MICHIGAN

OFFICE OF THE AUDITOR GENERAL

AUDIT REPORT

FINANCIAL AUDIT
INCLUDING THE PROVISIONS OF THE SINGLE AUDIT ACT
OF THE

MICHIGAN PUBLIC EDUCATIONAL FACILITIES AUTHORITY

(A Discretely Presented Component Unit of the State of Michigan)

October 1, 2007 through September 30, 2009

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

271-0275-10

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
Including the Provisions of the Single Audit Act

Michigan Public Educational Facilities Authority
(A Discretely Presented Component Unit of the State of Michigan)

October 1, 2007 through September 30, 2009

Report Number:
271-0275-10

Released:
May 2010

A Single Audit is designed to meet the needs of all financial report users, including an entity's federal grantor agencies. The audit determines if the financial schedules and/or financial statements are fairly presented; considers internal control over financial reporting and internal control over federal program compliance; determines compliance with requirements material to the financial schedules and/or financial statements; and assesses compliance with direct and material requirements of the major federal programs.

Financial Statements:

Auditor's Report Issued

We issued an unqualified opinion on the Michigan Public Educational Facilities Authority's financial statements.

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Internal Control Over Financial Reporting

We identified a significant deficiency in internal control over financial reporting (Finding 1). We consider Finding 1 to be a material weakness.

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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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Federal Awards:

Auditor's Report Issued on Compliance

We audited one program as a major program and issued a qualified opinion. We identified known questioned costs of $500,000. The Authority expended a total of $3,158,710 in federal awards during the two-year period ended September 30, 2009. The federal program audited as a major program is identified on the back of this summary.

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Internal Control Over Major Programs

We identified significant deficiencies in internal control over federal program compliance (Finding 2). We consider Finding 2 to contain material weaknesses.

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Required Reporting of Noncompliance

We identified instances of noncompliance that are required to be reported in accordance with U.S. Office of

Management and Budget (OMB) Circular A-133 (Finding 2).

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Background:
The Michigan Public Educational Facilities Authority was created by Executive Order No. 2002-3 to assist the State's public school academies in obtaining access to the market for cash flow financing needs.

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We audited the following program as a major program:

CFDA Number	***Program Title***	***Compliance Opinion***
84.354	Credit Enhancement for Charter School Facilities	Qualified

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

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

May 21, 2010

Mr. Robert J. Kleine
State Treasurer
and
Mr. David S. Mittleman, Chair
Michigan Public Educational Facilities Authority
Richard H. Austin Building
Lansing, Michigan

Dear Mr. Kleine and Mr. Mittleman:

This is our report on the financial audit, including the provisions of the Single Audit Act, of the Michigan Public Educational Facilities Authority, a discretely presented component unit of the State of Michigan, for the period October 1, 2007 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; the Authority's basic financial statements; and the schedule of expenditures of federal awards. This report also contains our independent auditor's report on internal control over financial reporting and on compliance and other matters, our independent auditor's report on compliance with requirements applicable to each major program and on internal control over compliance in accordance with U.S. Office of Management and Budget Circular A-133, and our schedule of findings and questioned costs. In addition, this report contains the Authority's summary schedule of prior audit findings, its corrective action plan, and a glossary of acronyms and terms.

Our findings and recommendations are contained in Section II and Section III of the schedule of findings and questioned costs. The agency preliminary responses are contained in the corrective action plan.

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

AUDITOR GENERAL

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GLOSSARY

INDEPENDENT AUDITOR'S REPORT

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
the Financial Statements

Mr. Robert J. Kleine
State Treasurer
and
Mr. David S. Mittleman, Chair
Michigan Public Educational Facilities Authority
Richard H. Austin Building
Lansing, Michigan

Dear Mr. Kleine and Mr. Mittleman:

We have audited the accompanying basic financial statements of the Michigan Public Educational Facilities Authority, a discretely presented component unit of the State of Michigan, as of and for the fiscal years ended September 30, 2009 and September 30, 2008, 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 Public Educational Facilities 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 September 30, 2008 and the changes in financial position and cash flows thereof for the fiscal years 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 Public Educational Facilities Authority as of September 30, 2009 and September 30, 2008 and the changes in financial position and cash flows for the fiscal years 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 May 3, 2010 on our consideration of the 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 14 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.

The schedule of expenditures of federal awards, required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, is presented for purposes of additional analysis and is not a required part of the Authority's basic financial statements referred to in the first paragraph. Such information has been subjected to the auditing procedures applied in the audit of the financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the financial statements taken as a whole.

AUDITOR GENERAL

May 3, 2010

MANAGEMENT'S DISCUSSION AND ANALYSIS

We are pleased to present the financial statements of the Michigan Public Educational Facilities 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 presents information on the Authority's assets and liabilities, with differences between the two reported as net assets. Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of the Authority is improving or not. The statement of revenues, expenses, and changes in net assets presents information showing how the net assets changed during fiscal years 2008-09 and 2007-08. The statement of cash flows shows how cash was received and used throughout each fiscal year to conduct the Authority's activities.

The Authority was created in 2002 by Executive Order No. 2002-3 to assist the State's public school academies in obtaining access to the market for cash flow and facility financing needs.

The Authority is governed by a five-member board. The Governor, with the advice and consent of the Senate, appoints four members, and the State Treasurer serves as a member by virtue of the appointed office. The Authority is a proprietary component unit of the State of Michigan. The Authority is housed within the Bureau of Bond Finance, Department of Treasury. The Department of Treasury has oversight of all administrative functions of the Authority, including budgeting and payroll. The costs associated with these administrative functions are allocated to the Authority based on predetermined percentages.

The Authority's long-term limited obligation debt financings provide a low-cost alternative to public school academies for the purpose of financing land, facilities, or equipment or refinancing existing debt. The Authority completed 1 and 5 long-term limited obligation debt financings totaling $10.7 million and $25.9 million in fiscal years 2008-09 and 2007-08, respectively. The Authority primarily funds its operations with fees charged to the public school academies based on the public school academies' outstanding debt.

Additionally, the Authority's State aid note program provides schools access to the capital markets at competitive interest rates. The State aid note program provides funds for short-term financing to meet cash flow needs for operating purposes. The Authority issued State aid notes and loaned proceeds of $41.2 million to 49 schools and $16.6 million to 31 schools in fiscal years 2008-09 and 2007-08, respectively.

The following is a condensed summary of financial information for the fiscal years ended September 30, 2009, 2008, and 2007, respectively.

Condensed Financial Information

Category	Fiscal Year 2008-09	Fiscal Year 2007-08	Fiscal Year 2006-07
Total assets	$50,341,119	$32,610,220	$ 29,160,326
Total liabilities	45,397,766	27,729,236	24,476,190
Total net assets	$ 4,943,353	$ 4,880,984	$ 4,684,136
Operating revenues	$ 2,523,052	$ 3,652,517	$ 172,130
Operating expenses	1,454,596	2,477,180	116,178
Operating income	$ 1,068,456	$ 1,175,337	$ 55,951
Nonoperating revenues and (expenses)	(1,006,087)	(1,048,258)	(66,934)
Transfers in and (out)	0	0	(519,053)
Change in net assets	$ 62,369	$ 127,079	$ 530,035

Financial Analysis

Net Assets

Total assets increased from $32.6 million in fiscal year 2007-08 to $50.3 million in fiscal year 2008-09. This was attributable to an increase of $24.6 million in amounts due from charter schools for the State aid note program. Total assets increased from $29.2 million in fiscal year 2006-07 to $32.6 million in fiscal year 2007-08. This increase was attributable to an increase in cash of $6.6 million caused by the receipt of federal funds and cash proceeds from State aid note issuance greater than the amounts loaned to charter schools and a decrease of $3.0 million in amounts due from charter schools.

Total liabilities increased from $27.7 million in fiscal year 2007-08 to $45.4 million in fiscal year 2008-09. This increase was attributable to the increase in the State aid notes issued. Total liabilities increased from $24.5 million in fiscal year 2006-07 to $27.7 million in fiscal year 2007-08. This increase was attributable to an increase of

$4.6 million in deferred revenue related to federal funds advanced to the Authority and a decrease of $1.3 million in State aid notes issued.

Operating Results

The Authority's operating revenues are primarily derived from loan interest income, federal revenue, and fees charged to the public school academies.

The Authority was awarded a $6.5 million federal grant in fiscal year 2007-08 from the U.S. Department of Education. This grant was recorded as deferred revenue in the fiscal year 2007-08 financial statements. As the funds are used for credit enhancement for charter school facilities, the Authority recognizes revenue and expenses. The Authority recognized $1.0 million and $2.0 million of revenue and expenses in fiscal years 2008-09 and 2007-08, respectively. The decrease in operating revenues and expenses for the Authority in fiscal year 2008-09 was due to the decrease in the amounts recognized for these grant-related revenues and expenses. The increase in operating revenues and expenses in fiscal year 2007-08 was due to the amounts recognized for these grant-related revenues and expenses and the reclassification of loan interest income and expenses from nonoperating to operating revenues and expenses (please see Note 2 of the financial statements).

Nonoperating revenues and expenses include issuance costs and interest expense associated with the Authority's State aid note program. The change in nonoperating revenues and expenses was the result of changes in the issuance costs and interest expense.

Michigan Finance Authority

On March 4, 2010, the Governor issued Executive Order No. 2010-2, which will consolidate certain public finance authorities in Michigan, including the Michigan Public Educational Facilities Authority, into the Michigan Finance Authority, a single autonomous public body corporate and politic within the Department of Treasury. Under the terms of Executive Order No. 2010-2, the Michigan Finance Authority shall acquire and succeed to all the rights, properties, obligations, and duties of the Michigan Public Educational Facilities Authority and the Michigan Public Educational Facilities Authority Board shall be abolished. If the Legislature takes no action concerning Executive Order No. 2010-2 within 60 days of issuance, Executive Order No. 2010-2 will go into effect on May 30, 2010.

Additional information about the Authority as well as annual statistical reports can be found at www.michigan.gov/treasury.

The contact information for the Authority is:

Michigan Public Educational Facilities Authority
Richard H. Austin Building
430 W. Allegan
Lansing, MI 48922
Phone (517) 335-0994

BASIC FINANCIAL STATEMENTS

MICHIGAN PUBLIC EDUCATIONAL FACILITIES AUTHORITY
Statement of Net Assets
As of September 30

	2009	2008
ASSETS		
Current assets:		
Cash and cash equivalents (Notes 1 and 3)	$ 8,579,254	$ 15,861,271
Amounts due from other governmental units	1,785	518
Amounts due from local units - Charter schools (Note 4)	41,236,000	16,606,640
Other current assets:		
Interest income receivable (Note 2)	483,664	106,814
Administrative fees receivable (Note 1)	40,416	34,977
Total assets	$ 50,341,119	$ 32,610,220
LIABILITIES AND NET ASSETS		
Current liabilities:		
Interest payable	$ 404,407	$ 142,473
Notes payable (Notes 1 and 5)	41,407,250	23,003,050
Deferred revenue (Notes 1 and 2)	3,556,496	4,556,496
Total current liabilities	$ 45,368,153	$ 27,702,019
Noncurrent liabilities:		
Compensated absences	29,613	27,217
Total liabilities	$ 45,397,766	$ 27,729,236
Net assets (Note 2):		
Unrestricted	$ 223,164	$ 217,333
Restricted	4,720,189	4,663,651
Total net assets	$ 4,943,353	$ 4,880,984
Total liabilities and net assets	$ 50,341,119	$ 32,610,220

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

MICHIGAN PUBLIC EDUCATIONAL FACILITIES AUTHORITY
Statement of Revenues, Expenses, and Changes in Net Assets
Fiscal Years Ended September 30

	2009	2008
OPERATING REVENUES		
Loan interest income (Note 2)	$ 1,077,279	$ 992,756
Federal revenue (Note 2)	1,000,000	1,974,750
Loan investment income	291,817	534,710
Charges for services (Note 2)	153,493	150,301
Other income	463	
Total operating revenues	$ 2,523,052	$ 3,652,517
OPERATING EXPENSES		
Grants to charter schools (Note 2)	$ 1,000,000	$ 1,974,750
Miscellaneous loan expenses	301,111	378,265
Personnel services	95,102	96,098
Purchased professional and technical services	54,097	23,538
Other expenses	4,286	4,529
Total operating expenses	$ 1,454,596	$ 2,477,180
Operating income	$ 1,068,456	$ 1,175,337
NONOPERATING REVENUES (EXPENSES)		
Investment income	$ 32,714	$ 126,913
Note interest expense	(837,851)	(854,694)
Note issuance costs	(200,950)	(320,477)
Total nonoperating revenues (expenses)	$ (1,006,087)	$ (1,048,258)
Change in net assets	$ 62,369	$ 127,079
Net assets		
Beginning of fiscal year (Note 2)	4,880,984	4,753,905
End of fiscal year (Note 2)	$ 4,943,353	$ 4,880,984

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

MICHIGAN PUBLIC EDUCATIONAL FACILITIES AUTHORITY
Statement of Cash Flows
Fiscal Years Ended September 30

	2009	2008
CASH FLOWS FROM OPERATING ACTIVITIES		
Receipts from federal government	$	$ 6,531,246
Receipts from customers	148,517	133,852
Payments to grantees	(1,000,000)	(1,974,750)
Payments to employees	(93,973)	(91,641)
Payments to suppliers	(58,383)	(28,068)
Loans made to local units - Charter schools	(47,490,360)	(21,163,275)
Loan collections	22,861,000	24,167,000
Loan interest received	992,247	1,565,810
Miscellaneous loan expenses	(301,111)	(378,265)
Net cash provided (used) by operating activities	$ (24,942,063)	$ 8,761,909
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Proceeds from sale of notes	$ 41,373,928	$ 23,038,437
Payment of note principal	(22,865,000)	(24,240,000)
Payment of note interest	(680,646)	(959,721)
Payment of note issuance costs	(200,950)	(320,477)
Net cash provided (used) from noncapital financing activities	$ 17,627,332	$ (2,481,761)
CASH FLOWS FROM INVESTING ACTIVITIES		
Interest and dividends received	$ 32,714	$ 126,913
Net cash provided (used) by investing activities	$ 32,714	$ 126,913
Net increase (decrease) in cash and cash equivalents	$ (7,282,017)	$ 6,407,061
Cash and cash equivalents - Beginning of year	15,861,271	9,454,210
Cash and cash equivalents - End of year	$ 8,579,254	$ 15,861,271
RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES		
Operating income	$ 1,068,456	$ 1,175,337
Adjustments to reconcile operating income to net cash provided (used) by operating activities:		
Change in administrative fees receivable	(5,439)	(16,449)
Change in amounts due from other governmental units	(1,267)	1,316
Change in amounts due from local units - Charter schools	(24,629,360)	3,003,725
Change in interest income receivable	(376,849)	38,344
Change in compensated absences liability	2,396	3,140
Change in deferred revenue	(1,000,000)	4,556,496
Net cash provided (used) by operating activities	$ (24,942,063)	$ 8,761,909

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

Note 1 Summary of Significant Accounting Policies

The accounting policies of the Michigan Public Educational Facilities Authority conform to accounting principles generally accepted in the United States of America (GAAP) as applicable to governmental units. The following is a summary of the significant accounting policies:

a. Reporting Entity

The Michigan Public Educational Facilities Authority (the Authority), a discretely presented component unit of the State of Michigan, is a public body corporate and politic of the State and is authorized by Executive Order No. 2002-3 (Section 12.192 of the *Michigan Compiled Laws*) to issue bonds for the purpose of making loans through the purchase by the Authority of municipal obligations in fully marketable form of a governmental unit or making loans to a nonprofit entity for the benefit of a public school academy.

The Authority is governed by a Board of Trustees that consists of five members. The Governor, with the advice and consent of the Senate, appoints four members, and the State Treasurer serves as a member by virtue of the appointed office. The Board provides overall governing direction for the Authority. The Authority is not empowered to create debt or liabilities on behalf of the State or to pledge the full faith and credit of the State.

The Authority is housed within the Department of Treasury but exercises its statutory functions independently of the State Treasurer. All administrative functions of the Authority, including budgeting, procurement, personnel, and management functions, are under the direction and supervision of the State Treasurer.

The Authority is reported as a discretely presented component unit of the State of Michigan in the *State of Michigan Comprehensive Annual Financial Report* (*SOMCAFR*).

b. Basis of Presentation and Accounting

The accompanying 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 Authority and have been prepared in accordance with GAAP as prescribed by the Governmental Accounting Standards Board (GASB). The Authority is considered a business-type activity and has no component units.

The accompanying financial statements present only the Michigan Public Educational Facilities 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 of Michigan or its component units in conformity with GAAP.

The Authority follows the accounting rules promulgated by GASB. Additionally, the Authority follows all Financial Accounting Standards Board (FASB) statements and interpretations, Accounting Principles Board (APB) opinions, and Accounting Research Bulletins (ARBs) issued on or before November 30, 1989, unless pronouncements conflict with or contradict GASB statements.

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.

c. Assets, Liabilities, and Net Assets

Cash and cash equivalents - Cash and cash equivalents include deposits with financial institutions and cash deposited in the State of Michigan's common cash pool.

Amounts due from local units - Charter schools - The Authority issues State aid notes and loans the proceeds to charter schools to meet cash flow needs for operating purposes. These loans were recorded as "Amounts due from local units - Charter schools."

Administrative fees receivable - Administrative fees receivable are stated at the amount management expects to collect from outstanding balances. Participating public school academies share the administrative costs of the Authority in an amount related to the principal balances of the respective outstanding limited obligation bonds.

Notes payable - State aid notes are payable by the Authority, through designated trustees, solely from funds received from each participating public school academy in payment of the Authority's note and from investment earnings, undisbursed note proceeds, and other funds of each participating public school academy retained by the trustees on a note issue-specific basis.

Deferred revenue - The Authority deferred revenue reflects a federal capitalization grant which has been received but funds were not yet allocated to assist in funding charter school projects. As funds are used, the Authority recognizes the revenue.

d. Revenues and Expenses

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, federal grants, and interest earned on loans to charter schools. Operating expenses of the Authority include the cost of services, federal grants, expenses related to providing loans to charter schools, and administrative expenses. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the period. Actual results could differ from those estimates. The Authority estimated loan interest income.

Note 2 Differences in Reporting From *SOMCAFR*

Information in the Authority's fiscal year 2007-08 financial statements differs from the presentation in the combining statement of net assets and the combining statement of activities in the *SOMCAFR*. During fiscal year 2007-08, the Authority recorded certain financial transactions incorrectly and this caused incorrect balances to be reported in the fiscal year 2007-08 *SOMCAFR*.

In order to ensure that the Authority's financial statements present fairly the Authority's financial position and changes in financial position, the Authority has adjusted its financial statements to eliminate the effects of these incorrectly recorded financial transactions. In accordance with the State of Michigan Financial Management Guide, Part II, Chapter 24, Section 400, the Authority requested and the Office of Financial Management, State Budget Office, granted a waiver to present the Authority's fiscal year 2007-08 financial statements different from the *SOMCAFR*.

The Authority adjusted the following line items in its financial statements:

Fiscal Year 2007-08

Financial Statement Line Item	Increase (Decrease)
Loan interest income	$ 37,045
Federal revenue	$ 1,974,750
Charges for services	$ (12,933)
Grants to charter schools	$ 1,974,750
Operating transfers (net)	$ (4,543,564)
Interest income receivable	$ 106,814
Deferred revenue	$ 4,556,496
Net assets - Beginning of fiscal year	$ 69,769
Net assets - End of fiscal year	$ (4,449,682)

As a result of the fiscal year 2007-08 adjustments, the fiscal year 2008-09 *SOMCAFR* reflected a revised net assets beginning balance of $4,880,984.

In addition, the Authority has changed its definitions of operating revenues and expenses and reported loan interest income, loan investment income, and miscellaneous loan expenses as operating revenues and expenses on the Authority's statement of revenues, expenses, and changes in net assets. These balances were reported as nonoperating revenues and expenses in the fiscal year 2007-08 *SOMCAFR*.

Note 3 Deposits

a. Cash and cash equivalents - Cash and cash equivalents include deposits with financial institutions and other highly liquid short-term investments with original maturities of less than 3 months used for cash management rather than investing activities. Additionally, cash held by the State Treasurer for the Authority was deposited in the State of Michigan's common cash pool.

b. 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. The Authority does not have a deposit policy for custodial credit risk.

The Authority had $8.4 million and $15.7 million of bank deposits at September 30, 2009 and September 30, 2008, respectively. The deposits included cash and cash equivalents such as certificates of deposit, money market accounts, and commercial paper. The Authority evaluates each financial institution with which it deposits funds and assesses the level of risk of each institution; only those institutions with an acceptable estimated risk level are used as depositories. Bank deposits totaling $730,608 and $221,162 were covered by federal depository insurance coverage at September 30, 2009 and September 30, 2008, respectively. The remaining balances of $7.7 million and $15.5 million were subject to custodial credit risk.

The Authority had $210,600 and $209,000 invested in the State of Michigan's common cash pool at September 30, 2009 and September 30, 2008, respectively. The State of Michigan's common cash pool is managed by the State Treasurer. The State Treasurer's policy requires financial institutions to secure State funds with collateral, to be organized under federal or State law, and to maintain an office in Michigan. The policy also restricts deposits to a maximum of 50% of the financial institution's net worth. As of September 30, 2009 and September 30, 2008, the State's common cash was either covered by federal depository insurance or collateralized with securities held in the State's name by the State's agent. Additional details on this policy are described in the *SOMCAFR*.

Note 4 Amounts Due From Local Units - Charter Schools

The Authority issues State aid notes and loans the proceeds to charter schools to meet cash flow needs for operating purposes. These loans were recorded as "Amounts due from local units - Charter schools" and the balances were $41,236,000 and $16,606,640 at September 30, 2009 and September 30, 2008, respectively.

Note 5 Notes Payable

Notes payable for State aid notes consisted of the following at September 30, 2009 and September 30, 2008:

Series	Interest Rate (%)	Yield (%)	Maturity Date	October 1, 2008	Additions	Deletions	September 30, 2009
2008A-1	3.00	1.90	June 22, 2009	$ 3,280,000	$	$ (3,280,000)	$
2008A-2	3.00	1.90	July 20, 2009	18,630,000		(18,630,000)	
2008B	3.75	3.75	July 20, 2009	955,000		(955,000)	
2009	4.68	4.68	July 20, 2010	0	41,477,622		41,477,622
Total				$22,865,000	$41,477,622	$(22,865,000)	$ 41,477,622
Discounts and premiums							(70,372)
Notes payable balance							$ 41,407,250

Series	Interest Rate (%)	Yield (%)	Maturity Date	October 1, 2007	Additions	Deletions	September 30, 2008
2007A	5.00	3.83	June 24, 2008	$ 5,900,000	$	$(5,900,000)	$
2007B	4.50	3.67	August 22, 2008	7,890,000		(7,890,000)	
2007C	5.30	5.30	August 22, 2008	10,450,000		(10,450,000)	
2008A-1	3.00	1.90	June 22, 2009	0	3,280,000		3,280,000
2008A-2	3.00	1.90	July 20, 2009	0	18,630,000		18,630,000
2008B	3.75	3.75	July 20, 2009	0	955,000		955,000
Total				$24,240,000	$22,865,000	$(24,240,000)	$22,865,000
Discounts and premiums							138,050
Notes payable balance							$23,003,050

Note 6 Employee Benefits

a. 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 Public Educational Facilities Authority. The defined benefit and defined contribution plans are part of the State Employees' Retirement System administered by the Office of Retirement Services, Department of Technology, Management and Budget. 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 Web site at http://www.michigan.gov/ors. The financial report for the defined contribution plan may be obtained by writing to the Department of Technology, Management and Budget, Office of Retirement Services, 7150 Harris Drive, P.O. Box 30171, Lansing, MI 48909 or by calling (517) 322-5103.

b. 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 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 $1,700 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.

c. Other postemployment benefits - In addition, the Authority participates in the State of Michigan's other 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 Unrecorded Limited Obligation Debt

The Authority has issued limited obligation bonds to finance loans to qualified public school academies for capital improvements. These limited obligation bonds are not recorded as liabilities in the Authority's financial statements because the borrowings are, in substance, debts of other entities. Neither the State of Michigan nor the Authority have any obligation for this debt. The borrowings are repayable only from the repayment of loans, unloaned proceeds and related interest earnings, and any collateral which may be provided. The trustee, fiscal agent, registrar, and paying agent functions for the undefeased bonds are performed by an Authority-designated trustee. The Authority had bonds outstanding of $114,525,000 and $104,970,000, as of September 30, 2009 and September 30, 2008, respectively, all of which were undefeased.

Note 8 Risk Management

The Authority is exposed to various risks of loss related to property loss, torts, errors and omissions, and employee injuries (workers' compensation), as well as medical benefits provided to employees. The State of Michigan provides coverage for the Authority.

Note 9 Subsequent Events

a. Limited obligation bonds - The Authority issued the following limited obligation bonds subsequent to September 30, 2009:

Date	Bond Total
January 21, 2010	$15,290,000
January 28, 2010	$ 7,110,000
March 19, 2010	$ 2,410,000
April 27, 2010	$ 3,005,000
April 28, 2010	$ 8,390,000

b. State aid notes - The Authority issued State aid notes totaling $8,190,000 on March 17, 2010.

c. Michigan Finance Authority - On March 4, 2010, the Governor issued Executive Order No. 2010-2, which will consolidate certain public finance authorities in Michigan, including the Michigan Public Educational Facilities Authority, into the Michigan Finance Authority, a single autonomous public body corporate and politic within the Department of Treasury. Under the terms of Executive Order No. 2010-2, the Michigan Finance Authority shall acquire and succeed to all the rights, properties, obligations, and duties of the Michigan Public Educational Facilities Authority and the Michigan Public Educational Facilities Authority Board shall be abolished. If the Legislature takes no action concerning Executive Order No. 2010-2 within 60 days of issuance, Executive Order No. 2010-2 will go into effect on May 30, 2010.

SUPPLEMENTAL

FINANCIAL SCHEDULE

MICHIGAN PUBLIC EDUCATIONAL FACILITIES AUTHORITY
Schedule of Expenditures of Federal Awards
For the Period October 1, 2007 through September 30, 2009

Federal Agency/Program	*CFDA* * Number	Federal Awards Directly Expended (see Note 3) for the Fiscal Year Ended September 30 2008	2009
U.S. Department of Education			
Direct Program:			
Credit Enhancement for Charter School Facilities	84.354	$ 2,128,510	$ 3,158,710
Total U.S. Department of Education		**$ 2,128,510**	**$ 3,158,710**
Total Expenditures of Federal Awards		$ 2,128,510	$ 3,158,710

* *CFDA* is defined as *Catalog of Federal Domestic Assistance.* The U.S. Department of Education indicated on the award letter that the *CFDA* number for this program was 84.354A.

The accompanying notes are an integral part of this schedule.

Note 1 Basis of Presentation

This schedule of expenditures of federal awards (SEFA) presents the federal grant activity of the Michigan Public Educational Facilities Authority on the accrual basis of accounting and in accordance with the requirements of U.S. Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*.

Note 2 Significant Accounting Policies

The SEFA is prepared in accordance with accounting principles generally accepted in the United States of America. The accrual basis of accounting is used in connection with federal expenditures reported on the SEFA. Differences will exist between federal expenditures shown on the SEFA and related federal expenditures on federal financial reports because of additional accrual amounts recorded after the preparation of the federal financial reports for the fiscal year.

Note 3 SEFA Expenditures

The Authority used its Credit Enhancement for Charter School Facilities grant to establish the Michigan Charter School Credit Enhancement Fund to guarantee revenue bonds issued to provide financing for the acquisition, construction, repair, or renovation of Michigan charter school facilities.

The Authority drew down the entire federal grant amount of $6,531,246 in fiscal year 2007-08 and recorded deferred revenue. The Authority recognized federal revenue and expenses when it placed the federal grant funds into debt service reserve funds for individual charter school bond issuances.

During fiscal year 2008-09, the Authority used $1,000,000 to establish a debt service reserve fund for $10,720,000 of limited obligation bonds issued for 1 charter school. During fiscal year 2007-08, the Authority used $1,974,750 to establish debt service reserve funds for $25,865,000 of limited obligation bonds issued for 5 charter schools. Additionally, the Authority incurred administrative expenses of $488 and $247 in fiscal years 2008-09 and 2007-08, respectively.

The U.S. Department of Education program guidance for the Credit Enhancement for Charter School Facilities grant indicates that the value of federal awards expended is the total of the following amounts:

(a) The amount in the reserve fund at the beginning of the grantee fiscal year; plus

(b) Any funds drawn down in the grantee's fiscal year to add to the reserve fund; plus

(c) Any earnings on the reserve account.

The following table indicates the amounts used to calculate the SEFA expenditures:

	Fiscal Year 2007-08	Fiscal Year 2008-09
Reserve fund beginning balance	$ 0	$2,128,510
Funds placed in reserve fund during the fiscal year	1,975,238	1,000,247
Reserve account earnings	153,272	29,953
Total	$2,128,510	$3,158,710

INDEPENDENT AUDITOR'S REPORTS ON INTERNAL CONTROL AND COMPLIANCE

STATE OF MICHIGAN
OFFICE OF THE AUDITOR GENERAL
201 N. WASHINGTON SQUARE
LANSING, MICHIGAN 48913
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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
Mr. David S. Mittleman, Chair
Michigan Public Educational Facilities Authority
Richard H. Austin Building
Lansing, Michigan

Dear Mr. Kleine and Mr. Mittleman:

We have audited the financial statements of the Michigan Public Educational Facilities Authority, a discretely presented component unit of the State of Michigan, as of and for the fiscal years ended September 30, 2009 and September 30, 2008, as identified in the table of contents, and have issued our report thereon dated May 3, 2010. 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 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 Authority's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Authority's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed in the next paragraph, we identified a deficiency in internal control over financial reporting that we consider to be a significant deficiency.

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. We consider the deficiency described in Finding 1 in the accompanying schedule of findings and questioned costs to be a significant deficiency in internal control over financial reporting.

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 and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, we consider the significant deficiency identified in the third paragraph of this section to be a material weakness.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the 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*.

The Authority's responses to the findings identified in our audit are described in the accompanying corrective action plan. We did not audit the Authority's responses and, accordingly, we express no opinion on them.

This report is intended solely for the information and use of the Governor, the Legislature, the Michigan Public Educational Facilities Authority, management, others within the Department of Treasury, and the federal awarding agency 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

May 3, 2010

STATE OF MICHIGAN
OFFICE OF THE AUDITOR GENERAL
201 N. WASHINGTON SQUARE
LANSING, MICHIGAN 48913
(517) 334-8050
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THOMAS H. MCTAVISH, C.P.A.
AUDITOR GENERAL

Independent Auditor's Report on Compliance With Requirements Applicable to Each Major Program and on Internal Control Over Compliance in Accordance With OMB Circular A-133

Mr. Robert J. Kleine
State Treasurer
and
Mr. David S. Mittleman, Chair
Michigan Public Educational Facilities Authority
Richard H. Austin Building
Lansing, Michigan

Dear Mr. Kleine and Mr. Mittleman:

Compliance

We have audited the compliance of the Michigan Public Educational Facilities Authority with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) *Circular A-133 Compliance Supplement* that are applicable to each major federal program for the two-year period ended September 30, 2009. The Michigan Public Educational Facilities Authority's major federal program is identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each major federal program is the responsibility of the Authority's management. Our responsibility is to express an opinion on the Authority's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations.* Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to in the preceding paragraph that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the Authority's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of the Authority's compliance with those requirements.

As described in Finding 2 in the accompanying schedule of findings and questioned costs, the Authority did not comply with requirements regarding allowable costs/cost principles and special tests and provisions that are applicable to its Credit Enhancement for Charter School Facilities Program. Compliance with such requirements is necessary, in our opinion, for the Authority to comply with the requirements applicable to that program.

In our opinion, except for the noncompliance described in the preceding paragraph, the Michigan Public Educational Facilities Authority complied, in all material respects, with the requirements referred to in the first paragraph that are applicable to its major federal program for the two-year period ended September 30, 2009. The results of our auditing procedures also disclosed other instances of noncompliance with those requirements, which are required to be reported in accordance with OMB Circular A-133 and which are described in Finding 2 in the accompanying schedule of findings and questioned costs.

Internal Control Over Compliance

The management of the Authority is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered the Authority's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the Authority's internal control over compliance.

Our consideration of internal control over compliance was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in the Authority's internal control that might be significant deficiencies or material weaknesses as defined below. However, as discussed below, we identified certain deficiencies in internal control over compliance that we consider to be significant deficiencies and others that we consider to be material weaknesses.

A control deficiency in an entity's internal control over compliance 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 noncompliance with a type of compliance requirement of a federal program on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to administer a federal program such that there is more than a remote likelihood that noncompliance with a type of compliance requirement of a federal program that is more than inconsequential will not be prevented or detected by the entity's internal control. We consider the deficiencies in internal control over compliance described in the accompanying schedule of findings and questioned costs in Finding 2 to be significant deficiencies.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that material noncompliance with a type of compliance requirement of a federal program will not be prevented or detected by the entity's internal control. We consider Finding 2 to contain material weaknesses.

The Authority's responses to the findings identified in our audit are described in the accompanying corrective action plan. We did not audit the Authority's responses and, accordingly, we express no opinion on them.

This report is intended solely for the information and use of the Governor, the Legislature, the Michigan Public Educational Facilities Authority, management, others within the Department of Treasury, and the federal awarding agency 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

May 3, 2010

SCHEDULE OF FINDINGS
AND QUESTIONED COSTS

Section I: Summary of Auditor's Results

Financial Statements

Type of auditor's report issued:	Unqualified*
Internal control* over financial reporting:	
Material weaknesses* identified?	Yes
Significant deficiencies* identified that are not considered to be material weaknesses?	None reported
Noncompliance or other matters material to the financial statements?	No

Federal Awards

Internal control over major programs:	
Material weaknesses* identified?	Yes
Significant deficiencies* identified that are not considered to be material weaknesses?	Yes
Type of auditor's report issued on compliance for major programs:	Qualified*
Any audit findings disclosed that are required to be reported in accordance with U.S. Office of Management and Budget (OMB) Circular A-133, Section 510(a)?	Yes

Identification of major programs:

CFDA Number	Name of Federal Program
84.354	Credit Enhancement for Charter School Facilities

Dollar threshold used to distinguish between type A and type B programs:	$300,000
Auditee qualified as a low-risk auditee*?	No

** See glossary at end of report for definition.*

Section II: Findings Related to the Financial Statements

FINDING (2711001)

1. Internal Control Over Financial Transactions

The Michigan Public Educational Facilities Authority's internal control did not ensure that it recorded financial transactions in accordance with generally accepted accounting principles. As a result, the fiscal year 2008-09 and 2007-08 draft financial statements contained material errors and the Authority had to adjust the financial statements in order for them to be fairly stated.

Although the Authority corrected the material errors when brought to its attention, our audit disclosed a material weakness in that Authority personnel* had insufficient knowledge related to governmental financial accounting and reporting. Our review of fiscal year 2008-09 and 2007-08 transactions disclosed:

a. The Authority incorrectly recorded transfers in when it received an advance of federal funds for the Credit Enhancement for Charter School Facilities Grant in fiscal year 2007-08, and it incorrectly recorded transfers out when it expended $1,000,000 and $1,974,750 of the Credit Enhancement for Charter School Facilities Grant funds in fiscal years 2008-09 and 2007-08, respectively. Sections N50.112 and N50.118 of the *Codification of Governmental Accounting and Financial Reporting Standards* (Codification), published by the Governmental Accounting Standards Board (GASB), indicate that advances for grant programs should be reported as deferred revenue by recipients until allowable costs have been incurred and other eligibility requirements have been met, at which time revenue and expenses should be recognized. The Authority should have recorded deferred revenue of $6,531,246 when it received the advance of federal funds in fiscal year 2007-08. The Authority should have recognized revenue and expenses of $1,000,000 and $1,974,750 when it used the funds for program purposes in fiscal years 2008-09 and

** See glossary at end of report for definition.*

2007-08, respectively, and should have reduced the deferred revenue by corresponding amounts. These errors had the following financial statement impact:

Financial Statement Line Item	Fiscal Year 2008-09 Overstated (Understated)	Fiscal Year 2007-08 Overstated (Understated)
Deferred revenue	$(3,556,496)	$(4,556,496)
Federal revenue	$(1,000,000)	$(1,974,750)
Transfers in	$ 0	$ 6,531,246
Grants to charter schools	$(1,000,000)	$(1,974,750)
Transfers out	$ 1,000,000	$ 1,974,750

b. The Authority incorrectly recorded revenue and transfers out of $5,360 and $12,933 when transferring cash between bank accounts in fiscal years 2008-09 and 2007-08, respectively. These transactions did not meet the definition of revenue, an increase in fund financial resources, as defined by GASB Codification Section 1800.114. These transactions also did not meet the definition of a transfer, a flow of assets without equivalent flows of assets in return and without a requirement for repayment. These errors had the following financial statement impact:

Financial Statement Line Item	Fiscal Year 2008-09 Overstated (Understated)	Fiscal Year 2007-08 Overstated (Understated)
Charges for services	$5,360	$12,933
Transfers out	$5,360	$12,933

c. The Authority did not record loan interest income of $376,850 and $37,045 for certain loans to charter schools in fiscal years 2008-09 and 2007-08, respectively. The Authority also did not record related interest income receivable of $483,664 and $106,814 in fiscal years 2008-09 and 2007-08, respectively. The Authority made loans to charter schools before the end of each fiscal year and interest began accruing on the outstanding principal balances, but the Authority did not record the accrued loan interest income at the end of each fiscal year. GASB Codification Section 1600.103 indicates that revenues and assets resulting from exchange and exchange-like transactions should be recognized when the exchange takes place. These errors had the following financial statement impact:

Financial Statement Line Item	Fiscal Year 2008-09 Overstated (Understated)	Fiscal Year 2007-08 Overstated (Understated)
Loan interest income	$(376,850)	$ (37,045)
Interest income receivable	$(483,664)	$(106,814)

As a result of these material errors, the Authority processed transactions in fiscal year 2008-09 to adjust the accounting records and revised the financial statements for both fiscal years.

RECOMMENDATION

We recommend that the Authority improve its internal control to ensure that it records financial transactions in accordance with generally accepted accounting principles.

Section III: Findings and Questioned Costs* Related to Federal Awards

FINDING (2711002)

2. Credit Enhancement for Charter School Facilities, *CFDA* 84.354

U.S. Department of Education	*CFDA* 84.354: Credit Enhancement for Charter School Facilities
Award Number: U354A070002	Award Period: 07/13/2007 - 07/13/2032
	Known Questioned Costs: $500,000

The Authority's internal control over the Credit Enhancement for Charter School Facilities (CECSF) Program did not ensure its compliance with federal laws and regulations regarding allowable costs/cost principles, program income, reporting, and special tests and provisions for targeted charter schools, project time line, and

** See glossary at end of report for definition.*

investment types. Our review disclosed material weaknesses in internal control and material noncompliance* regarding allowable costs/cost principles and special tests and provisions. As a result, we issued a qualified opinion on compliance with federal laws and regulations for the CECSF Program.

Internal control that does not ensure compliance with federal laws and regulations could result in sanctions, disallowances, and/or future reductions of CECSF Program awards.

Federal expenses for the CECSF Program totaled $3.2 million for the two-year period ended September 30, 2009. We identified questioned costs totaling $500,000.

We noted several instances of noncompliance with the performance agreement as a result of insufficient grant management oversight procedures. Our exceptions, by compliance area, are as follows:

a. Allowable Costs/Cost Principles

   The Authority's internal control did not ensure that it limited the debt service reserve funds provided to charter schools to the maximum of $500,000.

   The Authority entered into a performance agreement with the U.S. Department of Education that established the goals and conditions of receiving the federal grant funds. The performance agreement limited the federally funded portion of a debt service reserve fund to a maximum of $500,000 for each charter school. The performance agreement also stated that nothing in the performance agreement was intended to prevent the Authority from revising the grant project as necessary to serve the best interests of the charter schools being financed provided that: (1) the U.S. Department of Education was notified in writing of such revisions beforehand; (2) such revisions did not result in the Authority's failure to comply with the terms and conditions of the performance agreement and the program's statutory and regulatory provisions; and (3) the U.S. Department of Education and the Authority mutually agreed in writing to such revisions.

** See glossary at end of report for definition.*

The Authority provided debt service reserve funds of $1,000,000 to one charter school in fiscal year 2008-09. Authority personnel informed us that the Authority's Board of Trustees approved the increased amount but that the Authority had not notified the U.S. Department of Education of the change to the limits set forth in the performance agreement. As a result, we identified questioned costs of $500,000.

b. Program Income

The Authority's internal control did not ensure that program income was deposited into the Authority's reserve account and used for program purposes. As a result, program income totaling $2,800 was not available to provide debt service reserve fund accounts for charter schools.

Title 20, section 7223d of the *United States Code* (*USC*) and the CECSF Guidance Manual indicate that all earnings must be deposited in the reserve account and be used for one of the program's statutory purposes.

Our review disclosed:

(1) The Authority entered into a trust indenture* for 1 of 6 charter schools that did not include language regarding what the trustee was to do with earnings on the debt service reserve fund account investments. As a result of the lack of direction provided to the trustee, earnings totaling approximately $2,100 had not been transferred to the Authority as of September 30, 2009.

(2) The Authority entered into trust indentures for 5 of 6 charter schools that required the trustee to transfer earnings from the debt service reserve fund account investments to the Authority at various dates. The Authority did not have a process in place to monitor trustee compliance with the trust indentures and did not take action when the trustees did not transfer the earnings in accordance with the trust indentures. As a result, earnings totaling approximately $700 had not been transferred to the Authority as of September 30, 2009.

** See glossary at end of report for definition.*

c. Reporting

The Authority's internal control did not ensure that the significant information it provided in the annual reports to the U.S. Department of Education was complete and accurate.

Federal law 20 *USC* 7223f requires that the Authority include in the annual report a listing and description of the charter schools served and the activities carried out by the Authority to assist the charter schools in meeting the CECSF Program objectives. The U.S. Department of Education provided reporting forms with required fields and reporting instructions that detailed the required reporting information.

Our review of the Authority's fiscal year 2008-09 and 2007-08 annual reports and its compliance with the reporting requirements disclosed the following errors, inconsistencies, and omissions:

(1) The Authority did not report the correct debt maturity date for 1 (16.7%) of the 6 charter schools.

(2) The Authority did not report the correct city for 1 (16.7%) of the 6 charter schools.

(3) The Authority did not report the correct number of additional students accommodated for 1 (16.7%) of the 6 charter schools.

(4) The Authority did not report the correct amount of fees paid by 1 (16.7%) of the 6 charter schools.

(5) The Authority did not use consistent sources to report the debt service interest rate for the 6 charter schools. The Authority reported the true interest cost rate* for 2 of the charter schools; however, it reported the coupon rate* for the other 4 charter schools.

** See glossary at end of report for definition.*

(6) The Authority did not complete the debt-to-collateral ratio for the 1 charter school in fiscal year 2008-09 and the 5 charter schools in fiscal year 2007-08.

(7) The Authority did not report the increase in physical space to educate students for 1 (16.7%) of the 6 charter schools.

(8) The Authority did not report the number of additional students accommodated for 2 (33.3%) of the 6 charter schools.

d. Special Tests and Provisions

The Authority's internal control did not ensure that it complied with CECSF Program federal laws and regulations regarding special tests and provisions requirements for targeted charter schools, project time line, and investment types.

Our review disclosed:

(1) The Authority had not established internal control to ensure that it targeted charter schools as described in the performance agreement.

The performance agreement's first goal was to serve communities and schools in need. The Authority indicated that it would achieve that goal by: (1) targeting charter schools in geographic areas in which a large proportion or number of public schools have been identified for improvement or restructuring; (2) targeting start-up charter schools (schools that are 1 to 3 years old) and mid-life charter schools (schools that are 3 to 5 years old); and (3) targeting charter schools where 50% of the student population is projected to qualify for free or reduced lunch. The Authority included a listing of 145 charter schools that met the need-based criteria and indicated that these charter schools would be the primary target group. The Authority also indicated that it would serve charter schools in all phases of development with 80% of the grant award going to start-up and mid-life schools.

The performance agreement also stated that nothing in the performance agreement was intended to prevent the Authority from revising the grant project as necessary to serve the best interests of the charter schools being financed provided that: (1) the U.S. Department of Education was notified in writing of such revisions beforehand; (2) such revisions did not result in the Authority's failure to comply with the terms and conditions of the performance agreement and the program's statutory and regulatory provisions; and (3) the U.S. Department of Education and the Authority mutually agreed in writing to such revisions.

Our review disclosed:

(a) Only 1 (16.7%) of the 6 charter schools was on the targeted school list and was located in the geographic area indicated as a target area.

(b) Only 2 (33.3%) of the 6 charter schools were start-up or mid-life charter schools. Of the remaining 4 charter schools, 3 had been in existence over 10 years.

(c) Only 4 (66.7%) of the 6 charter schools had a student population where at least 50% of the students received free or reduced lunch. The remaining 2 charter schools had student populations of which 48.1% and 11.9% received free or reduced lunch.

Authority personnel informed us that the Authority had provided the federal funds to whichever charter schools requested bond issuance assistance in a first-come, first-served approach and planned to continue to do so until the federal funds are depleted. The Authority had not established a process to evaluate if the charter schools that requested assistance were in the target group or met the need-based criteria described in the performance agreement. Authority personnel indicated that the Authority had not informed the U.S. Department of Education that it had changed from the targeted approach to the first-come, first-served approach.

(2) The Authority's internal control did not ensure that it adhered to the time line contained in the performance agreement.

The performance agreement's second goal was to implement the grant project in a timely fashion. The Authority indicated that it would achieve that goal by: (1) serving 23 schools in the first 5 years; (2) allocating 60% of program funds to secure financing for charter schools within the first 24 months of receiving the grant; and (3) adhering to the time line contained in the performance agreement. This time line indicated the following:

Number of Charter Schools to Be Served	Funds to Be Provided to Charter Schools	Deadline Date	Cumulative Total Number of Charter Schools to Be Served	Cumulative Total of Funds to Be Provided to Charter Schools
3	$1,050,000	September 2008	3	$1,050,000
6	$2,100,000	September 2009	9	$3,150,000
9	$3,150,000	September 2010	18	$6,300,000
3	$1,050,000	September 2011	21	$7,350,000
2	$ 700,000	September 2012	23	$8,050,000*

* The cumulative total of funds to be provided to charter schools consists of the federal award amount of $6,531,246 plus $1,518,754 that the Authority estimated would be received in reserve fund interest earnings.

The Authority had not achieved the allocation of 60% of program funds within the first 24 months of receiving the grant. The Authority had allocated 44.3% of total program funds available within the first 24 months of receiving the grant.

During the audit period (October 1, 2007 through September 30, 2009), the Authority did not adhere to the time line that was included in the performance agreement. The actual results achieved were as follows:

Number of Charter Schools Served	Funds Provided to Charter Schools	Deadline Date	Cumulative Total Number of Charter Schools Served	Cumulative Total of Funds Provided to Charter Schools
5	$1,974,750	September 2008	5	$1,974,750
1	$1,000,000	September 2009	6	$2,974,750
2	$1,668,853	September 2010*	8	$4,643,603

* Results as of February 28, 2010.

Because the Authority provided reserve fund amounts greater than the $350,000 average per school used in the time line development and the $500,000 maximum per school stated in the performance agreement, as discussed in part a. of this finding, the Authority's average amount provided to each charter school was $580,450 through February 28, 2010. Providing the greater amount of reserve funds combined with lower than expected interest earnings on the reserve funds resulted in serving fewer charter schools than agreed to in the performance agreement. Authority personnel indicated that the Authority had not informed the U.S. Department of Education in writing that it had changed the number of charter schools to be served and the amounts to be provided to charter schools within the deadline dates.

(3) The Authority's internal control did not ensure that it complied with certain CECSF investment type requirements for 1 (16.7%) of the 6 charter schools.

The CECSF Guidance Manual requires that the reserve funds be invested in obligations guaranteed by the United States government or by a state or in similar low-risk securities. Also, the reserve accounts must be designed to preserve principal. The Authority invested one charter school debt service reserve fund of $388,500 into a savings account that was only insured by the Federal Deposit Insurance Corporation up to $250,000. As a result, $138,500 of federal funds was uninsured and subject to loss in a bank failure.

(4) The Authority's internal control did not ensure that it complied with disclosure requirements for 1 (16.7%) of the 6 charter schools.

The performance agreement stated that the Authority would clearly indicate with each financial obligation undertaken that neither the full faith and credit nor any implied guarantee of the United States applies to any transactions of the Authority, or any other party, with respect to the grant project. For 1 (16.7%) of the 6 charter schools, the charter school's official statement* did not indicate that the debt service would not be backed by the full faith and credit of the United States government.

RECOMMENDATION

We recommend that the Authority improve its internal control over the CECSF Program to ensure its compliance with federal laws and regulations regarding allowable costs/cost principles, program income, reporting, and special tests and provisions for targeted charter schools, project time line, and investment types.

** See glossary at end of report for definition.*

OTHER SCHEDULES

MICHIGAN PUBLIC EDUCATIONAL FACILITIES AUTHORITY
Summary Schedule of Prior Audit Findings
As of May 3, 2010

The Michigan Public Educational Facilities Authority had not expended federal awards prior to fiscal year 2007-08. As a result, the Authority had not received a financial audit that included the provisions of the Single Audit Act and did not have any prior audit findings to report on this schedule.

FINDINGS RELATED TO THE FINANCIAL STATEMENTS

Finding Number: 2711001
Finding Title: Internal Control Over Financial Transactions

Management Views: The Authority agrees with the finding.

The Authority, although it has been in existence since 2002, has not been previously audited as a single entity. In prior years, the Authority submitted financial statements to the Office of Financial Management, State Budget Office, for review prior to publication of information in the *State of Michigan Comprehensive Annual Financial Report*. In these prior submissions, there were no comments made that lead management to believe the statements were being presented incorrectly.

The issues identified in the audit report are related to timing and classification. Correcting entries were made prior to issuance of the financial statements.

Reference is made in the report to Authority personnel. The Authority does not have personnel. Bureau of Bond Finance, Michigan Department of Treasury, personnel are assigned to perform work for the Authority including compiling information and preparing the financial statements.

Planned Corrective Action: Internal control procedures have been reviewed and the issues identified have been addressed to ensure that transactions comply with generally accepted

	accounting principles. The changes implemented include assigning additional personnel to record the accounting transactions and the Accounting Director reviewing all journal entries and the interim monthly financial statements to ensure that assets, liabilities, income, and expenses are properly classified. Any issues that are identified will be corrected at the time.
Anticipated Completion Date:	September 30, 2010
Responsible Individual:	Lois Sauers, Accounting Director

FINDINGS RELATED TO FEDERAL AWARDS

Finding Number:	2711002
Finding Title:	Credit Enhancement for Charter School Facilities, *CFDA* 84.354
Management Views:	The Authority agrees in part with the finding.
	Allowable Costs/Cost Principles - There were no indications now or prior to this time that lead management to believe that funds were not being used for the purposes for which they were intended. In ongoing discussions, the U.S. Department of Education informed the Authority that the grant dollars are allowed to be used in a manner to get them out and best help charter schools, the performance agreement is composed of "guidelines," and the U.S. Department of Education is not so concerned if the guidelines in any one particular period of time are met. The U.S. Department of Education further informed the Authority that it does not want to amend the performance agreement, it would just like communication on anything that changes as grant

funds are used, and it does not want to turn away charter schools that can use the funds and issue bonds to fund projects. The U.S. Department of Education contact liaison informed the Authority that she encourages the Office of the Auditor General to contact her if further clarification is needed.

Reporting - None of the items cited are material to the use of grant funds per discussion with the U.S. Department of Education. The annual report involves an ongoing process with additional communication between Michigan Department of Treasury personnel and the U.S. Department of Education. After the initial report is filed, there are questions and clarifications discussed with the U.S. Department of Education that are not reflected in the audit findings.

Program Income - The Credit Enhancement for Charter School Facilities (CECSF) guidelines state that earnings shall be transferred but does not specify time lines for the transfers. The decision to adopt a time line for return of interest earnings every six months (on bond payment dates) was added by Bureau of Bond Finance personnel to allow for funds to be reused, if needed. Funds have not been needed for funding new debt service reserves so the overall grant program has not been negatively impacted. The funds are being transferred in the normal course of business and therefore the guidelines are being met. Interest earnings in the current market are minimal. Therefore, trustees have been allowed to hold onto the few dollars earned until they accumulate to an amount large enough to make sense to transfer.

Special Tests and Provisions - Grant dollars were being used in a manner to best help charter schools, which was the intended use of the funds. Regarding the use of reserve funds of up to $1 million, significant turmoil in the financial markets in fiscal year 2007-08 required a review of the original assumptions used in the grant application. It became very difficult to issue debt for charter schools in general and more specifically for start-up charter schools. Thus, verbal communication was made with the U.S. Department of Education regarding the use of grant funds. Changes were discussed with and approved by the Michigan Public Educational Facilities Authority's Board of Trustees. The Authority contacted the U.S. Department of Education and it verbally agreed to the increase at that time and followed up with an e-mail dated April 1, 2010. The U.S. Department of Education verbally informed the Authority that it does not want to amend the performance agreement to reflect this. This change in the grant amount greatly benefited the ability to help with the financing of charter schools that could get bond transactions done and get the money out, which was properly aligned with the intended purpose of the grant program.

Planned Corrective Action: Allowable Costs/Cost Principles - The Authority does not concur that corrective action is needed.

Reporting - The Authority has implemented changes to ensure management level review of the annual reports before submission to the U.S. Department of Education.

Program Income - The funds are being transferred in the normal course of business and therefore the guidelines are being met. Interest earnings in the current market are minimal. Therefore, trustees have been allowed to hold onto the few dollars earned until they accumulate to an amount large enough to make sense to transfer. A new payment time line will be reviewed and revised if earnings start to materialize.

Special Tests and Provisions - Regarding parts d.(1) and d.(2), the Authority does not concur that corrective action is needed. Regarding part d.(3), the Authority will review investment choices and ensure that the requirements are met. Regarding part d.(4), the Authority is modifying the bond related documents to reflect the language that states that the debt service is not backed by the full faith and credit of the U.S. government. The Authority will amend its policies to prevent this omission in the future.

Anticipated Completion Date: Ongoing

Responsible Individual: Lois Sauers, Accounting Director

GLOSSARY

Glossary of Acronyms and Terms

Authority	Michigan Public Educational Facilities Authority.
Authority personnel	As indicated in Executive Order No. 2008-03, the Authority is staffed by personnel within the Department of Treasury.
CECSF	Credit Enhancement for Charter School Facilities.
CFDA	*Catalog of Federal Domestic Assistance*.
Codification	*Codification of Governmental Accounting and Financial Reporting Standards.*
control deficiency in internal control over federal program compliance	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 on a timely basis noncompliance with a type of compliance requirement of a federal program.
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.
coupon rate	The interest rate stated on a bond, note, or other fixed income security, expressed as a percentage of the principal (face value).
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.
GAAP	accounting principles generally accepted in the United States of America.

GASB	Governmental Accounting Standards Board.
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.
low-risk auditee	As provided for in OMB Circular A-133, an auditee that may qualify for reduced federal audit coverage if it receives an annual Single Audit and it meets other criteria related to prior audit results. In accordance with State statute, this Single Audit was conducted on a biennial basis; consequently, this auditee is not considered a low-risk auditee.
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 noncompliance	Violations of laws, regulations, contracts, and grants that could have a direct and material effect on major federal programs or on financial schedule and/or financial statement amounts.
material weakness in internal control over federal program compliance	A significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that material noncompliance with a type of compliance requirement of a federal program will not be prevented or detected.
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.

official statement — A legal statement that serves as the prospectus for a municipal bond. It is a disclosure of the financing surrounding the issue of the municipal bond and is prepared by the state government and its legal counsel. The official statement indicates how investors in the bonds will be repaid.

OMB — U.S. Office of Management and Budget.

qualified opinion — An auditor's opinion in which the auditor:

a. Identifies a scope limitation or one or more instances of misstatements that impact the fair presentation of the financial schedules and/or financial statements presenting the basic financial information of the audited agency in conformity with the disclosed basis of accounting or the financial schedules and/or financial statements presenting supplemental financial information in relation to the basic financial schedules and/or financial statements. In issuing an "in relation to" opinion, the auditor has applied auditing procedures to the supplemental financial schedules and/or financial statements to the extent necessary to form an opinion on the basic financial schedules and/or financial statements, but did not apply auditing procedures to the extent that would be necessary to express an opinion on the supplemental financial schedules and/or financial statements taken by themselves; or

b. Expresses reservations about the audited agency's compliance, in all material respects, with the cited requirements that are applicable to each major federal program.

questioned cost — A cost that is questioned by the auditor because of an audit finding: (1) which resulted from a violation or possible violation of a provision of a law, regulation, contract, grant, cooperative agreement, or other agreement or document governing the use of federal funds, including funds used to match federal funds;

	(2) where the costs, at the time of the audit, are not supported by adequate documentation; or (3) where the costs incurred appear unreasonable and do not reflect the actions a prudent person would take in the circumstances.
SEFA	schedule of expenditures of federal awards.
significant deficiency in internal control over federal program compliance	A control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to administer a federal program such that there is more than a remote likelihood that noncompliance with a type of compliance requirement of a federal program that is more than inconsequential 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.
Single Audit	A financial audit, performed in accordance with the Single Audit Act Amendments of 1996, that is designed to meet the needs of all federal grantor agencies and other financial report users. In addition to performing the audit in accordance with the requirements of 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, a Single Audit requires the assessment of compliance with requirements that could have a direct and material effect on a major federal program and the consideration of internal control over compliance in accordance with OMB Circular A-133.
SOMCAFR	*State of Michigan Comprehensive Annual Financial Report.*

true interest cost rate	The rate that will discount all future cash payments so that the sum of the present value of all cash flows will equal the bond proceeds.
trust indenture	An agreement in the bond contract made between a bond issuer and a trustee that represents the bondholder's interest by highlighting the rules and responsibilities to which each party must adhere.
unqualified opinion	An auditor's opinion in which the auditor states that: a. 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; or b. The financial schedules and/or financial statements presenting supplemental financial information are fairly stated in relation to the basic financial schedules and/or financial statements. In issuing an "in relation to" opinion, the auditor has applied auditing procedures to the supplemental financial schedules and/or financial statements to the extent necessary to form an opinion on the basic financial schedules and/or financial statements, but did not apply auditing procedures to the extent that would be necessary to express an opinion on the supplemental financial schedules and/or financial statements taken by themselves; or c. The audited agency complied, in all material respects, with the cited requirements that are applicable to each major federal program.
USC	*United States Code*.

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STATE OF MICHIGAN

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