until July 1, 2018—four years later than specified in the 2004 act. The result of the authority's amendments to the program regulations was that it effectively reserved \$67.9 million in remaining 2004 act funds for Loma Linda—the only hospital awaiting a 2004 act award as of June 30, 2014.

According to the authority's counsel, the amended regulations fulfill the act's purposes and fairly award funds to any hospital that has not yet been able to receive its share of funds by June 30, 2014. Moreover, the authority's counsel asserts that the state's Office of Administrative Law approved the regulations, and no public comments or objections were made. Further, its counsel emphasized that the proposed amendments were supported by the California Children's Hospital Association, which represents

The authority's amendments to the program regulations effectively reserved \$67.9 million in remaining 2004 act funds for Loma Linda—the only hospital awaiting a 2004 act award as of June 30, 2014.

By adopting regulations that prohibit eligible hospitals from applying for the funds that currently remain after June 30, 2014, the authority's regulations are in conflict with the 2004 act.

the eight eligible hospitals. According to the authority's operations manager, Loma Linda submitted in August 2015 an application for a project that will use up the remaining 2004 act funds as well as its earmarked funds related to the 2008 act, totaling \$166 million.

Despite the authority's assertions, while the authority may adopt regulations to carry out the provisions of the voter-approved 2004 act, it is not empowered to adopt regulations that conflict with it. By adopting regulations that prohibit eligible hospitals from applying for the funds that currently remain after June 30, 2014, as authorized by the 2004 act, the authority's regulations are in conflict with the 2004 act. For this reason, if challenged, the regulations would likely be deemed null and void by a court.

The Authority Consistently Applied Grant Award Procedures Covering All Eligibility Requirements, and It Disbursed Funds According to Law

The evaluation process for project applications established and carried out by the authority is sufficient to properly award grants to eligible hospitals. The authority uses grant award checklists to evaluate applications by hospitals, ensuring that the applications are complete and that the projects meet the eligibility requirements of the program. Our review of five grant applications showed that the authority properly evaluated the applications and awarded the grants. The projects described in the applications we reviewed met the requirements established in regulation, and the application files for these grants contained adequate documentation, such as completed checklists and approvals. The authority processed these applications within the 60-day time frame, as required by regulation.

The authority also followed its procedures to ensure that it disbursed bond proceeds in accordance with the requirements stipulated in the 2004 and 2008 acts and the grant agreements. It uses grant disbursement checklists to ensure adherence to regulations for the release of funds. To ensure that it pays only for eligible costs, the authority reviews invoices and other support that hospitals submit to document project expenditures associated with each disbursement request. Our review of 10 disbursement transactions showed that the authority properly evaluated and processed these disbursement requests. Our review of 19 invoices related to these disbursements found that payments were for allowable costs, as specified in regulation.

Finally, the authority adequately monitored projects to ensure their timely completion. The authority monitors progress toward grant completion during the disbursement process and obtains documentation supporting project closure. Our review

of four grants found that the related projects were completed in a timely manner. Documentary evidence—such as closing checklists and certificates of occupancy—also demonstrated project completion.

Grantee hospitals we visited used bond proceeds in a manner that is consistent with statutes. We conducted site visits at four grantee hospitals and found appropriate uses of program funds for capital improvement projects that benefit the health and welfare of California’s critically ill children. The University of California, Davis, Children’s Hospital used grant money to fund the children’s portion of its expanded Comprehensive Cancer Center, including five examination rooms and 13 infusion chairs for chemotherapy treatment of its pediatric cancer patients. The Children’s Hospital and Research Center Oakland and Rady Children’s Hospital—San Diego used grants to acquire and install electronic medical records systems that integrate and centralize patients’ medical records to allow timely coordination between care providers for effective patient care. Children’s Hospital Central California and Children’s Hospital and Research Center Oakland renovated their facilities and purchased patient care equipment for detecting and treating acute diseases, including a computerized tomography (CT) scanner, bacteria analyzer, patient monitors, echocardiograph machines, and a neuro-microscope. Figures 1 through 3 depict examples of a project and equipment items funded by the program.

Figure 1
Expansion Project at University of California, Davis, Children’s Hospital



Source: Photo provided by UC Davis Health System.

Figure 2
Computerized Tomography (CT) Scanner at Children's Hospital Central California



Source: Photo provided by the California State Auditor.

Figure 3
Echocardiograph Machine at Children's Hospital and Research Center Oakland



Source: Photo provided by the California State Auditor.

The Authority Has Resolved Its Issue Related to High Fund Balances

In our July 2012 audit, we reported excessive fund balances as an issue and found that the authority's estimates of cash needs had far exceeded actual disbursements, resulting in a fund balance of \$355 million as of January 2012. This pattern, as well as some hospital project delays that it could have anticipated, indicated that the authority needed to revise its process for projecting its cash needs. We recommended that the authority limit future bond sales to the level of disbursements that it reasonably expected to make during the following six-month period. We also recommended that the authority reduce its fund balance by continuing to make disbursements to hospitals while refraining from requesting additional bond sales.

Our current review found that the authority has revised its process for forecasting cash needs to ensure a reasonable fund balance. The authority now obtains from each hospital quarterly fund disbursement estimates for a 15-month period. Using these quarterly estimates, the authority prepares a cash needs estimate for the upcoming six-month period, and twice a year submits that estimate to the California Department of Finance (Finance) for approval. Upon approval by Finance, the Public Finance Division of the California State Treasurer's Office raises the cash necessary for the program's short-term needs either through bond issuances or through use of the State's general obligation commercial paper program. Under the commercial paper program, the authority can use proceeds from the issuance of short-term unsecured promissory notes, known as commercial paper, for up to 270 days. The commercial paper is subsequently retired with proceeds from the issuance of general obligation bonds. As a result of this process, the authority's fund balance declined from \$355 million as of January 2012 to approximately \$36.3 million as of February 28, 2015, and now appears reasonable for the program.

Recommendation

The authority should amend its regulations to bring them into accord with the 2004 act, thus allowing any eligible hospital to apply for the 2004 act's funds that remained as of June 30, 2014.

We conducted this audit under the authority vested in the California State Auditor by Section 8543 et seq. of the California Government Code and according to generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives specified in the Scope and Methodology section of the report. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Respectfully submitted,



ELAINE M. HOWLE, CPA
State Auditor

Date: September 15, 2015

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August 31, 2015

Ms. Elaine M. Howle, State Auditor*
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RE: California Health Facilities Financing Authority (Authority)
Response to California State Audit Report No.: 2015-042
Children's Hospital Bond Act

Dear Ms. Howle:

Thank you for the opportunity to review and respond to the draft copy of your report on the Children's Hospital Programs as created by Propositions 61 and 3 in 2004 and 2008, respectively. We appreciate all the time, effort and good communication invested by your audit team over these past several months.

The purpose of the Children's Hospital Program is to improve the health and welfare of California's critically ill children, by providing a stable and ready source of funds for capital improvement projects for children's hospitals. The Authority will continue to implement this purpose and therefore, does not intend to amend its regulations. Please reference our attached legal analysis of your audit recommendation.

Please contact me anytime to further explore or discuss our comments.

Sincerely,

DIANE STANTON
Executive Director

Enclosures

* California State Auditor's comment appears on page 17.

Response to California State Audit Report No.: 2015-042
August 31, 2015

Recommendation

The Authority should amend its regulations to bring them into accord with the 2004 act, thus allowing any eligible hospital to apply for funds related to the 2004 act that remained as of June 30, 2014.

Authority Response:

The purpose of the Children's Hospital Bond Act of 2004 (the "Act") is to "improve the health and welfare of California's critically ill children, by providing a stable and ready source of funds for capital improvement projects for children's hospitals." (Health & Saf. Code, § 1179.21.) Essentially, the Act is designed to provide funding for all eligible children's hospitals. In interpreting a statute, the courts will construe the statutory language "in the context of the statute as a whole and the overall statutory scheme [in light of the electorate's intent]." (*California Chamber of Commerce v. Brown* (2011) 196 Cal.App.4th 233, 248 (brackets in original), citing *Horwich v. Superior Court* (1999) 21 Cal.4th 272, 276.)

① The purpose of Health and Safety Code section 1179.24, subdivisions (c) and (d), is to address the award of any remaining funds after all of the eligible children's hospitals have received their requested funds, or the event in which any of the children's hospitals did not receive its allocation. Not all of the eligible children's hospitals have been able to receive their allocated grant. Therefore, to meet the purpose of subdivisions (c) and (d) and the purpose of the Act as a whole (funding for all eligible children's hospitals), the Authority adopted regulations to fairly award funds to any children's hospital that had not yet been able to receive its share of the funds by June 30, 2014. (Cal. Code Regs., tit. 4, §§ 7030, subd. (gg), 7032) The regulations establish a criteria for grant awards after that date. This grant award method gives the first opportunity to any children's hospital that has not received its allocated funds. The phrase "[n]otwithstanding this grant limitation" in subdivisions (c) and (d) is interpreted to mean that the Authority is not *required* to take into consideration the maximum amounts when awarding the remaining funds to "any children's hospital". (Health & Saf. Code, § 1179.24, subds. (c) and (d).) Pursuant to Health and Safety Code section 1179.22, "[t]he Authority is authorized to award grants to any children's hospital for purposes of funding projects, as defined in subdivision (g) of Section 1179.11." The Authority is given this broad authority to administer the program under the Act. Courts will show deference and give considerable weight to a state agency's construction of a statute. (*Sara M. v. Superior Court* (2005) 36 Cal.4th 998, 1011.)

As defined in Government Code section 11342.600, the Authority's regulations "implement, interpret, or make specific the law enforced or administered by it, or ... govern its procedure." The Authority complied with the Administrative Procedure Act and the amended regulations were approved by the Office of Administrative Law. There were no public comments or objections to the amended regulations, and the California Children's Hospital Association expressed support for the amendment to the regulations and the Authority's method of allocating the remaining funds.

① The Authority will continue to implement the purpose of the Act and therefore does not intend to amend its regulations.

Comment

CALIFORNIA STATE AUDITOR'S COMMENT ON THE RESPONSE FROM THE CALIFORNIA HEALTH FACILITIES FINANCING AUTHORITY

To provide clarity and perspective, we are commenting on the response to our audit from the California Health Facilities Financing Authority (authority). The number below corresponds to the number we have placed in the margin of the authority's response.

As we stated on pages 9 and 10 of our report, we believe that the amended regulations adopted by the authority, effective May 19, 2014, are in conflict with the Children's Hospital Bond Act of 2004 (2004 act) that governs the disposition of these funds. We disagree with the authority's position and believe it is not consistent with the act's requirement that any eligible hospital may apply for the remaining funds. Further, we believe that if the amended regulations were to be challenged, a reviewing court would find them invalid.

①