



## Children's Hospital Program:

Procedures for Awarding Grants Are Adequate, but Some Improvement Is Needed in Managing Grants and Complying With the Governor's Bond Accountability Program

May 2009 Report 2009-042



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May 21, 2009

2009-042

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 the California Health and Safety Code, Section 1179.25, the Bureau of State Audits presents its audit report concerning the first audit in a series on the Children's Hospital Program (program).

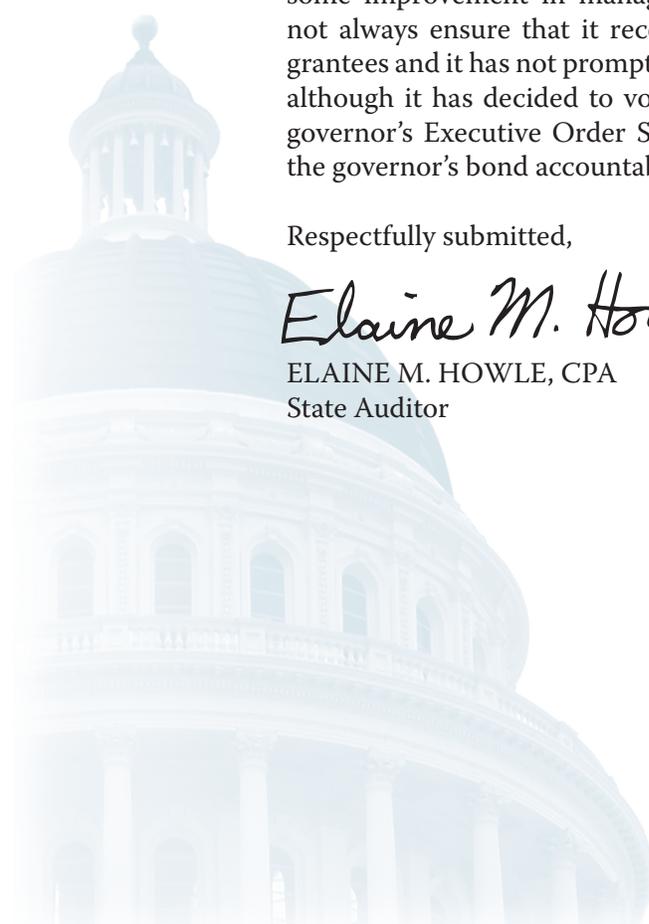
This report concludes that although eligibility requirements for the Children's Hospital Bond Act of 2004 restrict funds to a few hospitals, the California Health Facilities Financing Authority's (authority) efforts to award grants appear adequate. The authority, however, needs some improvement in managing grants of program funds. Specifically, the authority does not always ensure that it receives interest earned on advances of program funds to certain grantees and it has not promptly and effectively closed out grants for completed projects. Lastly, although it has decided to voluntarily comply with the bond accountability standards in the governor's Executive Order S-02-07, the authority is uncertain of its timeline to implement the governor's bond accountability program.

Respectfully submitted,



*Elaine M. Howle*

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State Auditor



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## Summary

### Results in Brief

The Children's Hospital Bond Act of 2004 (2004 act) established the Children's Hospital Program (program) and authorized the State to sell \$750 million in general obligation bonds to fund it. The purpose of the program is to improve the health and welfare of California's critically ill children by funding capital improvement projects for qualifying children's hospitals. Eligible projects include those to construct, expand, improve, or finance children's hospitals, including their furnishings or equipment. Because of the act's restrictive requirements, only 13 hospitals are eligible for the program: five specific University of California (UC) hospitals and eight children's hospitals throughout the State that are also members of the California Children's Hospital Association. In November 2008 California voters approved an additional \$980 million for the program (2008 act); however, these funds have not been available to the hospitals because of the State's recent budget crisis.

The California Health Facilities Financing Authority (authority) is authorized by both the 2004 act and the 2008 act to award grants for the purpose of funding eligible projects. Established in 1979, the authority was created to administer the State's programs that provide loans, 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 the proposed projects, and make recommendations to its governing board for approval or rejection of the grant applications. As of February 2009 the authority had awarded about \$404 million in program grants authorized by the 2004 act and disbursed about \$339 million to the grantees.

Although it has procedures to provide reasonable assurance that program funds are awarded to eligible hospitals for eligible projects, we found that the authority could improve its management of those grants. For example, the authority did not always comply with its regulations by failing to recover interest totaling more than \$34,000 the hospitals had earned on program funds. Moreover, although the authority's regulations state that any interest earned on advances of program funds to hospitals other than UC children's hospitals will be recovered by the authority, they do not require these grantees to deposit those advances in interest-bearing accounts.

### Audit Highlights . . .

*Our review of the administration and use of bond proceeds from the Children's Hospital Bond Act of 2004 (2004 act) revealed the following:*

- » *The 2004 act's restrictive requirements limit the number of hospitals that can use the funds.*
- » *The California Health Facilities Financing Authority (authority) did not always recover interest earnings on funds paid to the hospitals in advance of actual expenditures—we identified more than \$34,000 of interest due to the State.*
- » *The authority's regulations do not require grantees that are not in the UC system to deposit fund advances in interest-bearing accounts.*
- » *The authority has not finalized and implemented procedures to close out program grants.*
- » *Although the authority desires to voluntarily comply with the governor's 2007 executive order regarding accountability for bond proceeds, it is uncertain of its timeline to do so.*

We also found that for six grants with completed projects the authority did not promptly perform procedures to close out the grants to ensure compliance with regulations designed, in part, to certify completion of projects and to gain an accounting of project costs and the use of grant funds. Further, it has not identified all the steps it should take to close out grants. Finally, although the program manager stated that the authority desires to voluntarily comply with the governor's 2007 executive order regarding accountability for bond proceeds, it is uncertain of its timeline to implement the bond accountability structure to provide assurance that bond proceeds are properly used and to offer the public easily accessible information regarding their use.

### **Recommendations**

The authority should verify that it has the legal authority to require grantees that are not in the UC system to deposit grant funds paid in advance of project expenditures in an interest-bearing account and, if it has such authority, require that grantees earn interest on grant funds. In addition, the authority should develop and implement procedures to ensure that it promptly identifies and collects interest earned on those advances.

To ensure that it meets the objectives contained in the program regulations for the completion of grant-funded projects, including gaining certification that projects are completed and grants do not exceed project costs, the authority should take the steps necessary to ensure that it promptly executes its project completion checklist, determines any additional steps it needs to perform to close out grants, and finalizes and implements the necessary steps to ensure that grant closeout procedures are followed.

As the authority has decided that it desires to comply with the governor's executive order to provide accountability for the use of bond proceeds, it should develop and submit to the Department of Finance (Finance) an accountability plan for its administration of the program bonds. In addition, it should take the necessary steps to periodically update Finance's bond accountability Web site to provide public access to information regarding its use of the bond proceeds.

### **Agency Comments**

Authority staff recognizes the need to continually evaluate its processes and to look for ways to make improvements. The report highlights areas that can be improved and provides valuable feedback to that effect.

# 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 it. In November 2008 California voters approved an additional \$980 million in general obligation bonds for the program (2008 act). However, because of the State’s budget crisis, funds from the 2008 act are not yet available for grants to eligible hospitals. 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. Eligible projects include those to construct, expand, improve, or finance children’s hospitals, including their furnishings or equipment.

The acts identify two groups of general acute care hospitals as eligible for the program. The first group consists of five specific University of California (UC) hospitals, as shown in Table 1 on the following page. Of the total funds available under both acts, 20 percent is earmarked for grants to these UC hospitals. Each hospital may receive more than one grant, but the total for all grants awarded to a given hospital is limited to \$30 million for the 2004 act and \$39.2 million for the 2008 act. Thus, each of the five hospitals can receive grants totaling up to one-fifth of the bond proceeds earmarked for this group of hospitals.

As shown in Table 1, only eight other hospitals are eligible for the program, based on the eligibility requirements shown in the text box. The remaining 80 percent of the total 2004 and 2008 bond funds is earmarked for these eight hospitals. These eight 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.

The California Health Facilities Financing Authority (authority) is authorized by the 2004 and 2008 acts to award grants for the purpose of funding eligible projects. Established in 1979, the authority was created to administer the State’s programs to provide loans, funded through the issuance of

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

A general acute care hospital that is, or is an operating entity of, a California nonprofit corporation established prior to January 1, 2003, and that:

- Has a mission of clinical care, teaching, research, and advocacy that focuses on children.
- Provides 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 chronic medical conditions that affect children.
- Provided evidence of the following, based on information hospitals reported for their fiscal year ending between June 30, 2001, and June 29, 2002, to the Office of Statewide Health Planning and Development on or before July 1, 2003:
  - At least 160 licensed beds for pediatric acute care, pediatric intensive care, and neonatal intensive care.
  - Over 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: California Health and Safety Code and the Department of Health Care Services.

**Table 1**  
**Hospitals Eligible for Grants From the Children's Hospital Program**  
**(In Millions)**

HOSPITAL	MAXIMUM AMOUNT AUTHORIZED UNDER BOTH ACTS
<b>University of California Hospitals Specifically Identified as Eligible*</b>	
University of California, Davis Children's Hospital	\$69.2
University Children's Hospital at University of California, Irvine	69.2
Mattel Children's Hospital at University of California, Los Angeles	69.2
University of California, San Diego Children's Hospital	69.2
University of California, San Francisco Children's Hospital	69.2
<b>Hospitals Eligible Under Specific Requirements Listed in the Children's Hospital Bond Acts of 2004 and 2008†</b>	
Children's Hospital Los Angeles	172.0
Children's Hospital Central California (Madera)	172.0
Children's Hospital and Research Center Oakland	172.0
Children's Hospital of Orange County	172.0
Loma Linda University Children's Hospital	172.0
Lucile Packard Children's Hospital at Stanford	172.0
Miller Children's Hospital (Long Beach)	172.0
Rady Children's Hospital San Diego	172.0

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

\* Receive 20 percent of program funds.

† Receive 80 percent of program funds.

tax-exempt bonds, to public and nonprofit health care providers. The authority employs a process to review applications for grants, evaluate the proposed projects, and make recommendations to its governing board for approval or rejection of the grant applications. In addition to the program requirements contained in the 2004 act, the program is also governed by regulations that detail program requirements regarding eligibility, applying for funding, closing out grants, and remitting to the authority any interest grantees earn on advances of program funds. As of February 2009 the authority had awarded about \$404 million in program grants authorized by the 2004 act and disbursed about \$339 million to the grantees.

The eligibility requirements for the 2008 act resulted in the same hospitals qualifying for grants as for the 2004 act. However, as a result of the State's budget crisis, in December 2008 the Department of Finance (Finance) directed all agencies that have expenditure control and oversight of general obligation bond programs to cease authorizing any new grants or obligations for bond projects. This suspension of funding activity affected disbursements of bond proceeds from both the 2004 act and

the 2008 act. In February 2009 Finance stated that it would be some time before it knows the amount of cash available for the suspended or new projects and grants.

According to its program manager, the authority is in contact with the Office of the State Treasurer to track when funds will become available again for the program. He indicated that the latest available guidance on the matter is Budget Letter 09-06, dated February 19, 2009, which states that it will take about a month to analyze the budget agreement, and that it would “be some time before we know the amount of cash available to address past and future obligations.” The program manager further indicated that the amount authorized by the 2008 act will be subject to the same uncertainty of funding availability as the remaining funds from the 2004 act. However, the funding process for the 2008 program may take a month or so longer, as the authority has not yet been able to apply for the initial loan it will need from the State’s Pooled Money Investment Account for interim financing until bonds can be sold, nor has it been able to have the initial meeting of the 2008 bond act committee to authorize the sale of the 2008 bonds. The 2008 act created the Children’s Hospital Bond Act Finance Committee, comprising the state controller, director of finance, and state treasurer, or their designated representative, to determine when it is necessary or desirable to issue bonds to carry out the purposes of the program.

In addition to the authority’s activities to administer the program, the Facilities Development Division (division) of the Office of Statewide Health Planning and Development provides oversight of hospital construction projects. Overall, the division is responsible for overseeing all aspects of facility construction for general acute care hospitals, psychiatric hospitals, skilled nursing homes, and intermediate care facilities in California. The division reviews and inspects health facility construction projects and reviews and approves plans and specifications of architectural, structural, mechanical, plumbing, and electrical systems for facility projects to ensure compliance with California’s Building Standards Code. In addition, through a combination of division staff, structural engineers, and safety and compliance officers, the division facilitates observation of construction projects to ensure that they comply with the approved plans and the building code. When projects are completed in accordance with project specifications and building standards, the division provides the hospitals a certificate of occupancy. Grantees provide the certificate of occupancy to licensing agencies to signal the successful completion of a construction project and to acquire a license to operate the health facility.

In November 2006 California voters approved about \$43 billion in bonds to improve and maintain the State's infrastructure primarily for transportation, education, water supply, and flood control, as identified in the State's strategic growth plan. In January 2007 the governor issued Executive Order S-02-07 (executive order), declaring that all entities of state government that are responsible for expending the proceeds of these infrastructure bonds are accountable for ensuring that the bond proceeds are spent in accordance with applicable laws and in the best interests of the people of the State of California. As such, each agency is responsible for establishing an accountability structure that outlines procedures for awarding, monitoring, and auditing expenditures of bond proceeds and providing information that is easily accessible to the public regarding how the bond proceeds are used. Although the executive order does not apply to state agencies that are not under the governor's authority, those agencies are requested to comply voluntarily with the requirements of the executive order.

### **Scope and Methodology**

The 2004 and 2008 acts state that the Bureau of State Audits 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, and that grantees of bond proceeds are using funds in compliance with applicable provisions. However, because no grants had been awarded that were funded by the 2008 bonds at the time of our fieldwork, we focused on the authority's grants of proceeds from the bonds authorized by the 2004 act. To gain an understanding of program requirements, we reviewed the laws and regulations for the program, interviewed management and staff of the authority, and reviewed applicable documentation such as grant applications and instructions for grant applications.

To determine if bond proceeds were awarded in a manner consistent with the requirements of the 2004 act, we reviewed the process used by the authority to award grants and sampled nine of the 18 grants awarded thus far to determine whether the hospitals and their proposed projects met the requirements to receive program funds. The authority uses a checklist to ensure that required documentation has been submitted and to assist staff in making grant award determinations. We reviewed the checklist for the grants we sampled to determine the thoroughness of the authority's review and to verify that the applicant hospitals were eligible for the program. In early to mid-2007, according to the program manager, the authority began using a revised checklist that we determined addressed in greater detail the critical elements of the laws and regulations necessary to ensure

that bond funds are awarded as intended by the bond act. For our sample grants that were awarded prior to mid-2007, we completed the revised checklist to gain further assurance of the adequacy of the authority's efforts to review those grant applications. In addition, we determined whether information prepared by the authority's staff regarding its evaluation of proposed grants and presented to its board for consideration was consistent with the information contained in the grant applications. Lastly, we reviewed the resolutions by the authority's board to ensure that the grants were approved, and we reviewed the grant agreements to ensure that they contained critical elements required by the regulations.

To determine if the authority processed applications and awarded grants in a timely fashion, we compared the date on the application to the date of the formal approval by the authority's board. We found the grants were generally awarded within the 60 days required by state law.

To determine if grantees are using bond proceeds in compliance with applicable program requirements, we chose a sample of disbursements related to the nine grants we selected and reviewed invoices, grant agreements, and contracts. The disbursements were adequately supported by documents such as invoices, purchase orders, or contracts provided by the grantee hospitals. However, we did not visit the hospitals to evaluate their controls to ensure that the invoices they presented to the authority for payment represented only eligible project costs. For six of the nine grants we sampled for which the projects had been completed, we also reviewed the authority's closeout of the grants. Lastly, we reviewed whether the authority complied with its regulations requiring that interest earned by grantees on previously released grant funds be paid back to the authority or offset against future disbursements of grant funds.

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## Audit Results

### **Although Eligibility Requirements Restrict Funds to a Few Hospitals, Efforts to Award Grants Appear Adequate**

The Children's Hospital Bond Act of 2004 (2004 act) authorized the Children's Hospital Program (program) and the sale of general obligation bonds totaling \$750 million, and the Children's Hospital Bond Act of 2008 (2008 act) provided an additional \$980 million to further fund the program. Both acts identify specific hospitals as eligible to receive program grants—a group of five children's hospitals operated by the University of California (UC) in the southern and northern parts of the State—and identify specific requirements that other general acute care hospitals must meet to be eligible for the program. The acts also provide for reimbursement of project costs incurred by eligible hospitals before the voters approved the acts but after January 31, 2003, for the 2004 act and after January 31, 2008, for the 2008 act. For the 2004 act, about \$162 million of the program's funding has been provided to seven children's hospitals for projects with some costs that were incurred before voters approved the act in November 2004. In total, as of February 2009 the California Health Facilities Financing Authority (authority) had awarded about \$404 million to eligible hospitals for projects, and had disbursed about \$339 million of grant funds to the hospital grantees.

The eligibility requirements of the acts restrict the program's funds to a relatively small number of hospitals. The only hospitals eligible for the program make up 13 of the 14 members of the California Children's Hospital Association (association). The five UC children's hospitals specifically identified as eligible in the acts, along with the Children's Center at Sutter Medical Center, Sacramento, are associate members of the association, and the eight hospitals eligible for the program under the specific requirements are regular members. The chief executives of these eight hospitals serve on the association's board of directors. According to the association's Web site, these eight regional private nonprofit children's hospitals treat children with the most serious and life-threatening diseases, such as leukemia and other cancers, human immunodeficiency virus, and cystic fibrosis, and provide multidisciplinary health care to children from all counties in the State, as well as 24-hour care and services such as trauma, burn, neonatal intensive care, and pediatric intensive care. The association states that for more than 20 years it has been advancing the needs of the State's children's hospitals through public and legislative advocacy.

Five UC children's hospitals are eligible for the program, not because they meet the eligibility criteria other hospitals are subject to, but because the acts specifically identify them as eligible.

*Although somewhat similar in the population of pediatric patients served, 12 hospitals did not qualify for the program because of the act's restrictions regarding hospitals not in the UC system.*

We noted that 12 hospitals not in the UC system, including two Shriners hospitals and Cedar-Sinai Medical Center, do not qualify under the eligibility criteria of the acts, even though their reported licensed bed and pediatric patient day operational data are similar to those of the UC hospitals. Eligibility for the program is determined, in part, based on data reported by the hospitals to the Office of Statewide Health Planning and Development (Statewide Health Planning) for the target years specified in the acts. The UC children's hospitals reported licensed pediatric beds ranging from 60 to 160 and pediatric patient days ranging from 17,083 to 38,867. Similarly, the 12 hospitals not in the UC system that do not qualify for the program reported licensed pediatric beds ranging from 60 to 116 and pediatric patient days ranging from 8,374 to 30,602. Although somewhat similar in the population of pediatric patients served, these hospitals did not qualify because of the acts' restrictions regarding children's hospitals not in the UC system, as outlined in the text box on page 3 of the Introduction.

Table 2 shows the eligible hospitals, the maximum amount of grants available to each under the 2004 act, the grant award amounts, and the amounts disbursed. Although eligible hospitals are limited in the amount of grant funds they may receive, each may apply for more than one grant until it reaches that limit. As of February 2009 the authority had awarded 18 grants to 10 of the eligible hospitals.

Our review of one grant for each of the nine hospitals that have actually received grant funds revealed that the authority has procedures in place to provide reasonable assurance that it awards program funds to eligible hospitals for eligible projects. Documents provided by the authority demonstrate that it used organizational information from the Office of the Secretary of State and the hospitals, together with data reported to Statewide Health Planning by the hospitals, to verify the general acute care hospitals' eligibility for the program, using the specific eligibility characteristics shown in the text box on page 3 of the Introduction.

Some eligibility requirements are quantitative and require little, if any, analysis on the part of authority staff. Others cannot be determined so readily. For example, one criterion for determining hospital eligibility is whether a hospital serves a high volume of children eligible for government programs. According to the authority's manager for the program, to determine whether a hospital meets this criterion, the authority considers the proportion of the hospital's patient days that are represented by Medi-Cal patients. Among the hospitals that are not in the UC system that the authority has identified as eligible for the program, about one-third or more of the total patient days are related to patients eligible for Medi-Cal, based on the program manager's review of 2007 Statewide Health Planning data. The average for all hospitals

**Table 2**  
**Hospitals Eligible for Children’s Hospital Program Funds and Grant Amounts**  
**Awarded and Disbursed Related to the 2004 Act**  
**(In Millions)**

HOSPITAL	MAXIMUM AMOUNT AVAILABLE	GRANT AMOUNT AWARDED	GRANT AMOUNT DISBURSED
University of California, Davis Children’s Hospital	\$30.0	\$8.4	\$8.3
University Children’s Hospital at University of California, Irvine	30.0	0.0	0.0
Mattel Children’s Hospital at University of California, Los Angeles	30.0	30.0*	29.8
University of California, San Diego Children’s Hospital	30.0	0.0	0.0
University of California, San Francisco Children’s Hospital	30.0	0.0	0.0
Children’s Hospital Los Angeles	74.0	74.0*	72.2
Children’s Hospital Central California (Madera)	74.0	15.1	14.8
Children’s Hospital and Research Center Oakland	74.0	5.8	5.8
Children’s Hospital of Orange County	74.0	45.5	39.2
Loma Linda University Children’s Hospital	74.0	3.2	0.0
Lucile Packard Children’s Hospital at Stanford	74.0	74.0*	51.4
Miller Children’s Hospital (Long Beach)	74.0	74.0*	73.9
Rady Children’s Hospital San Diego	74.0	74.0*	44.0
<b>Totals</b>	<b>\$742.0†</b>	<b>\$404.0</b>	<b>\$339.4</b>

Source: California Health Facilities Financing Authority (authority).

Note: According to the program manager, as of mid-April 2009, the authority had not awarded any grants related to the Children’s Hospital Bond Act of 2008.

\* The authority has awarded these hospitals the maximum total grant amount allowed by the Children’s Hospital Bond Act of 2004. Hospitals may receive more than one grant.

† This maximum amount available is \$8 million less than the maximum amount of bonds authorized by the Children’s Hospital Bond Act of 2004. According to the program manager, this amount included together with any unexpended grant funds allocated to the children’s hospitals not in the University of California system, less any administrative costs and bond issuance costs, could be available to those hospitals after the first round of program funding ends on June 30, 2014.

is about 28 percent, according to the program manager. Our review of 2001 data reported by all hospitals to Statewide Health Planning, data called for by the acts to determine program eligibility, shows that patient days paid for by the traditional and managed care Medi-Cal programs for the program-eligible hospitals ranged from 38 percent to 69 percent of total patient days, with an average of 54 percent. For the same period, patient days paid by traditional and managed care Medi-Cal for all other hospitals averaged 27 percent of total patient days. Thus, the hospitals the authority identified as eligible for the program serve a higher percentage of patients eligible for Medi-Cal.

### Children's Hospital Program Project Eligibility Requirements

- Expand or improve health care access by children eligible for government health insurance programs and indigent, underserved, and uninsured children.
- Improve child health care or pediatric patient outcomes.
- Provide uncompensated or under-compensated care to indigent or public pediatric patients.
- Provide services to vulnerable pediatric populations.
- Promote pediatric teaching or research programs.
- Demonstrate project readiness and feasibility.

Source: California Health and Safety Code.

To help it determine the eligibility of the hospitals and the projects it proposes for program funding, the authority has developed an application package that elicits critical program information from hospitals applying for program grants. For example, the application form is divided into broad categories, such as applicant and project eligibility, project description, project readiness and feasibility, sources and uses of funds, and the financial capacity of the applicant hospital to operate. The application also elicits specific information for each of the broad categories that reflect the program requirements set forth in the act and the authority's regulations. For example, it requires the applying hospital to provide an explanation of how the proposed project satisfies the eligibility requirements shown in the text box.

The authority also uses a set of checklists to award and manage grants, including three checklists to evaluate the applications submitted to ensure that they are complete and that the projects meet program eligibility requirements. These checklists are listed in the text box on the following page. Through these five checklists, the authority determines whether grant applications meet the critical program requirements contained in the act and program regulations. For all nine of the grants we reviewed, the application was supported by the checklist information and the hospitals met the necessary requirements to receive the grants.

As with the hospital eligibility requirements, not all project eligibility requirements are readily determinable. For example, one criterion for project eligibility is whether the project can be completed within a reasonable time. *Reasonable time* is not defined in the statutes and, according to the program manager, is determined on a case-by-case basis using timelines, project descriptions, and other information provided by a grant applicant. Staff use their experience in hospital bond financing analysis, as well as other loan and grant analysis, in making determinations of reasonableness and in recommending the project period for any grant award.

### The Authority Needs Some Improvement in Managing Grants of Children's Hospital Program Funds

Although the authority has procedures to provide reasonable assurance that grants of program funds are awarded to eligible hospitals for eligible projects, the authority could improve its management of those grants. For example, the authority's

regulations state that the authority must recover interest that grantee hospitals not in the UC system earn on program funds paid to the hospitals in advance of actual expenditures by reducing subsequent disbursements of grant funds. However, our review of a sample of grant awards revealed that the authority did not always recover the interest earnings. In addition, the authority does not promptly perform procedures to close out grants as a means of ensuring that projects are completed and to gain an accounting of project costs and to ensure the appropriate use of grant funds. Further, it has not identified all the steps it should take to close out grants. Finally, although the program manager stated that the authority desires to comply voluntarily with the governor's January 2007 executive order regarding accountability over the use of bond proceeds, the authority has yet to do so.

**Checklists Used by the California Health Facilities Financing Authority to Award and Manage Grants**

- Eligibility of Hospital/Completeness of Application
- Project Evaluation/Project Feasibility
- Requirements for Construction on Leased Property
- Release of Funds and Documentation of Expenditures—Private Hospitals and Universities of California
- Project Completion and Documentation of Expenditures

Source: California Health Facilities Financing Authority.

***The Authority Does Not Always Ensure That It Receives Interest Earned on Advances of Program Funds to Grantees***

The authority's regulations state that disbursements to UC hospitals shall be paid only as reimbursements for expenditures made for approved projects. Children's hospitals not within the UC system, on the other hand, may receive advances of program funds, and the authority is required to recover any interest earned on these advanced funds by reducing subsequent disbursements. However, the authority does not always comply with this requirement. For example, we noted that for the second grant awarded to the Children's Hospital of Orange County, the hospital reported interest earned on advances of grant funds of more than \$15,500. Although the authority received this report by August 1, 2007, it did not credit these interest earnings against an additional \$6.6 million disbursement to the hospital on December 3, 2007. Similarly, for a grant awarded to the Lucile Packard Children's Hospital at Stanford, the hospital reported interest earnings of more than \$19,000 as of January 31, 2007. Nevertheless, the authority did not recover this interest in any of three subsequent disbursements to the hospital. The program manager confirmed that as of March 2009 the authority had still not collected the interest in either instance. According to the program manager, the authority should be recovering such earned interest, and it plans to do so by reducing future grant disbursements to the two hospitals by the amount of the interest earnings.

The authority's agreements for the grants we reviewed require that grantees establish separate bank accounts or subaccounts for grant funds and provide to the authority copies of all statements for these accounts. However, the authority has not ensured that hospital grantees not in the UC system submit all bank statements. Periodic collection of these bank statements would assist the authority in identifying interest that may have been earned, allowing it to credit this interest against future disbursements or to collect the interest from the hospitals.

Revisions to the regulations currently proposed by the authority would require it to recover any interest earnings prior to the final release of grant funds, rather than offsetting identified interest earnings against subsequent disbursements to grantees. When we asked the program manager about any new procedures that may need to be developed to implement the revised regulations, he stated that he did not believe any were needed. However, as we describe above, the authority's current procedures do not ensure that interest earned on advances of program funds is offset or collected by the authority.

In addition, the authority's current regulations do not require that grantees deposit advances of grant funds in interest-bearing accounts, although some grantees have done so. Given the amount of bond proceeds earmarked for hospitals not in the UC system by the 2004 and 2008 acts—\$592 million and \$784 million, respectively—the potential interest earnings on funds advanced to grantees may be significant. According to the program manager, the authority has taken the position that program funds should be kept as safe as possible, with minimal risk, and the authority should not be counseling the grantees as to the level of interest, if any, they should be earning on their accounts. However, given the amount of funds to be disbursed from the bonds authorized by the 2004 and 2008 acts, it seems fiscally responsible that any unused program funds be placed in an interest-bearing account and the earnings returned to the authority for program purposes or to defray the interest costs associated with the bonds that finance the program. The program manager stated that he knows of no legal prohibition against such a requirement and intends to seek an opinion from the program's staff counsel.

***The Authority Has Not Promptly and Effectively Closed Out Grants for Completed Projects***

The authority has not yet finalized and implemented procedures to close out program grants. Although it has received some documentation from the grantees regarding project completion, it does not ensure that all required information is received and has

not determined all the steps it needs to perform to close out grants after projects are completed. The authority's regulations contain requirements for completed projects that include the items shown in the text box. The authority has developed a checklist to use in gathering and evaluating information regarding completed projects (closeout checklist). The closeout checklist reflects the requirements of the program regulations for completed projects.

However, the authority does not promptly complete the closeout checklist or ensure that it is properly completed. For example, documents provided by the authority indicate that the projects were completed for six of the nine grants we sampled. We obtained the closeout checklists for the six completed projects, and although the completion dates for five of them ranged from October 2007 to August 2008, the authority did not process the closeout checklists until mid- to late October 2008. In addition, the closeout checklists for all six were not complete and showed no evidence of review by program management. Items not completed include whether the grantee has certified to the authority that the project is complete and whether the grantee provided a final report describing the results of the project and the completion of any associated larger project. Moreover, some checklist items regarding final payment certification by the architect and copies of bank statements for accounts in which grantees held program funds were marked as not applicable without any explanation of why.

According to the program manager, he reviewed the closeout checklists shortly after staff worked on them, and the entries appeared to have addressed the items included in the checklists, except for items referring to the Completion Certificate and Final Report, which the authority had not yet received as of October 2008. At the time of our testing (March 2009), the authority had received these certificates relating to four of the six completed projects. The authority uses the Completion Certificate and Final Report to document information from grantees, under penalty of perjury, regarding the uses of funds expended on the project; estimated total cost of the project; interest earned on advanced grant funds; whether the hospital received a notice of completion for the project; the results of the project and performance measures used; and any follow-up implementation actions required such as equipment, staffing, or licensing. The program manager stated that although he had reviewed the closeout checklists, he would like to review them again in

#### Information Required at Completion of Grant-Funded Projects for the Children's Hospital Program

- Certification that project is complete.
- For construction projects, documentation including copies of a certificate of occupancy, final payment certification by the architect, final payment request from the contractor, and copies of corresponding cancelled checks.
- Copies of final closing statements for real property acquisition projects.
- For equipment acquisition projects, copies of contracts, purchase orders, invoices, and cancelled checks.
- Documentation clearly showing that grant awards do not exceed the cost of the project.

Source: California Code of Regulations.

*Although two grantees completed their projects in October 2007 and September 2008, respectively, the authority still had not received a Completion Certificate and Final Report from either grantee as of March 2009.*

greater detail. He indicated that he may have not yet looked at each checklist “with a fine-tooth comb”—a level of detail review that is necessary, in part, since the completion certificate calls for the inclusion of a listing of expenditures of all grant award proceeds.

We also noted that at the time of our fieldwork, March 2009, the authority still had not received a Completion Certificate and Final Report from two grantees—Rady Children’s Hospital San Diego and Children’s Hospital of Orange County—although their projects had completion dates of October 2007 and September 2008, respectively. The authority received these closeout documents from the other four grantees we reviewed, with projects completed from December 2007 through August 2008, after requesting the documents in a letter dated December 2008. According to the program manager, he overlooked sending a letter to Rady Children’s Hospital San Diego and has not sent a letter to Children’s Hospital of Orange County, possibly because the scheduled project completion date had not yet passed when he was drafting the letters for the other grantees.

Also, according to the program manager, the authority may need to take additional steps to achieve final closeout of the grants for completed projects. For example, according to the program manager, although the closeout checklist addresses the section of the regulations regarding the completion of grant projects, additional appropriate steps may include a site visit to verify project completion. He also stated that it is important to note that closeout may not be a universally defined term, but one possible definition could be the grantor’s process to determine that the grantee has completed all administrative requirements of the award and has completed the grant award project. According to the program manager, the authority’s official closeout procedure for program grants will be to complete a memorandum for each grant addressing the closeout checklist and any other issues that might be relevant to that award. The program manager believes it is fair to say that the authority’s closeout checklist is a written closeout procedure with regard to the grantee, in the sense that it reflects the parts of the regulations that address project completion, and that the addition of a completed memorandum to the checklist would be an extra step to be taken by the authority as the awarding agency. However, as the program manager points out, the authority has not yet identified the additional steps it would need to take to officially close out an award.

### **The Authority Is Uncertain of Its Timeline to Voluntarily Implement the Governor's Bond Accountability Program**

The authority is not required to comply with the bond accountability standards in the governor's Executive Order S-02-07 (executive order), as discussed in the Introduction, because the bonds that finance the program are not part of the strategic growth plan infrastructure bonds targeted by the executive order. Nonetheless, according to the program manager, the authority desires to comply with the bond accountability standards and is currently working with the Department of Finance (Finance) to implement the executive order. We believe that the information required by the executive order regarding the use of the bond proceeds provided by the acts will benefit interested members of the public. However, the authority's program manager indicated that he is uncertain whether the authority has sufficient staff time available to ensure compliance in the near future. He stated that even though the authority plans to hire one additional staff member, a considerable amount of time and effort will be needed to address existing program needs, as well as to implement the program authorized by the 2008 act.

### **Recommendations**

The authority should verify that it has the legal authority to require grantees that are not in the UC system to deposit grant funds paid in advance of project expenditures in an interest-bearing account and, if it has such authority, require that grantees earn interest on grant funds. In addition, the authority should develop and implement procedures to ensure that it promptly identifies and collects interest earned on those advances.

To ensure that it meets the objectives contained in the program regulations for the completion of grant-funded projects, including obtaining certification that projects are completed and grants do not exceed project costs, the authority should take the steps necessary to ensure that it promptly executes its project completion checklist, determines any additional steps it needs to perform to close out grants, and finalizes and implements the necessary steps to ensure that grant closeout procedures are followed.

As the authority has decided that it desires to comply with the governor's executive order to provide accountability for the use of bond proceeds, it should develop and submit to Finance an accountability plan for its administration of the program bonds. In addition, it should take the necessary steps to periodically update Finance's bond accountability Web site to provide public access to information regarding its use of the bond proceeds.

We conducted this review 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. We limited our review to those areas specified in the audit scope section of the report.

Respectfully submitted,



ELAINE M. HOWLE, CPA  
State Auditor

Date: May 21, 2009

Staff: Denise L. Vose, CPA, Audit Principal  
Norm Calloway, CPA  
Joe Jones, CPA, CIA  
Rosa Reyes

For questions regarding the contents of this report, please contact Margarita Fernández, Chief of Public Affairs, at (916) 445-0255.

*(Agency response provided as text only.)*

California Health Facilities Financing Authority  
915 Capitol Mall, Suite 590  
Sacramento, CA 95814

May 7, 2009

Elaine M. Howle, State Auditor\*  
Bureau of State Audits  
555 Capitol Mall, Suite 300  
Sacramento, CA 95814

Dear Ms. Howle:

Thank you for the opportunity to review the draft copy of your report on the Children's Hospital Program.

We are appreciative of the efforts of your audit team to assist us in improving our processes. As you are aware, the Authority was asked to implement the programs resulting from the passage of Proposition 61 in 2004 and Proposition 3 in 2008. The Authority has responded enthusiastically to this direction and has assumed responsibility for programs designed to improve the health and welfare of California's critically ill children by providing funds for capital improvement projects for children's hospitals.

Authority staff recognizes the need to continually evaluate its processes and to look for ways to make improvements. The report highlights areas which can be improved and provides valuable feedback to that effect. The specific comments are enclosed.

If I can be of further assistance, please let me know.

Sincerely,

(Signed by: Barbara J. Liebert)

BARBARA J. LIEBERT  
Executive Director

Attachment

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\* California State Auditor's comment appears on page 21.

Response to Bureau of State Audits Draft Report 2009-042**Recommendation**

- The authority should verify it has the legal authority to require that grantees deposit grant funds paid in advance of project expenditures in an interest-bearing account and, if so, require that grantees earn interest on grant funds. In addition, the authority should develop and implement procedures to ensure it promptly identifies and collects interest earned on those advances.

**Response**

Counsel to the Authority has recently advised there are no legal impediments to requiring non-University of California grantees to establish interest bearing accounts. The Authority notes the Bureau's recommendation in this regard and agrees to forthwith form a working group to determine how best to implement the recommendation. The Authority currently has procedures in place to identify and collect interest earned on advances, but takes note of the Bureau's recommendations to ensure these tasks are performed as promptly as possible.

**Recommendation**

- To ensure it meets the objectives contained in the program regulations for the completion of grant-funded projects, including gaining certification that projects are completed and grants do not exceed project costs, the authority should take the steps necessary to ensure it promptly executes its project completion checklist, determines any additional steps it needs to perform to close out grants, and finalizes and implements the necessary steps to ensure that grant close-out procedures are followed.

**Response**

- ① The Authority believes it is and has taken all reasonable steps necessary to verify completion of a project and to close-out grants, but duly notes the specific recommendations of the Bureau in this regard.

**Recommendation**

- As the authority has decided that it desires to comply with the governor's executive order to provide accountability for the use of bond proceeds it should develop and submit to Finance an accountability plan for its administration of the program bonds. In addition, it should take the necessary steps to periodically update Finance's bond accountability Web site to provide the public access to information regarding its use of the bond proceeds.

**Response**

The Authority desires to voluntarily comply with the Governor's executive order and is already doing so by working with the Department of Finance. The Authority will also work thereafter to periodically update Finance's bond accountability website.

## 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 report from the California Health Facilities Financing Authority (authority). The number below corresponds with the number we have placed in the margin of the authority's response.

In its response the authority states that it believes it has taken all reasonable steps necessary to verify completion of a project and to close out grants. However, this statement conflicts with the statements the authority made during our fieldwork and which we present on page 16 in the report. In these statements the authority pointed out that it may need to take additional steps to close out grants for completed projects and has not yet identified those additional steps. In addition, although the authority indicates it "duly notes the specific recommendations of the bureau in this regard", it does not present a clear course of action for implementing our recommendation.

①

cc: Members of the Legislature  
Office of the Lieutenant Governor  
Milton Marks Commission on California State  
Government Organization and Economy  
Department of Finance  
Attorney General  
State Controller  
State Treasurer  
Legislative Analyst  
Senate Office of Research  
California Research Bureau  
Capitol Press