STATE OF CONNECTICUT

AUDITORS' REPORT
STATE OF CONNECTICUT HEALTH AND
EDUCATIONAL FACILITIES AUTHORITY
FOR THE FISCAL YEARS ENDED JUNE 30, 2002 AND 2003

AUDITORS OF PUBLIC ACCOUNTS

KEVIN P. JOHNSTON ♦ ROBERT G. JAEKLE

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We have made an examination of the financial records of the State of Connecticut Health and Educational Facilities Authority for the fiscal years ended June 30, 2002 and 2003. We have relied on the financial and compliance audits conducted of the Authority by independent public accountants covering these fiscal years after having satisfied ourselves as to the firm's professional reputation, qualifications and independence, and verifying that generally accepted accounting principles and auditing standards were followed in the audits and in the preparation of the reports. Financial statements are included in the Authority's annual reports for the fiscal years ended June 30, 2002 and 2003. In addition to reviewing the audits and related working papers prepared by the independent public accountants, we reviewed the Authority's compliance with State statutory annual reporting requirements. We also reviewed the minutes of the Authority. We conducted our audit in accordance with generally accepted government auditing standards for financial related audits. This report on our examination consists of the following Comments and Recommendations.

COMMENTS

FOREWORD:

The State of Connecticut Health and Educational Facilities Authority (CHEFA) operates under Title 10a, Chapter 187, of the General Statutes.

The Authority is a public instrumentality, created as a public benefit corporation, whose purpose is to assist institutions of higher education, health care institutions, nursing homes and qualified nonprofit organizations in the construction, financing and refinancing of projects. Section 10a-186a of the General Statutes provides for the maintenance of Special Capital Reserve Funds to be used for the payment of principal and interest on Authority bonds used to finance projects at participating nursing homes and public institutions of higher education. According to Section 10a-186a, the State is contingently liable to provide annual debt service requirements for such bonds, if Authority funds are not sufficient to meet minimum reserve requirements for the Special Capital Reserve Funds. The Authority is empowered to issue its bonds, bond anticipation notes and any other obligations of the Authority for any of its corporate purposes and to fund and refund the same.

Debt issued by the Authority is not a debt of the State of Connecticut and the State is not obligated for such debt, except as specified in Section 10a-186a of the General Statutes. In addition, the Authority does not expend any State funds. However, in accordance with Section 2-90 of the General Statutes, the Authority, as a quasi-public body created by the General Assembly, is subject to audit by the Auditors of Public Accounts.

The Authority consists of ten members, including the State Treasurer and the Secretary of the Office of Policy and Management, who serve as ex officio members, and eight members who are appointed by the Governor.

As of June 30, 2003, the members of the Authority were as follows:

Ex-Officio:
Denise L. Nappier, State Treasurer
Marc S. Ryan, Secretary, Office of Policy and Management

Appointed by the Governor:
Barbara Rubin, Chairman
Patrick A. Colangelo, Vice Chairman
Lorraine M. Aronson
John M. Biancamano
William J. Cibes, Jr., Ph.D.
Benson R. Cohn
Laurence R. Smith, Jr.
Dori Taylor Sullivan, Ph.D.

The following also served on the Board during the audited period:

James R. Birle
Phyllis C. DeLeo, Ph.D.
John A. Barone, Ph.D.

It should be noted that Lorraine Aronson's appointment expired on June 30, 2003, and her seat, as of August 2, 2004, remains vacant.

Richard D. Gray was appointed Executive Director on May 23, 1996, and served in that capacity throughout the audited period. Jeffrey A. Asher was appointed Managing Director and Chief Financial Officer on June 30, 1997, and served in that capacity throughout the audited period.

Significant Legislation:

There was no new significant legislation during the audited period affecting the Authority's operations.

Accounting Policies:

The Authority maintains books of accounts for its own operations and for each of the issues of debt outstanding. In accordance with the requirements of bond issue documents, separate funds are maintained for each issue. A brief description of each fund and its purpose follows:

General Fund - Revenues and expenses applicable to the operations of the Authority are accounted for within this account. The retained earnings of the Authority's General Account exists as the total of a reserve designated for operations representing approximately 2.5 times current year operating expenses and a reserve designated for contingencies that is to equal the annual interest due on all bond issues rated less than AA, not insured and not collateralized by letters of credit. This reserve could be used to avoid default in the event of a failure on the part of any general obligation bond issue.

Construction and Project Funds - The receipt and disbursement of moneys for the payment of construction and equipment of projects are accounted for in these funds.

Debt Service and Bond Funds - These funds account for the receipt and disbursement of moneys for the payment of bond or note interest and principal.

Debt Service Reserve Funds - These funds record the receipt of a portion of the bond proceeds held in reserve to comply with the various bond resolutions. The balances are generally required to be maintained at an amount equal to the greatest amount of principal and interest payable in the then current or any future bond year.

Project Reserve Funds - Bond issue documents for specific issues establish balances to be held in reserve should major repairs be necessary. These funds account for the receipt and disbursement of assets held for such reserves.

Redemption Funds - The accumulation of assets not required by other funds for the eventual redemption or purchase of bonds are accounted for in these funds.

Rebate Funds - The Federal government requires the rebate of amounts earned on the investment of bond proceeds in excess of the yield on the bonds. Rebate funds are established for the institutions to account for the accumulation of assets to pay the rebate liability.

Renewal and Replacement Funds - These funds account for the cost of renewal, renovation, repair or replacement of the mortgaged premises or the project equipment.

Loan Reserve Funds - These funds are used to repay the principal and interest portions of the institutions' repayment schedule.

Working Capital Funds - To account for the receipt and disbursement of moneys for the payment of all or a portion of the operating expenses of the institution, as well as, the debt service payments by the institution on indebtedness other than bonds.

Special Capital Reserve Funds - These funds are maintained to ensure compliance with minimum capital reserve requirements of each bond issue. Any deficiencies in the reserves are required to be funded by the institution after notification by the trustee. If the institution does not replenish this fund, the State is obligated to do so, in accordance with Section 10a-186a of the General Statutes.

Working Capital Reserve Funds - The trustee shall transfer amounts on deposit in the Working Capital Reserve Fund to the Debt Service and Bond Funds to the extent that an institution has failed to make its principal or interest payments on its loan. This is done before any withdrawals from the Special Capital Reserve Fund are made. Also, if the institution certifies to the Authority that it has no other source of moneys to pay operating expenses, and the State Treasurer consents, transfer can be made from this fund for operating expenses.

The assets of the Debt Service and Bond Funds, Debt Service Reserve, Project Reserve, Redemption Funds, Escrow Funds, Working Capital Funds, Loan Reserve Funds and Special Capital Reserve Funds are held by trustees in accordance with the bond resolutions.

Financial and Compliance Audits:

Two certified public accounting firms, one for each fiscal year under review, audited the books and accounts of the Authority, as required by the provisions of Section 10a-194 of the General Statutes. We accepted the financial statements as audited, after satisfying ourselves as to the professional reputation, qualifications and independence of the auditors, and verifying that generally accepted accounting principles and auditing standards were followed.

There were no recommendations contained in the audit reports covering the fiscal years ended June 30, 2002 and 2003.

The firms of certified public accountants also performed tests of compliance with statutory requirements in accordance with Section 1-122 of the General Statutes. The results of those tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

RÉSUMÉ OF OPERATIONS:

From the inception of the Authority on July 1, 1965, to June 30, 2003, approximately 276 bond issuances have been authorized by the Authority in the aggregate amount of $7,385,830,000, of which $4,543,230,000 was outstanding at June 30, 2003. From its inception, through July 1, 1979, the Authority issued general obligation bonds for which the Authority is ultimately responsible for payment. As of June 30, 2003, only $1,960,000 of those general obligation bonds remained outstanding and is included in the Authority's aforementioned aggregate outstanding issues of bonds. Subsequent to July 1, 1979, the Authority issued only special obligation bonds for which payment is made from the revenues of the benefited institutions. These bonds are considered conduit debt obligations of the Authority and are not considered direct obligations of the Authority. Payments for principal and interest of $1,770,000 and $93,000, respectively, on general obligation bonds were made on July 1, 2002. Payments for principal and interest of $1,960,000 and $49,000, respectively, on general obligation bonds were made on July 1, 2003.

Operating revenue of the Authority for the fiscal years ended June 30, 2002 and 2003, totaled $3,452,132 and $4,628,824, respectively, as summarized below with the fiscal year ended June 30, 2001, presented for comparative purposes:

	Fiscal Year Ended June 30,		
	2001	**2002**	**2003**

Annual Administrative fees	$3,615,768	$2,688,189	$4,261,393
Bond issuance fees income	128,060	64,610	42,670
Investment income	1,006,602	699,333	324,761
Total	**$4,750,430**	**$3,452,132**	**$4,628,824**

The chief source of revenue for the Authority is an annual administrative fee paid by each institution for each bond series issued and outstanding. The amount of the annual fee is specified in each bond issue resolution. No Special Capital Reserve Fund (SCRF) Program issues were made during the audited period because such issues were restricted by Section 10a-186a, subsection (b), of the General Statutes. However, for those SCRF issues that were outstanding during the audited period, an annual fee of 15 basis points on the outstanding par amount was charged; all other issues were charged ten basis points. In addition, the Authority charges a bond issuance fee of fifteen thousand dollars, five thousand of which is collected at issuance.

It should be noted that during the 2001-2002 fiscal year, the Authority gave $1,327,485 in annual administrative fees back to client institutions in the form of a fee rebate. This fee rebate reduced the annual administrative fees collected during the 2001-2002 fiscal year. During the 2002-2003 fiscal year the Authority also returned portions of the annual administrative fees to client institutions, but not as a fee rebate; rather, as part of a grant program in which client institutions may submit applications to receive amounts the Authority deems appropriate for the specific needs of individual institutions. This grant program method of returning portions of administrative fees to client institutions did not reduce the reported annual administrative fees collected in the 2002-2003 fiscal year. However, $1,370,483 of the reported $4,261,393 collected has been expensed for the 2002-2003 fiscal year. An accounts payable was established to distribute the funds during the 2003-2004 fiscal year, as determinations are made as to how much each applying institution will be allowed under the program.

During the fiscal years ended June 30, 2002 and 2003, operating expenses of the Authority totaled $2,370,919 and $4,335,988, respectively, as summarized below with the fiscal year ended June 30, 2001, presented for comparative purposes. These totals exclude the trustee, accounting, and special fees that are recovered from the various institutions as part of bond issue expenses. However, the total expenses for the 2002-2003 fiscal year is significantly higher than those for the 2001-2002 fiscal year because of the fee rebate versus the grant program method of returning fee payments to client institutions, as explained above relative to revenues. The expensing of what was called a fee rebate in the 2001-2002 fiscal year, as a grant in the 2002-2003 fiscal year, increases total expenses and over states fee revenue in the 2002-2003 fiscal year. However, the end result is identical.

	Fiscal Year Ended June 30, 2001	2002	2003
Personal services	$1,024,880	$1,147,352	$1,219,340
Employee benefits	204,132	251,563	274,913
Rent	178,230	187,395	196,493
Fees for Outside Profession Services	166,766	155,026	57,951
Insurance	86,628	71,454	93,779
Office supplies and expenses	94,267	115,091	119,458
Travel, conferences and seminars	36,137	29,959	27,082
Depreciation expense	56,227	63,852	71,317
Issuance costs	24,504	34,182	20,311
Provision for uncollectible accounts	267,853	52,694	5,745
Child care funding reserve	64,773	149,601	228,606
Contributions	269,586	32,486	36,745
Grants	-	40,000	782,211
Client grant expense	-	-	1,370,483
All other expenses	96,305	40,264	(168,446)
Refund of expenses	(139,340)	-	-
Total	**$2,430,949**	**$2,370,919**	**$4,335,988**

The retained earnings of the Authority's General Fund increased during the audited period. A summary of the changes in the General Fund balance for the fiscal years ended June 30, 2002 and 2003, with June 30, 2001, presented for comparative purposes, follows:

	Fiscal Year Ended June 30, 2001	2002	2003
Revenues	$4,750,431	$3,452,132	$4,628,824
Expenses	2,430,949	2,370,919	4,335,988
Excess of Revenues over Expenses	2,319,482	1,081,213	292,836
Retained Earnings, beginning of year	16,185,537	18,505,019	19,586,232
Retained Earnings, End of Year	**$18,505,019**	**$19,586,232**	**$19,879,068**

During the audited period the cash surplus balance of the Authority's General Fund was invested in a collateralized money market fund and obligations of the U. S. Treasury.

Outstanding bonds issued under the SCRF program for which the State has a contingent liability totaled $268,185,000 and $373,925,000, for the fiscal years ended June 30, 2002 and 2003, respectively. There are no loans in default as of June 30, 2003.

CONDITION OF RECORDS

We did not note any reportable conditions during our current review.

RECOMMENDATIONS

Status of Prior Recommendations:

- There were no prior recommendations.

Current Audit Recommendations:

- No audit recommendations resulted from our current review.

CONCLUSION

In conclusion, we wish to express our appreciation for the courtesy and cooperation extended to our Office by the personnel of the State of Connecticut Health and Educational Facilities Authority during the course of our examination.

Mark Dickerson,
Associate Auditor

Approved:

Kevin P. Johnston Auditor of Public Accounts	Robert G. Jaekle Auditor of Public Accounts