



MICHIGAN

OFFICE OF THE AUDITOR GENERAL

AUDIT REPORT



THOMAS H. MCTAVISH, C.P.A.
AUDITOR GENERAL

The auditor general shall conduct post audits of financial transactions and accounts of the state and of all branches, departments, offices, boards, commissions, agencies, authorities and institutions of the state established by this constitution or by law, and performance post audits thereof.

– Article IV, Section 53 of the Michigan Constitution

Audit report information can be accessed at:

<http://audgen.michigan.gov>



Michigan
Office of the Auditor General
REPORT SUMMARY

Financial Audit

*Michigan State Hospital Finance Authority
(A Discretely Presented Component Unit of the State of Michigan)
October 1, 2008 through September 30, 2009*

Report Number:
271-0280-10

Released:
December 2009

A financial audit determines if the financial statements are fairly presented; considers internal control over financial reporting; and determines compliance with requirements material to the financial statements. This financial audit of the Michigan State Hospital Finance Authority was conducted as part of the constitutional responsibility of the Office of the Auditor General.

Financial Statements:

Auditor's Report Issued

We issued an unqualified opinion on the Michigan State Hospital Finance Authority's financial statements.

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Internal Control Over Financial Reporting

We did not report any findings related to internal control over financial reporting.

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**Noncompliance and Other Matters
Material to the Financial Statements**

We did not identify any instances of noncompliance or other matters applicable to the financial statements that are

required to be reported under *Government Auditing Standards*.

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Background:

The Michigan State Hospital Finance Authority was organized under Act 38 of the Michigan Public Acts of 1969, as amended. The Authority issues bonds and makes loans to facilitate the ability of nonprofit, nonpublic health care corporations and facilities to obtain financing and refinancing for capital improvements.

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A copy of the full report can be obtained by calling 517.334.8050 or by visiting our Web site at: <http://audgen.michigan.gov>



Michigan Office of the Auditor General
201 N. Washington Square
Lansing, Michigan 48913

Thomas H. McTavish, C.P.A.
Auditor General

Scott M. Strong, C.P.A., C.I.A.
Deputy Auditor General



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THOMAS H. MCTAVISH, C.P.A.
AUDITOR GENERAL

December 22, 2009

Mr. Robert J. Kleine
State Treasurer
and
Susan W. Martin, Ph.D., Chair
Michigan State Hospital Finance Authority
Richard H. Austin Building
Lansing, Michigan

Dear Mr. Kleine and Ms. Martin:

This is our report on the financial audit of the Michigan State Hospital Finance Authority, a discretely presented component unit of the State of Michigan, for the period October 1, 2008 through September 30, 2009.

This report contains our report summary, our independent auditor's report on the financial statements, the Authority management's discussion and analysis, and the Authority's basic financial statements. This report also contains our independent auditor's report on internal control over financial reporting and on compliance and other matters and a glossary of acronyms and terms.

We appreciate the courtesy and cooperation extended to us during this audit.

AUDITOR GENERAL

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INDEPENDENT AUDITOR'S REPORT



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THOMAS H. MCTAVISH, C.P.A.
AUDITOR GENERAL

Independent Auditor's Report on the Financial Statements

Mr. Robert J. Kleine
State Treasurer
and
Susan W. Martin, Ph.D., Chair
Michigan State Hospital Finance Authority
Richard H. Austin Building
Lansing, Michigan

Dear Mr. Kleine and Ms. Martin:

We have audited the accompanying financial statements of the Michigan State Hospital Finance Authority, a discretely presented component unit of the State of Michigan, as of and for the fiscal year ended September 30, 2009, as identified in the table of contents. These financial statements are the responsibility of the Authority's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As described in Note 1, the financial statements present only the Michigan State Hospital Finance Authority and do not purport to, and do not, present fairly the financial position of the State of Michigan or its component units as of September 30, 2009 and the changes in financial position and cash flows thereof for the fiscal year then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to in the first paragraph present fairly, in all material respects, the financial position of the Michigan State Hospital Finance

Authority as of September 30, 2009 and the changes in financial position and cash flows for the fiscal year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 9, 2009 on our consideration of the Michigan State Hospital Finance Authority's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The management's discussion and analysis on pages 11 through 13 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

AUDITOR GENERAL

December 9, 2009

MANAGEMENT'S DISCUSSION AND ANALYSIS

We are pleased to present the financial statements of the Michigan State Hospital Finance Authority (the "Authority"). The Authority's financial statements include a statement of net assets; a statement of revenues, expenses, and changes in net assets; and a statement of cash flows. The statement of net assets and the statement of revenues, expenses, and changes in net assets report the Authority's net assets as of September 30, 2009 and how they have changed since September 30, 2008. Net assets, the difference between the Authority's assets and liabilities, is one way to measure the Authority's financial health or position. Over time, increases or decreases in the Authority's net assets are an indicator of whether its financial health is improving or deteriorating, respectively. The statement of cash flows shows how cash was received and used throughout the fiscal year to conduct the Authority's operations.

The Michigan State Hospital Finance Authority was organized under Act 38 of the Michigan Public Acts of 1969. The mission of the Authority is to provide low-cost capital financing to nonprofit providers of health care services that participate in any phase of the continuum of health care. It is the vision of the Authority to be the first choice of capital financing sources for all health care providers in the State of Michigan.

The Authority is a public corporate body within the Michigan Department of Treasury, Bureau of Bond Finance. The Authority is governed by a seven-member board appointed by the Governor with the advice and consent of the Senate. The Authority is a discretely presented component unit of the State of Michigan.

The Authority issues or sells tax-exempt bonds in the national public finance markets. The proceeds from these bonds are then lent to providers of health care services to finance capital projects. Short-term financing is also available through the Authority's Healthcare Equipment Loan Program (HELP). This is a pooled loan program, which provides financing for equipment, small capital projects, and renovations.

The following is a condensed summary of financial information for the fiscal years ended September 30, 2009 and September 30, 2008, respectively:

Condensed Financial Information

Category	Fiscal Year	
	2008-09	2007-08
Total Assets	\$6,728,254	\$6,567,706
Total Liabilities	\$ 174,128	\$ 157,827
Total Net Assets	\$6,554,126	\$6,409,879
Operating Revenues	\$ 992,571	\$1,016,898
Operating Expenses	\$ 937,964	\$ 990,523
Operating Income	\$ 54,607	\$ 26,375
Nonoperating Revenues	\$ 89,640	\$ 234,422
Changes in Net Assets	\$ 144,247	\$ 260,797
Ending Net Assets	\$6,554,126	\$6,409,879

Fees charged to its clients fund the operations of the Authority. The fees are based on the outstanding debt of its clients. For fiscal year 2008-09, the new bond issues exceeded the principal retirement of debt by \$218 million. Although the issues exceeded the principal retirement of debt, the Authority saw a reduction in operating revenues this fiscal year. The majority of clients that were served this fiscal year were returning clients to the Authority and already at the maximum fees level.

The Department of Treasury has oversight of all administrative functions of the Authority including budgeting and payroll. The indirect costs associated with these functions are allocated to the Authority based on predetermined percentages. The operating expenses for the Authority decreased by 5.3% from the previous fiscal year. Because of the lower cost of operations, the Authority had a greater operating profit compared to fiscal year 2007-08.

Nonoperating revenues decreased this fiscal year because of the market value fluctuation. The nonoperating revenues were \$89,640 and \$234,422 for fiscal years 2008-09 and 2007-08, respectively. This resulted in a \$144,782 decrease in nonoperating revenues for fiscal year 2008-09.

The Authority issued over \$816 million in limited obligation debt in fiscal year 2008-09 with interest rates varying from .9% to 7.18%. The majority of clients for the bonds issued by the Authority this fiscal year were previous clients who returned for financing. The offset to this issuance was that \$373 million of prior Authority bond issues were refunded.

BASIC FINANCIAL STATEMENTS

MICHIGAN STATE HOSPITAL FINANCE AUTHORITY

Statement of Net Assets

September 30, 2009

ASSETS

CURRENT ASSETS:

Cash and cash equivalents (Notes 1 and 2)	\$ 449,156
Amounts due from primary government	135,833
Amounts due from other governmental units (Note 8)	11,001
Investments - operations (Notes 1 and 2)	2,584,782
Other current assets:	
Investment income receivable	\$ 24,738
Administrative fees receivable (Note 1)	614,005
Due from HELP issues (Note 3)	<u>120,000</u>

Total other current assets 758,743

TOTAL CURRENT ASSETS \$ 3,939,515

NONCURRENT ASSETS:

Investments - operations unrestricted (Notes 1 and 2) \$ 2,788,739

Capital assets (Notes 1 and 4):

Property, plant and equipment	\$ 64,114
Less accumulated depreciation	<u>(64,114)</u>

Total capital assets \$ 0

TOTAL NONCURRENT ASSETS \$ 2,788,739

TOTAL ASSETS \$ 6,728,254

LIABILITIES AND NET ASSETS

NONCURRENT LIABILITIES:

Employee compensated absences (Note 5) \$ 174,128

NET ASSETS:

Unrestricted \$ 6,554,126

TOTAL NET ASSETS \$ 6,554,126

TOTAL LIABILITIES AND NET ASSETS \$ 6,728,254

The accompanying notes are an integral part of the financial statements.

MICHIGAN STATE HOSPITAL FINANCE AUTHORITY
Statement of Revenues, Expenses, and Changes in Net Assets
Fiscal Year Ended September 30, 2009

OPERATING REVENUES:	
Authority fees	<u>\$ 992,571</u>
OPERATING EXPENSES:	
Personnel services	\$ 573,821
Purchased professional and technical services	334,032
Purchased property services	17,095
Other purchased services	8,780
Supplies	3,174
Depreciation	<u>1,062</u>
Total operating expenses	<u>\$ 937,964</u>
Operating income	\$ 54,607
NONOPERATING REVENUES:	
Investment income	<u>89,640</u>
CHANGE IN NET ASSETS	\$ 144,247
NET ASSETS:	
Beginning of fiscal year	<u>6,409,879</u>
End of fiscal year	<u><u>\$ 6,554,126</u></u>

The accompanying notes are an integral part of the financial statements.

MICHIGAN STATE HOSPITAL FINANCE AUTHORITY
Statement of Cash Flows
Fiscal Year Ended September 30, 2009

CASH FLOWS FROM OPERATING ACTIVITIES:	
Receipts from customers	\$ 1,000,487
Payments to employees and suppliers	<u>(992,183)</u>
Net cash provided (used) by operating activities	<u>\$ 8,304</u>
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:	
Transfers to other funds	\$ (120,000)
Advances from other funds	<u>240,000</u>
Net cash provided (used) by noncapital financing activities	<u>\$ 120,000</u>
CASH FLOWS FROM INVESTING ACTIVITIES:	
Proceeds from sale and maturities of investment securities	\$ 3,730,000
Purchase of investment securities	(3,969,230)
Interest and investment income (nonprogram)	<u>159,701</u>
Net cash provided (used) by investing activities	<u>\$ 79,529</u>
NET INCREASE IN CASH AND CASH EQUIVALENTS	\$ 48,775
CASH AND CASH EQUIVALENTS:	
Beginning of fiscal year	<u>400,381</u>
End of fiscal year	<u><u>\$ 449,156</u></u>
RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES:	
Operating income	<u>\$ 54,607</u>
Adjustments to reconcile operating income to net cash provided (used) by operating activities:	
Depreciation expense	\$ 1,062
Changes in assets and liabilities:	
Amounts due from primary government	(71,581)
Accounts receivable	7,917
Compensated absences payable	<u>16,301</u>
Total adjustments	<u>\$ (46,302)</u>
Net cash provided (used) by operating activities	<u><u>\$ 8,304</u></u>

The accompanying notes are an integral part of the financial statements.

Notes to the Financial Statements

Note 1 Summary of Significant Accounting Policies

a. Reporting Entity

The Michigan State Hospital Finance Authority (the "Authority"), a discretely presented component unit of the State of Michigan, was organized under Act 38 (the "Act") of the Michigan Public Acts of 1969, as amended, to facilitate the ability of nonprofit, nonpublic health care corporations and facilities (the "facilities") to obtain financing and refinancing for capital improvements. The Authority consists of seven members, including a chairperson and four public members appointed by the Governor with the advice and consent of the Senate and two ex-officio members (the State Treasurer and the Director of the Department of Community Health). The Authority functions independently of the State Treasurer who, as agent for the Authority, may not commingle funds and must maintain a separate bank account for the Authority. The Authority is a discretely presented component unit of the State of Michigan (the "State") and is reported as such in the *State of Michigan Comprehensive Annual Financial Report (SOMCAFR)*.

The Act empowers the Authority to issue bonds for the purpose of making related loans to facilities. The Authority issues bonds for facility equipment loans through the Healthcare Equipment Loan Program (HELP) and issues revenue bonds, including insured revenue bonds, and mortgage bonds for other capital needs of the facilities. Eligible facilities obtain funds from the Authority for specific capital projects by arranging for the Authority to offer bonds for sale. Each facility signs a note and enters into a loan agreement with the Authority for payment of the note. Such bonds are payable with monies received from each respective facility, as described below, and not from the general assets of the Authority. In general, loans made under HELP are secured by the financed equipment.

All bonds are limited obligations of the Authority and are not obligations of the State. The State is not liable for payment of the bonds. The bonds are payable by the Authority, through designated trustees, solely from funds received from each participating facility in payment of the Authority's note and from investment earnings, undisbursed bond proceeds, and other

funds of each participating facility retained by the trustees on a bond issue-specific basis. Certain revenue and mortgage bonds are guaranteed by a bond insurance policy or a letter of credit if payments under the note and pledged assets are not sufficient to pay the bonds.

Participating facilities share the administrative costs of the Authority in an amount related to the principal balances of the respective outstanding bonds.

The accompanying financial statements have been prepared in accordance with criteria established by the Governmental Accounting Standards Board Statements No. 14 and No. 39. These criteria include oversight responsibility, accountability for fiscal matters, scope of public services, and special financing relationships.

Executive Order 2002-12 combined the Authority's administrative staff with the administrative staff of several similar authorities into a single work unit under the direction and supervision of the State Treasurer.

b. Financial Statements

The financial statements (i.e., statement of net assets; statement of revenues, expenses, and changes in net assets; and statement of cash flows) report information on all activities of the government. The Authority is considered a business-type activity and has no component units.

The accompanying financial statements present only the Michigan State Hospital Finance Authority. Accordingly, they do not purport to, and do not, present fairly the financial position and the changes in financial position and cash flows of the State or its component units in conformity with accounting principles generally accepted in the United States of America.

c. Measurement Focus, Basis of Accounting, and Financial Statement Presentation

The Authority is accounted for as a proprietary fund. A proprietary fund is used to account for operations:

- (1) That are financed and operated in a manner similar to private business enterprises - where the intent of the governing body is that the costs (expenses, including depreciation) of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges, or
- (2) Where the governing body has decided periodic determination of revenues, expenses, and net income is appropriate for capital maintenance, public policy, management control, accountability, or other purposes.

Proprietary fund financial statements are presented using the "economic resources measurement focus" and the "accrual basis of accounting." Revenues are recognized when earned and expenses are recognized when the materials, services, or benefits are received. Service fees and other fees and charges are recorded as income when earned, and the associated administrative expenses are recorded as incurred.

Designated trustees maintain separate accounting records pertaining to each individual bond issue for each participating facility. Assets managed by the trustees for each facility are restricted for payment of bond principal and interest and approved construction expenditures except for certain investment income which may be returned to the facility. None of the assets or liabilities held by the trustees are reflected in the Authority's financial statements, as more fully described in Note 7.

Bond proceeds are retained by the trustees to fund interest costs and principal payments during the period of construction. After the construction period, interest and principal payments are funded by regular loan payments from the facilities.

Private-sector standards of accounting and financial reporting issued prior to December 1, 1989 are followed in proprietary fund financial statements

to the extent that those standards do not conflict with or contradict guidance of the Governmental Accounting Standards Board. Governments also have the option of following subsequent private-sector guidance for their business-type activities and enterprise funds, subject to the same limitation. The Authority has elected not to follow subsequent private-sector guidance.

Amounts reported as *program revenues* include charges to customers, services, or privileges provided. Likewise, general revenues include unrestricted investment income.

Proprietary funds distinguish *operating* revenues and expenses from *nonoperating* items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations. The principal operating revenues of the Authority are charges to customers for services. Operating expenses of the Authority include the cost of services, administrative expenses, and the depreciation on capital assets. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

d. Assets, Liabilities, and Net Assets

Cash and cash equivalents - Cash and cash equivalents include deposits with financial institutions.

Deposits and Investments - The Authority's deposits and investments are held in a fiduciary capacity by the State Treasurer. The Act restricts investments to obligations of the State or U.S. government, obligations of which the principal and interest are guaranteed by the State or U.S. government, certificates of deposit of a bank which is a member of the Federal Reserve System or a savings and loan association which is a member of the Federal Home Loan Bank System, certain classifications of commercial paper, U.S. government repurchase agreements, bankers' acceptances of U.S. banks, mutual funds composed of investment vehicles that are legal for direct investment by the Authority, and other obligations approved by the State Treasurer.

Investments are stated at fair value.

The Act requires all deposits of the Authority to be secured by obligations of the United States or of the State. The market value of these obligations must at all times be equal to the amount of the deposits of the Authority, and all banks and trust companies are authorized to give such security for such deposits.

Administrative fees receivable - Accounts receivable (administrative fees receivable) are stated at the amount management expects to collect from outstanding balances. Management provides for probable uncollectible amounts through a provision for bad debt expense when necessary and an adjustment to a valuation allowance based on its assessment of the current status of individual accounts. Balances that are still outstanding after management has used reasonable collection efforts are written off through a charge to the valuation allowance and a credit to accounts receivable. Changes in the valuation allowance have not been material to the financial statements and no allowances are currently deemed necessary.

Capital assets - Capital assets include office equipment. Capital assets are defined by the Authority as assets with an initial individual cost of more than \$1,000 and an estimated useful life in excess of one year.

Such assets are recorded at historical cost. The cost of normal maintenance and repairs that do not add to the value of the asset or materially extend assets lives are not capitalized. Capital assets are depreciated using the straight-line method over the following estimated useful lives:

Asset	Years
Office equipment	7
Computer equipment	5

Compensated absences - Vacation, banked leave time, and sick pay are recorded as expenses at the time the benefit is earned by the employee, taking into consideration maximum contractual amounts. The Authority is

allocated a percentage of assigned employees of the Bureau of Bond Finance. Each employee's total compensated absences is multiplied by the current allocation percentage.

Note 2 Deposits and Investments

As of September 30, 2009, the Authority had the following investments:

Investment Type	Fair Value	Standard & Poor's Rating	Percentage	Investment Maturities	
				Less Than 1 Year	1 to 5 Years
U.S. Treasury securities	\$5,373,521	AAA	100.0%	\$2,584,782	\$2,788,739

The above amounts are reported in the financial statements as follows:

Current:

Investments - operations \$2,584,782

Noncurrent:

Investments - operations unrestricted 2,788,739

\$5,373,521

Interest rate risk - The Authority does not maintain a formal investment policy. However, the Authority minimizes interest rate risk, which is the risk that the market value of securities in the portfolio will fall due to changes in market interest rates, by structuring the investment portfolio so that securities mature to meet cash requirements for ongoing operations, thereby avoiding the need to sell securities in the open market, and investing operating funds primarily in shorter-term securities, mutual funds, or similar investment pools and limiting the average maturity in accordance with the Authority's cash requirements.

Credit risk - Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. State law limits investments to government or government backed securities and deposits and commercial paper to within the two highest classifications established by two nationally recognized statistical rating organizations (NRSROs). The Authority has no formal investment policy that would further limit its investment choices.

Concentration of credit risk - The Authority places no limit on the amount the Authority may invest in any one issuer; however, the Authority does minimize concentration of credit risk, which is the risk of loss attributed to the magnitude of the Authority's investment in a single issuer, by diversifying the investment portfolio so that the impact of potential losses from any one type of security or issuer will be minimized.

Custodial credit risk - deposits - Custodial credit risk is the risk that, in the event of a bank failure, the Authority's deposits may not be returned to it. As of September 30, 2009, the carrying amount and the bank balance of the Authority's deposits was \$449,156. The September 30, 2009 balance was covered by federal depository insurance or collateral held with the Authority's agent in the Authority's name.

Custodial credit risk - investments - Custodial credit risk is the risk that, in the event of the failure of the counterparty, the Authority will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. The Authority minimizes custodial credit risk by limiting investments to the types of securities allowed by law and prequalifying the financial institutions, broker/dealers, intermediaries, and advisors with which the Authority will do business. At September 30, 2009, \$4.9 million of investment securities were uninsured and unregistered with securities held by the counterparty.

Note 3 Due from HELP Issues

The Authority has advanced funds for the purpose of paying the issuance costs related to the Healthcare Equipment Loan Program (HELP) bond issues. The proceeds from the HELP bond issues are loaned to qualifying hospitals for hospital equipment. These advances will be repaid to the Authority during the HELP loan repayment period. As of September 30, 2009, \$120,000 was advanced by the Authority.

Note 4 Capital Assets

As of September 30, 2009, depreciable assets consisted of the following:

	Balance September 30, 2008	Additions	Deletions	Balance September 30, 2009
Governmental activities:				
Capital assets:				
Furniture and fixtures	\$23,465	\$	\$	\$23,645
Computer equipment	40,649			40,649
Depreciable capital assets	\$64,114	\$ 0	\$ 0	\$64,114
Accumulated depreciation:				
Furniture and fixtures	\$23,465	\$	\$	\$23,465
Computer equipment	39,587	1,062		40,649
Total accumulated depreciation	\$63,052	\$ 1,062	\$ 0	\$64,114
Net governmental capital assets	\$ 1,062	\$(1,062)	\$ 0	\$ 0

All depreciation expense has been charged to the Authority's sole activity. Executive Order 2001-3 transferred the purchase and maintenance of the Authority's computer equipment to the Michigan Department of Information Technology. The Authority is charged back an allocation of the annual purchase and maintenance costs.

Note 5 Compensated Absences

Plan descriptions - Employees accumulate annual leave (vacation) balances to a maximum ranging from 296 to 356 hours. They receive a 100% termination payment upon separation of a maximum ranging from 256 to 316 hours based upon their final rate of pay. Employee sick leave balances accumulate without limit. Termination payments are made only upon separation from State service and only to employees hired prior to October 1, 1980. Payments at retirement or death are based on 50% of the employees' sick leave accumulation multiplied by their final rate of pay. When separating for any other reason, employees are paid a percentage of their unused sick leave, which increases from 0% to 50% depending upon the balance of their sick leave hours. From October 2003 through October 2005, employees were required to participate in the banked leave time (BLT) program. Under the BLT program, each employee's biweekly pay was reduced by up to 4 hours of pay. The unpaid

time was credited to the employee's BLT account and can be used for unpaid time off or it can accumulate up to 104 hours a year. Unused accumulated BLT is paid as an employer contribution to a 401(k) plan when the employee separates from service.

Accounting policy - The Authority has accrued liabilities for compensated absences as required by the Governmental Accounting Standards Board. Annual leave is valued at 100% of the balance plus the State's share of social security and retirement contributions. Sick leave is valued, as explained in the previous paragraph, at 0% to 50% plus the State's share of social security and retirement contributions. Banked leave time is valued at the unused accumulated hours at year-end. The pay rates in effect as of October 1, 2009 are used. The compensated absences balances were as follows:

Compensated Absence Type	Balance September 30, 2008	Increase	Decrease	Balance September 30, 2009
Annual leave	\$ 63,029	\$	\$12,081	\$ 50,948
Sick leave	89,102	12,095		101,197
Banked leave time	5,696	16,287		21,983
Total	\$157,827	\$28,382	\$12,081	\$174,128

Note 6 Employee Benefits

Plan descriptions - The Authority participates in the State of Michigan's defined benefit and defined contribution plans that cover most State employees, as well as related component units such as the Michigan State Hospital Finance Authority. The defined benefit and defined contribution pension plans are part of the State Employees' Retirement System administered by the Department of Management and Budget, Office of Retirement Services. Participants in each plan are eligible for retirement, healthcare, disability, and death benefits upon meeting certain vesting requirements. The State Employees' Retirement System issues a publicly available financial report that includes financial statements and required supplementary information for the defined benefit plan. That report is available on the State's website at <http://www.michigan.gov/ors>. The financial report for the defined contribution plan may be obtained by writing to the Department of Management and

Budget, Office of Retirement Services, 7150 Harris Drive, P.O. Box 30171, Lansing, MI 48909 or by calling (517) 322-5103.

Funding policy - For the defined benefit plan, the Authority was required to contribute at an actuarially determined rate of 30.64% and 30.12% of payroll for the fiscal years ended September 30, 2009 and September 30, 2008, respectively. Defined benefit plan members are not required to make contributions. For the defined contribution plan, the Authority was required to contribute to the defined contribution plan 4.0% of payroll with an additional match of up to 3.0% for the fiscal years ended September 30, 2009 and September 30, 2008. Employee contributions were not significant. The Authority transferred approximately \$10,935 to the State for its employer contribution. The contribution requirements of plan members and the Authority are established and may be amended by the State Legislature. The State Legislature establishes the extent to which the employer and employees are required to make contributions and establishes the benefit provisions for the plan.

Postemployment benefits - In addition, the Authority participates in the State of Michigan's postemployment benefits. The cost of retiree healthcare benefits is an allocation calculated by the State of Michigan and funded on a pay-as-you-go basis. The State will pay 90% of healthcare benefits for employees hired on or before March 30, 1997, who participate in either the defined benefit plan or the defined contribution plan and meet certain vesting and other requirements. For employees who were hired after March 30, 1997, the State will pay up to 90% of healthcare benefits for employees who meet certain vesting and other requirements.

Note 7 Limited Obligation Debt

The Authority has certain bonds outstanding. The trustee, fiscal agent, registrar, and paying agent functions for the defeased bonds are performed by an Authority-designated trustee. Because these obligations are, in substance, debts of other entities, the liabilities and related assets are not reflected in the Authority's financial statements.

The Authority has defeased, in substance, certain bonds by placing the proceeds of new bonds in an irrevocable trust to provide for all future debt service payments on the old bonds. Economic gains and accounting gains and

losses upon in-substance defeasance inure to the benefit of the facility for which the bonds were issued and, accordingly, are not reflected in the Authority's financial statements.

The defeased, undefeased, and total outstanding bonds as of September 30, 2009 were as follows:

Defeased	\$1,115,430,000
Undefeased	<u>5,599,963,590</u>
Total outstanding	<u><u>\$6,715,393,590</u></u>

Note 8 Transactions With Other State Agencies

The Authority is charged by various State agencies and departments for certain accounting, auditing, legal, and cash management services. These fees were approximately \$307,192 for the fiscal year ended September 30, 2009. As of September 30, 2009, no amounts were due from or to other State agencies or departments for these services.

The Authority received reimbursements from other State agencies for expenses relating to salaries and administrative costs in the amount of \$27,817. As of September 30, 2009, \$11,001 was due to the Authority.

Note 9 Risk Management

The Authority's risk management is provided through the State. The State has elected not to purchase commercial insurance for many of the risks of losses to which it is exposed. The State is self-insured for most general liability and property losses, portions of its employee insurance benefit and employee bonding programs, automobile liability, and workers' compensation and unemployment compensation claims. The State has established two internal service funds, the Risk Management Fund and the State Sponsored Group Insurance Fund, to account for certain aspects of the risk management program. Additional detail and other data on the State's risk management program are provided in the *SOMCAFR*.

Note 10 Subsequent Event

On November 3, 2009, the Authority issued bonds totaling \$330.7 million. Additionally, on November 13, 2009, the Authority issued bonds totaling \$102.8 million.

INDEPENDENT AUDITOR'S REPORT ON
INTERNAL CONTROL AND COMPLIANCE



STATE OF MICHIGAN
OFFICE OF THE AUDITOR GENERAL
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THOMAS H. MCTAVISH, C.P.A.
AUDITOR GENERAL

Independent Auditor's Report on Internal Control Over Financial Reporting and on Compliance and Other Matters

Mr. Robert J. Kleine
State Treasurer
and
Susan W. Martin, Ph.D., Chair
Michigan State Hospital Finance Authority
Richard H. Austin Building
Lansing, Michigan

Dear Mr. Kleine and Ms. Martin:

We have audited the financial statements of the Michigan State Hospital Finance Authority, a discretely presented component unit of the State of Michigan, as of and for the fiscal year ended September 30, 2009, as identified in the table of contents, and have issued our report thereon dated December 9, 2009. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Michigan State Hospital Finance Authority's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Michigan State Hospital Finance Authority's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Michigan State Hospital Finance Authority's internal control over financial reporting.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined in the preceding paragraph.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Michigan State Hospital Finance Authority's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of the Governor, the Legislature, the Michigan State Hospital Finance Authority, management, and others within the Department of Treasury and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

AUDITOR GENERAL

December 9, 2009

GLOSSARY

Glossary of Acronyms and Terms

Authority	Michigan State Hospital Finance Authority.
BLT	banked leave time.
control deficiency in internal control over financial reporting	The design or operation of a control that does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis.
financial audit	An audit that is designed to provide reasonable assurance about whether the financial schedules and/or financial statements of an audited entity are presented fairly in all material respects in conformity with the disclosed basis of accounting.
HELP	Healthcare Equipment Loan Program.
internal control	A process, effected by those charged with governance, management, and other personnel, designed to provide reasonable assurance about the achievement of the entity's objectives with regard to the reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations.
material misstatement	A misstatement in the financial schedules and/or financial statements that causes the schedules and/or statements to not present fairly the financial position or the changes in financial position or cash flows in conformity with the disclosed basis of accounting.
material weakness in internal control over financial reporting	A significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial schedules and/or financial statements will not be prevented or detected.

significant deficiency
in internal control over
financial reporting

A control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial schedules and/or financial statements that is more than inconsequential will not be prevented or detected.

SOMCAFR

State of Michigan Comprehensive Annual Financial Report.

unqualified opinion

An auditor's opinion in which the auditor states that the financial schedules and/or financial statements presenting the basic financial information of the audited agency are fairly presented in conformity with the disclosed basis of accounting.

