

MAINE STATE LEGISLATURE

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Annual Report

Maine Health & Higher Educational Facilities Authority

2004



MAINE HEALTH AND HIGHER
EDUCATIONAL FACILITIES AUTHORITY



ROBERT O. LENNA, EXECUTIVE DIRECTOR
3 UNIVERSITY DRIVE
P.O. BOX 2268
AUGUSTA, MAINE 04338-2268
207-622-1958
1-800-821-1113
FAX 207-623-5359
www.mhhefa.com

TO: INTERESTED PARTIES
FROM: Robert O. Lenna, Executive Director
SUBJECT: Annual Report

This is the fiscal 2004 report for the Maine Health and Higher Educational Facilities Authority. As of June 30, 2004, the Authority has \$59,253,616 outstanding under its general tax exempt conduit resolution, \$1,023,285,000 outstanding under its tax exempt reserve fund resolution, \$28,980,000 outstanding under its taxable reserve fund resolution, \$5,770,000 outstanding under its taxable II reserve fund resolution.

During fiscal year 2004 the Authority issued \$174,490,000 of bonds under its tax-exempt reserve fund resolution and \$6,435,000 under its taxable II reserve fund resolution. These sales were accomplished in five series for eight hospitals, seven colleges, three long term care facilities, three community mental health care facilities and one residential care facility.

Started in December of 1991, the Authority's unique health and higher education program, using a state moral obligation reserve fund make-up provision and the ability to intercept funds of borrowers prior to any failure to pay, provides unusual strength to a diversified and dispersed portfolio of loans to health care and higher educational facilities throughout Maine. By making use of our ability to aggregate issues, share costs for bond sales among multiple borrowers and provide the State's moral obligation credit enhancement to eligible institutions, we provide all of Maine's health and higher educational facilities, from the largest to the smallest, with the lowest cost available for the money they borrow to meet their capital needs.

If there is further information you might like or questions you may have concerning the Authority please feel free to give us a call at (207) 622-1958. Additional information about the Authority is available at our website : www.mhhefa.com.

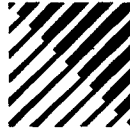
MAINE HEALTH AND HIGHER EDUCATIONAL FACILITIES AUTHORITY

Basic Financial Statements and Management's Discussion and Analysis

For the Year Ended June 30, 2004

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BAKER NEWMAN & NOYES

LIMITED LIABILITY COMPANY

CERTIFIED PUBLIC ACCOUNTANTS

INDEPENDENT AUDITORS' REPORT

To the Members of
Maine Health and Higher
Educational Facilities Authority

We have audited the accompanying basic financial statements, consisting of the consolidating balance sheet – operating fund and the balance sheets – restricted and trustee funds, including the General Resolution, Reserve Fund, Taxable Financing Reserve Fund and Taxable Financing Reserve Fund II, of Maine Health and Higher Educational Facilities Authority as of June 30, 2004, and the related consolidating statement of operations and changes in fund balance – operating fund, statements of changes in fund balance and funds held in trust – restricted and trustee funds and consolidating statement of cash flows – operating fund for the year then ended. 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 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 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.

In our opinion, the basic financial statements referred to above present fairly, in all material respects, the financial position of Maine Health and Higher Educational Facilities Authority and the individual fund groups referred to above at June 30, 2004, and the results of its operations and cash flows of its operating fund for the 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 October 8, 2004 on our consideration of Maine Health and Higher Educational Facilities Authority's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

To the Members of
Maine Health and Higher
Educational Facilities Authority

The Management's Discussion and Analysis on pages 3 – 9 is not a required part of the basic financial statements, but is supplementary information required by the Governmental Accounting Standards Board. The supplementary information is the responsibility of the Authority's management. We have applied certain limited procedures that consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.



Portland, Maine
October 8, 2004

Limited Liability Company

MAINE HEALTH AND HIGHER EDUCATIONAL FACILITIES AUTHORITY

MANAGEMENT'S DISCUSSION AND ANALYSIS

June 30, 2004

As financial management of the Maine Health and Higher Educational Facilities Authority (the "Authority"), we offer readers of these financial statements this narrative, overview and analysis of the financial activities of the Authority for the fiscal year ended June 30, 2004. This discussion and analysis is designed to assist the reader in focusing on the significant financial issues and activities of the Authority and to identify any significant changes in financial position. We encourage readers to consider the information presented here in conjunction with the basic financial statements as a whole.

Financial Highlights

- Consolidated operating revenues for the Authority's Operating Fund were \$8,752,165 for fiscal year 2004, an increase of \$376,523 or 4.5% over fiscal year 2003. Consolidated operating income for the Authority's Operating Fund was \$3,930,673 for fiscal year 2004, an increase of \$1,556,232 from fiscal year 2003. This increase in consolidated operating income was mainly due to \$1,400,000 in added provision on reserves on certain institutional loans and advances during 2003.
- Notes receivable from institutions in the Authority's Operating Fund of \$6,659,716 at June 30, 2004 represent subordinate loans that the Authority assumed as part of the refinancing of several taxable nursing home bonds with the U.S. Department of Housing and Urban Development (HUD) during 2004, 2003 and 2002 (refer to note 8 to the audited financial statements). These notes receivable increased \$1,111,716 (net) over fiscal year 2003 due to additional refinancings completed during 2004. The Authority is recording interest income on a cash basis for these loans.
- Loans receivable from operating fund in the Authority's Restricted and Trusteed Funds represent bond principal payments due from Portland Center for Assisted Living (the Center) at June 30, 2004. The Center was acquired by the Authority in 1998 and is 100% owned by the Authority.
- The Authority's loans receivable from institutions in the Restricted and Trusteed Funds at June 30, 2004 of \$1,010,569,620 represents a net increase of \$7,849,279 or 0.8% over the balance at June 30, 2003. This increase is the net result of the bond issuances described below, for which various funds were loaned out during fiscal 2004, and the repayment of loans by institutions during fiscal 2004.
- The Authority's gross bonds outstanding in the Restricted and Trusteed Funds at June 30, 2004 of \$1,117,288,616 represents a net increase of \$15,078,414 or 1.4% from the balance at June 30, 2003. This increase consists of the issuance of \$174,490,000 in Reserve Fund bonds and \$6,435,000 in Taxable Financing Reserve Fund II bonds, less scheduled bond principal payments and certain refundings and refinancings that occurred in 2004 (refer to notes 4 and 7 to the audited financial statements). The Authority's bonds are a combination of fixed and variable interest rate tax-exempt and taxable bonds, although a majority of the bonds are fixed interest rate and tax-exempt.

Overview of the Authority

The Authority was created in 1973 by an Act of the Maine Legislature, is a public body corporate and politic and is constituted as an instrumentality exercising public and essential governmental functions of the State. The Authority was established to issue bonds for the purpose, among other things, of assisting Maine health care institutions and institutions of higher education in the undertaking of projects involving the acquisition, construction, improvement, reconstruction and equipping of health care and educational facilities and the refinancing of existing indebtedness. The Authority, pursuant to the Student Loan Corporations Act of 1983, also has the power to finance student loan programs of institutions for higher education.

As the result of the Authority issuing tax-exempt debt, the Authority is required to prepare arbitrage rebate calculations for each series of bonds outstanding and remit payment to the Internal Revenue Service every five years. The Authority's policy is to prepare and review the calculations every six months for financial statement purposes.

For financial statement reporting purposes, the Authority is considered a component unit of the State of Maine. However, the Authority does not receive any State appropriations for its operations.

Overview of the Financial Statements

This discussion and analysis is intended to serve as an introduction to the Authority's financial statements, which are comprised of the basic financial statements and the notes to the financial statements.

Basic Financial Statements

The basic financial statements are designed to provide readers with a broad overview of the Authority's finances, in a manner similar to a private-sector business.

The balance sheets present information on all of the Authority's assets and liabilities, with the difference between the two reported as fund balance and funds held in trust. Over time, increases or decreases in fund balance and funds held in trust may serve as a useful indicator of whether the financial position of the Authority is improving or deteriorating. Fund balance and funds held in trust increase when revenues exceed expenses. Increases to assets without a corresponding increase to liabilities result in increased fund balance and funds held in trust, which may indicate an improved financial position.

The statements of operations and changes in fund balance and funds held in trust present information showing how the Authority's fund balance and funds held in trust changed during the fiscal year. Substantially all changes in fund balance and funds held in trust are reported as soon as the underlying event occurs, regardless of timing of related cash flows. Thus, revenues and expenses are reported in this statement for some items that will only result in cash flows in future periods.

Notes to the Financial Statements

The notes to the financial statements provide additional information that is essential to a full understanding of the data provided in the basic financial statements.

Financial Analysis

As indicated above, fund balance and funds held in trust may serve, over time, as a useful indicator of an entity's financial position. In the case of the Authority's Operating Fund, assets exceeded liabilities by \$19,739,319 at June 30, 2004. This represents an increase of \$3,930,673 or 24.9% over the previous fiscal year, which is the Authority's 2004 operating income within the Operating Fund.

The Authority's financial position and operations for the past two years are summarized below based on information included in the audited financial statements.

<u>CONSOLIDATED OPERATING FUND</u>	<u>2004</u>	<u>2003</u>	<u>Percentage Change</u>
Current assets:			
Cash and cash equivalents	\$ 7,705,389	\$ 5,535,760	39.2%
Investments, at fair value	8,558,586	2,792,895	206.4
Accrued investment income	6,438	7,946	(19.0)
Fees receivable from institutions	—	346,367	(100.0)
Fees and other amounts receivable from trustee funds	1,642,565	1,775,310	(7.5)
Resident accounts receivable, net of allowance	151,355	215,528	(29.8)
Other assets	<u>144,364</u>	<u>132,749</u>	<u>8.7</u>
Total current assets	18,208,697	10,806,555	68.5
Long-term assets:			
Advances receivable from institutions net of allowance	1,255,553	1,328,004	(5.5)
Notes receivable from institutions	6,659,716	5,548,000	20.0
Assets whose use is limited	705,519	611,061	15.5
Fixed and other assets, net	3,837,457	4,037,146	(4.9)
Deferred financing costs, net	<u>172,500</u>	<u>192,585</u>	<u>(10.4)</u>
Total long-term assets	<u>12,630,745</u>	<u>11,716,796</u>	<u>7.8</u>
Total assets	<u>\$30,839,442</u>	<u>\$22,523,351</u>	<u>36.9%</u>
Current liabilities:			
Current portion of loan payable to trustee funds	\$ 460,000	\$ 430,000	7.0%
Accounts payable	134,646	106,329	26.6
Estimated third-party payor settlements	1,050,687	1,272,342	(17.4)
Accrued payroll and other expenses	207,163	148,740	39.3
Resident funds held in trust	52,987	32,839	61.4
Deferred revenue	<u>4,099</u>	<u>1,442</u>	<u>184.3</u>
Total current liabilities	1,909,582	1,991,692	(4.1)
Long-term liabilities:			
Loan payable to trustee funds	4,263,013	4,723,013	(9.7)
Other amounts due to trustee funds	<u>4,927,528</u>	<u>—</u>	<u>—</u>
Total long-term liabilities	<u>9,190,541</u>	<u>4,723,013</u>	<u>94.6</u>
Total liabilities	11,100,123	6,714,705	65.3
Fund balance	<u>19,739,319</u>	<u>15,808,646</u>	<u>24.9</u>
Total liabilities and fund balance	<u>\$30,839,442</u>	<u>\$22,523,351</u>	<u>36.9%</u>

RESTRICTED AND TRUSTEED FUNDS:	<u>2004</u>	<u>2003</u>	<u>Percentage Change</u>
Current assets:			
Cash and cash equivalents	\$ 73,709,873	\$ 78,710,083	(6.4)%
Investments, at fair value	36,799,117	40,910,591	(10.0)
Accrued interest receivable	2,172,156	747,887	190.4
Loans receivable from institutions	37,107,684	35,941,587	3.2
Loan receivable from operating fund	460,000	430,000	7.0
Other receivables from institutions	<u>147,815</u>	<u>416,533</u>	<u>(64.5)</u>
Total current assets	150,396,645	157,156,681	(4.3)
Noncurrent assets:			
Cash and cash equivalents	795,600	—	—
Investments, at fair value	98,759,044	95,761,556	3.1
Loans receivable from institutions	973,461,936	966,778,754	0.7
Loan receivable from operating fund	4,263,013	4,723,014	(9.7)
Other amounts due from operating fund	<u>4,927,528</u>	<u>—</u>	<u>—</u>
Total noncurrent assets	<u>1,082,207,121</u>	<u>1,067,263,324</u>	<u>1.4</u>
	<u>1,232,603,766</u>	<u>1,224,420,005</u>	<u>0.67%</u>
Current liabilities:			
Bonds payable	\$ 37,567,684	\$ 36,371,587	3.3%
Interest payable	23,090,263	25,102,171	(8.0)
Fees payable to operating fund	1,642,565	1,775,310	(7.5)
Accounts payable	125,812	186,305	(32.5)
Rebate payable to Internal Revenue Service	505,018	577,498	(12.6)
Deferred revenue	<u>1,454,751</u>	<u>1,777,461</u>	<u>(18.2)</u>
Total current liabilities	64,386,093	65,790,332	(2.1)
Noncurrent liabilities:			
Bonds payable	1,079,720,932	1,065,838,615	1.3
Rebate payable to Internal Revenue Service	<u>1,278,542</u>	<u>1,489,912</u>	<u>(14.2)</u>
Total noncurrent liabilities	<u>1,080,999,474</u>	<u>1,067,328,527</u>	<u>1.3</u>
Total liabilities	1,145,385,567	1,133,118,859	1.1
Funds held in trust and fund balance:			
Construction/program funds	41,429,700	42,801,148	(3.2)
Expense funds	(45,106)	3,842	(1274.0)
Debt service funds	38,782,886	41,115,480	(5.7)
Debt service reserve funds	6,511,554	6,522,587	(0.2)
Earnings funds	1,606	1,507	6.6
Redemption funds	362,863	361,730	0.3
Unrestricted fund balance	<u>174,696</u>	<u>494,852</u>	<u>(64.7)</u>
Total funds held in trust and fund balance	<u>87,218,199</u>	<u>91,301,146</u>	<u>(4.5)</u>
	<u>\$ 1,232,603,766</u>	<u>\$ 1,224,420,005</u>	<u>0.67%</u>

The Authority's results of operations for the past two years is summarized below based on information included in the audited financial statements.

CONSOLIDATED OPERATING ACCOUNT	<u>2004</u>	<u>2003</u>	<u>Percentage Change</u>
Operating revenues:			
Net resident service revenue	\$ 4,248,433	\$ 4,251,743	(0.1)%
Administrative and other fees	3,672,515	3,505,119	4.8
Investment income	232,107	189,738	22.3
Net decrease in the fair value of investments	(181,360)	(10,772)	1583.6
Interest income from advances and notes receivable from institutions	644,568	310,989	107.3
Other income	<u>135,902</u>	<u>128,825</u>	<u>5.5</u>
	8,752,165	8,375,642	4.5
Operating expenses:			
Salaries	370,479	348,959	6.2
Employee benefits	87,839	93,221	(5.8)
Travel	8,200	8,816	(7.0)
Office expenses	64,801	56,003	15.7
Accounting and auditing	47,100	50,000	(5.8)
Legal	113,890	71,642	59.0
Telephone	7,093	8,471	(16.3)
Building lease	54,535	54,535	0.0
Assistance paid to borrowing institutions	-	1,400,000	(100.0)
Bad debt expense	15,559	-	-
Paid to trustee funds	81,696	-	-
Nursing services	1,473,923	1,429,456	3.1
Administrative services	439,579	421,262	4.3
Dietary services	586,747	555,041	5.7
Depreciation and amortization	335,330	338,921	(1.1)
Plant operations and maintenance	266,937	294,566	(9.4)
Housekeeping services	102,880	98,167	4.8
Other services	344,120	322,197	6.8
Interest expense	<u>420,784</u>	<u>449,944</u>	<u>(6.5)</u>
	<u>4,821,492</u>	<u>6,001,201</u>	<u>(19.7)</u>
Operating income	3,930,673	2,374,441	65.5
Fund balance at beginning of year	<u>15,808,646</u>	<u>13,434,205</u>	<u>17.7</u>
Fund balance at end of year	<u>\$19,739,319</u>	<u>\$15,808,646</u>	<u>24.9%</u>

RESTRICTED & TRUSTEED FUNDS:	<u>2004</u>	<u>2003</u>	<u>Percentage Change</u>
Fund balance and funds held in trust, beginning of year	\$ 91,301,146	\$ 77,422,740	17.9%
Additions:			
Bond and note proceeds	180,925,000	136,125,000	32.9
Received and receivable from institutions	94,712,779	90,801,426	4.3
Received and receivable from operating fund	746,696	—	—
Transfer from debt service reserves	1,356,416	3,880,418	(65.0)
Income from investments	7,198,988	7,574,238	(4.9)
Net change in the fair value of investments	(1,049,837)	966,345	(208.6)
Other income	<u>152,516</u>	<u>312,762</u>	<u>(51.2)</u>
Total additions	284,042,558	239,660,189	18.5
Deductions:			
Construction and program costs	51,952,807	110,876,712	(53.1)
Bond issuance costs	2,400,529	2,611,988	(8.1)
Principal payments	37,036,586	44,097,470	(16.0)
Interest expense	54,226,457	53,067,614	2.2
Paid to institutions	1,580,529	4,760,263	(66.8)
Paid to refunding and refinancing escrows	129,650,060	—	—
Paid to operating fund	5,639,400	—	—
Transfer to debt service reserves	5,177,942	9,623,534	(46.2)
Other deductions	<u>461,195</u>	<u>744,202</u>	<u>(38.0)</u>
	<u>288,125,505</u>	<u>225,781,783</u>	<u>27.6</u>
(Decrease) increase in fund balance and funds held in trust	<u>(4,082,947)</u>	<u>13,878,406</u>	<u>(129.4)</u>
Fund balance and funds held in trust, end of year	\$ <u>87,218,199</u>	\$ <u>91,301,146</u>	<u>(4.5)%</u>

Operating fund consolidated cash and cash equivalents at June 30, 2004 increased \$2,169,629 or 39.2% over balances at June 30, 2003. This increase was the result of investing excess funds into short-term investments.

Investments within the Operating Fund at June 30, 2004 increased \$5,765,691 or 206.4% over the balance at June 30, 2003. The majority of this increase was the result of replenishing the operating fund with the proceeds from the sale of the Taxable Financing Reserve Fund II bond issue during 2004. Offsetting these investments under noncurrent liabilities is an amount due to trustee funds that may be drawn to make future debt service payments on the Taxable Financing Reserve Fund II bonds.

Investments within the Restricted and Trustee Funds at June 30, 2004 decreased \$1,113,986 or 0.8% from June 30 2003. This decrease is the net result of the investment of bond proceeds from the Series 2003C, 2003D, and 2004A issues, and the disbursement of funds to institutions for project costs throughout the year. The Authority's investment portfolio is comprised of cash and cash equivalents, U.S. Government obligations (including treasury bills, notes, and bonds), agency notes and guaranteed investment contracts. All investments are carried at fair value. Any unrealized gains or losses (primarily due to fluctuations in market values) are recognized in the statements of operations and changes in fund balance and funds held in trust. Decreases in the fair value of investments in 2004 versus 2003 in both the Operating Fund and the Restricted and Trustee Funds are mainly due to an improvement in the interest rate environment which resulted in a decline in market value of certain debt securities held by the Authority.

Accrued interest receivable within the Restricted and Trusteed Funds at June 30, 2004 increased \$1,424,269 or 190.4% from June 30 2003. This increase was simply the result of timing, whereby the trustee collected interest earned on investments for fiscal year 2003 on or before June 30, 2003, but did not collect the interest earned for fiscal year 2004 until after the end of the fiscal year.

Notes receivable from institutions within the Operating Fund at June 30, 2004 increased \$1,111,716 over balances at June 30, 2003 primarily due to the Authority retaining subordinated debt on additional refinancings with HUD in the Taxable Financing Reserve Fund.

Income from investments in 2004 increased 22.3% in the Operating Fund (consolidated) and decreased 4.9% in the Restricted and Trusteed Funds from 2003. The increased earnings in the Operating Fund was the direct result of an increase in investment balances transferred from the Taxable Financing Reserve Fund II during 2004. The reduction in the Restricted and Trusteed Funds was primarily the result of drawing down investments for ongoing projects costs.

Bond and note proceeds for 2004 in the Restricted and Trusteed Funds increased 32.9% from 2003 as a result of an increase in loan requests from the borrowers, which resulted in the bond issues described above during 2004. This also increased loans receivable from institutions and gross bonds outstanding in the Restricted and Trusteed Funds at June 30, 2004 as compared to June 30, 2003. Finally, received and receivable from institutions increased 5.1% over 2003 due to the new bond issues, and principal payments decreased 16.0% from 2003 in the Restricted and Trusteed Funds due primarily to a reduction in scheduled principal payments required from institutions during 2004. This reduction in required principal payments was the result of paydowns in prior years, as well as refundings and refinancings in the various resolutions during 2004 and 2003.

The Authority shares office space and staff with the Maine Municipal Bond Bank (the Bond Bank). The Authority reimburses the Bond Bank for its proportionate share of personnel services, employee benefits, office space, equipment rental and other miscellaneous costs.

Requests for Information

This financial report is designed to provide a general overview of the Authority's financial statements for all those with an interest in its finances. Questions concerning any of the information provided in this report or request for additional information should be addressed to the Executive Director, Maine Health and Higher Educational Facilities Authority, P.O. Box 2268, Augusta, ME 04338-2268.

MAINE HEALTH AND HIGHER EDUCATIONAL FACILITIES AUTHORITY

CONSOLIDATING BALANCE SHEET – OPERATING FUND

June 30, 2004

ASSETS

	<u>Authority's Operating Fund</u>	<u>Portland Center For Assisted Living (note 9)</u>	<u>Eliminations</u>	<u>Consolidated Operating Fund</u>
Current assets:				
Cash and cash equivalents (note 3)	\$ 7,245,584	\$ 459,805	\$ —	\$ 7,705,389
Investments, at fair value (note 3)	8,558,586	—	—	8,558,586
Accrued investment income	6,438	—	—	6,438
Fees and other amounts receivable from trusteed funds	1,642,565	—	—	1,642,565
Resident accounts receivable, net of allowance of \$11,551	—	151,355	—	151,355
Other assets	<u>1,500</u>	<u>142,864</u>	<u>—</u>	<u>144,364</u>
 Total current assets	 17,454,673	 754,024	 —	 18,208,697
Long-term assets:				
Advances receivable from institutions net of allowance of \$2,050,270 (note 8)	6,954,392	—	(5,698,839)	1,255,553
Notes receivable from institutions (note 8)	6,659,716	—	—	6,659,716
Assets whose use is limited	—	705,519	—	705,519
Fixed and other assets, net	—	3,837,457	—	3,837,457
Deferred financing costs, net	<u>—</u>	<u>172,500</u>	<u>—</u>	<u>172,500</u>
 Total long-term assets	 <u>13,614,108</u>	 <u>4,715,476</u>	 <u>(5,698,839)</u>	 <u>12,630,745</u>
	<u>\$ 31,068,781</u>	<u>\$ 5,469,500</u>	<u>\$ (5,698,839)</u>	<u>\$ 30,839,442</u>

LIABILITIES AND FUND BALANCE

	Authority's Operating Fund	Portland Center For Assisted Living (note 9)	Eliminations	Consolidated Operating Fund
Current liabilities:				
Current portion of loan payable to trustee funds	\$ —	\$ 460,000	\$ —	\$ 460,000
Accounts payable	97,438	37,208	—	134,646
Estimated third-party payor settlements	—	1,050,687	—	1,050,687
Accrued payroll and other expenses	—	207,163	—	207,163
Resident funds held in trust	—	52,987	—	52,987
Deferred revenue	—	4,099	—	4,099
Total current liabilities	97,438	1,812,144	—	1,909,582
Long-term liabilities:				
Loan payable to trustee funds	—	4,263,013	—	4,263,013
Other amounts due to trustee funds	4,927,528	—	—	4,927,528
Advances due to Authority's operating fund	—	5,698,839	(5,698,839)	—
Total long-term liabilities	4,927,528	9,961,852	(5,698,839)	9,190,541
Total liabilities	5,024,966	11,773,996	(5,698,839)	11,100,123
Common stock, no par value; authorized 10,000 shares, issued and outstanding 200 shares	—	200	(200)	—
Fund balance (deficit)	26,043,815	(6,304,696)	200	19,739,319
	26,043,815	(6,304,496)	—	19,739,319
	\$ 31,068,781	\$ 5,469,500	\$ (5,698,839)	\$ 30,839,442

See accompanying notes.

MAINE HEALTH AND HIGHER EDUCATIONAL FACILITIES AUTHORITY

BALANCE SHEETS – RESTRICTED AND TRUSTEED FUNDS

June 30, 2004

ASSETS

	<u>General Resolution</u>	<u>Reserve Fund</u>
Current assets:		
Cash and cash equivalents (note 3)	\$ 5,428,636	\$ 64,181,521
Investments, at fair value (note 3)	13,711,498	23,087,619
Accrued investment income	69,195	2,093,478
Loans receivable from institutions (note 8)	1,147,684	34,210,000
Loan receivable from operating fund (note 9)	—	—
Other receivables from institutions	<u>8,113</u>	<u>138,944</u>
Total current assets	20,365,126	123,711,562
Noncurrent assets:		
Cash and cash equivalents (note 3)	—	—
Investments, at fair value (note 3)	6,260,475	88,115,357
Loans receivable from institutions (note 8)	58,105,932	897,232,229
Loan receivable from operating fund (note 9)	—	—
Other amounts due from operating fund	<u>—</u>	<u>—</u>
Total noncurrent assets	<u>64,366,407</u>	<u>985,347,586</u>
Total assets	<u>\$ 84,731,533</u>	<u>\$ 1,109,059,148</u>

LIABILITIES, FUNDS HELD IN TRUST AND FUND BALANCE

Current liabilities:		
Bonds payable (note 4)	\$ 1,147,684	\$ 34,210,000
Interest payable	1,006,232	21,648,399
Fees payable to operating fund	17,465	826,613
Accounts payable	3,500	76,532
Rebate payable to Internal Revenue Service	—	505,018
Deferred revenue	<u>—</u>	<u>1,349,420</u>
Total current liabilities	2,174,881	58,615,982
Noncurrent liabilities:		
Bonds payable (note 4)	58,105,932	989,075,000
Rebate payable to Internal Revenue Service	<u>—</u>	<u>1,278,542</u>
Total noncurrent liabilities	<u>58,105,932</u>	<u>990,353,542</u>
Total liabilities	60,280,813	1,048,969,524
Funds held in trust and fund balance:		
Construction/program funds	13,901,574	26,659,074
Expense funds	—	1,529
Debt service funds	3,673,123	33,273,117
Debt service reserve funds	6,511,554	—
Earnings funds	1,606	—
Redemption funds	362,863	—
Unrestricted fund balance	<u>—</u>	<u>155,904</u>
Total funds held in trust and fund balance	<u>24,450,720</u>	<u>60,089,624</u>
	<u>\$ 84,731,533</u>	<u>\$ 1,109,059,148</u>

See accompanying notes.

<u>Taxable Financing Reserve Fund</u>	<u>Taxable Financing Reserve Fund II</u>	<u>Total</u>
\$ 4,055,789	\$ 43,927	\$ 73,709,873
—	—	36,799,117
9,158	325	2,172,156
1,750,000	—	37,107,684
460,000	—	460,000
<u>758</u>	<u>—</u>	<u>147,815</u>
6,275,705	44,252	150,396,645
—	795,600	795,600
4,383,212	—	98,759,044
18,123,775	—	973,461,936
4,263,013	—	4,263,013
<u>—</u>	<u>4,927,528</u>	<u>4,927,528</u>
<u>26,770,000</u>	<u>5,723,128</u>	<u>1,082,207,121</u>
<u>\$ 33,045,705</u>	<u>\$ 5,767,380</u>	<u>\$ 1,232,603,766</u>
\$ 2,210,000	\$ —	\$ 37,567,684
391,714	43,918	23,090,263
798,487	—	1,642,565
45,780	—	125,812
—	—	505,018
<u>105,331</u>	<u>—</u>	<u>1,454,751</u>
3,551,312	43,918	64,386,093
26,770,000	5,770,000	1,079,720,932
<u>—</u>	<u>—</u>	<u>1,278,542</u>
<u>26,770,000</u>	<u>5,770,000</u>	<u>1,080,999,474</u>
30,321,312	5,813,918	1,145,385,567
869,052	—	41,429,700
237	(46,872)	(45,106)
1,836,632	14	38,782,886
—	—	6,511,554
—	—	1,606
—	—	362,863
<u>18,472</u>	<u>320</u>	<u>174,696</u>
<u>2,724,393</u>	<u>(46,538)</u>	<u>87,218,199</u>
<u>\$ 33,045,705</u>	<u>\$ 5,767,380</u>	<u>\$ 1,232,603,766</u>

MAINE HEALTH AND HIGHER EDUCATIONAL FACILITIES AUTHORITY

CONSOLIDATING STATEMENT OF OPERATIONS AND CHANGES IN FUND BALANCE – OPERATING FUND

Year Ended June 30, 2004

	Authority's Operating <u>Fund</u>	Portland Center For Assisted Living (note 9)	Elimi- nations	Consolidated Operating <u>Fund</u>
Operating revenues:				
Net resident service revenue	\$ —	\$ 4,248,433	\$ —	\$ 4,248,433
Administrative and other fees	3,672,515	—	—	3,672,515
Investment income	232,107	—	—	232,107
Net decrease in the fair value of investments	(181,360)	—	—	(181,360)
Interest income from advances and notes receivable from institutions	1,212,514	—	(567,946)	644,568
Other income	<u>133,579</u>	<u>2,323</u>	<u>—</u>	<u>135,902</u>
	5,069,355	4,250,756	(567,946)	8,752,165
Operating expenses (note 6):				
Salaries	370,479	—	—	370,479
Employee benefits	87,839	—	—	87,839
Travel	8,200	—	—	8,200
Office expenses	64,801	—	—	64,801
Accounting and auditing	47,100	—	—	47,100
Legal	113,890	—	—	113,890
Telephone	7,093	—	—	7,093
Building lease	54,535	—	—	54,535
Bad debt expense	15,559	—	—	15,559
Paid to trustee funds	81,696	—	—	81,696
Nursing services	—	1,473,923	—	1,473,923
Administrative services	—	439,579	—	439,579
Dietary services	—	586,747	—	586,747
Depreciation and amortization	—	335,330	—	335,330
Plant operations and maintenance	—	266,937	—	266,937
Housekeeping services	—	102,880	—	102,880
Other services	—	344,120	—	344,120
Interest expense	<u>—</u>	<u>988,730</u>	<u>(567,946)</u>	<u>420,784</u>
	<u>851,192</u>	<u>4,538,246</u>	<u>(567,946)</u>	<u>4,821,492</u>
Operating income (loss)	4,218,163	(287,490)	—	3,930,673
Fund balance (deficit) at beginning of year	<u>21,825,652</u>	<u>(6,017,206)</u>	<u>200</u>	<u>15,808,646</u>
Fund balance (deficit) at end of year	<u>\$ 26,043,815</u>	<u>\$ (6,304,696)</u>	<u>\$ 200</u>	<u>\$ 19,739,319</u>

See accompanying notes.

MAINE HEALTH AND HIGHER EDUCATIONAL FACILITIES AUTHORITY

**STATEMENTS OF CHANGES IN FUND BALANCE
AND FUNDS HELD IN TRUST – RESTRICTED AND TRUSTEED FUNDS**

Year Ended June 30, 2004

	<u>General Resolution</u>	<u>Reserve Fund</u>
Fund balance and funds held in trust, beginning of year	\$ 24,518,679	\$ 62,456,651
Additions:		
Bond and note proceeds	—	174,490,000
Received and receivable from institutions	5,786,184	76,600,169
Received and receivable from operating fund	—	—
Transfer from debt service reserves	—	—
Income from investments	944,995	5,925,692
Net decrease in the fair value of investments	(1,049,837)	—
Other income	<u>—</u>	<u>152,516</u>
Total additions	5,681,342	257,168,377
Deductions:		
Construction and program costs	1,500,000	50,208,159
Bond issuance costs	—	2,353,657
Principal payments	1,096,586	32,640,000
Interest expense	2,927,074	48,639,278
Paid to institutions	6,458	1,492,612
Paid to refunding and refinancing escrows (notes 7 and 8)	—	119,600,060
Paid to operating fund	—	—
Transfer to debt service reserves	—	4,382,342
Other deductions	<u>219,183</u>	<u>219,296</u>
Total deductions	<u>5,749,301</u>	<u>259,535,404</u>
Decrease in fund balance and funds held in trust	<u>(67,959)</u>	<u>(2,367,027)</u>
Fund balance and funds held in trust, end of year	\$ <u>24,450,720</u>	\$ <u>60,089,624</u>

See accompanying notes.

<u>Taxable Financing Reserve Fund</u>	<u>Taxable Financing Reserve Fund II</u>	<u>Total</u>
\$ 4,325,816	\$ —	\$ 91,301,146
—	6,435,000	180,925,000
12,326,426	—	94,712,779
—	746,696	746,696
1,356,416	—	1,356,416
325,103	3,198	7,198,988
—	—	(1,049,837)
<u>—</u>	<u>—</u>	<u>152,516</u>
14,007,945	7,184,894	284,042,558
244,648	—	51,952,807
—	46,872	2,400,529
2,635,000	665,000	37,036,586
2,575,545	84,560	54,226,457
81,459	—	1,580,529
10,050,000	—	129,650,060
—	5,639,400	5,639,400
—	795,600	5,177,942
<u>22,716</u>	<u>—</u>	<u>461,195</u>
<u>15,609,368</u>	<u>7,231,432</u>	<u>288,125,505</u>
<u>(1,601,423)</u>	<u>(46,538)</u>	<u>(4,082,947)</u>
\$ <u>2,724,393</u>	\$ <u>(46,538)</u>	\$ <u>87,218,199</u>

MAINE HEALTH AND HIGHER EDUCATIONAL FACILITIES AUTHORITY

CONSOLIDATING STATEMENT OF CASH FLOWS – OPERATING FUND

Year Ended June 30, 2004

	Authority's Operating <u>Fund</u>	Portland Center For Assisted Living <u>(note 9)</u>	<u>Elimi- nations</u>	Consolidated Operating <u>Fund</u>
Operating activities:				
Cash received from units	\$ 4,134,568	\$ —	\$ —	\$ 4,134,568
Cash received from patients	—	4,093,608	—	4,093,608
Cash received from other income	133,579	2,323	—	135,902
Cash payments for interest	—	(988,730)	567,946	(420,784)
Cash payments for operating expenses	(810,649)	(3,152,430)	—	(3,963,079)
Cash payments for other assets and liabilities	<u>—</u>	<u>(10,115)</u>	<u>—</u>	<u>(10,115)</u>
Net cash provided (used) by operating activities	3,457,498	(55,344)	567,946	3,970,100
Financing activities:				
Net advances from Authority's operating fund	—	507,861	(507,861)	—
Advances from trustee funds	4,927,528	—	—	4,927,528
Payments on loan to trustee funds	<u>—</u>	<u>(430,000)</u>	<u>—</u>	<u>(430,000)</u>
Net cash provided by financing activities	4,927,528	77,861	(507,861)	4,497,528
Investing activities:				
Proceeds from sales and maturities of investments	4,500,000	—	—	4,500,000
Purchase of equipment	—	(115,556)	—	(115,556)
Purchase of investments	(10,447,051)	—	—	(10,447,051)
Change in assets whose use is limited	—	(74,310)	—	(74,310)
Income received from investments and advances	1,446,129	—	(567,946)	878,183
Net advances receivable from institutions	(435,410)	—	507,861	72,451
Increase in notes receivable from institutions	<u>(1,111,716)</u>	<u>—</u>	<u>—</u>	<u>(1,111,716)</u>
Net cash used by investing activities	<u>(6,048,048)</u>	<u>(189,866)</u>	<u>(60,085)</u>	<u>(6,297,999)</u>
Increase (decrease) in cash and cash equivalents	2,336,978	(167,349)	—	2,169,629
Cash and cash equivalents at beginning of year	<u>4,908,606</u>	<u>627,154</u>	<u>—</u>	<u>5,535,760</u>
Cash and cash equivalents at end of year	\$ <u>7,245,584</u>	\$ <u>459,805</u>	\$ <u>—</u>	\$ <u>7,705,389</u>

MAINE HEALTH AND HIGHER EDUCATIONAL FACILITIES AUTHORITY

**CONSOLIDATING STATEMENT OF CASH FLOWS – OPERATING FUND
(CONTINUED)**

Year Ended June 30, 2003

	Authority's Operating <u>Fund</u>	Portland Center For Assisted Living <u>(note 9)</u>	<u>Elimi- nations</u>	Consolidated Operating <u>Fund</u>
Reconciliation of operating income (loss) to net cash provided (used) by operating activities:				
Operating income (loss)	\$ 4,218,163	\$ (287,490)	\$ —	\$ 3,930,673
Adjustments to reconcile operating income (loss) to net cash provided (used) by operating activities:				
Investment and interest income	(1,444,621)	—	567,946	(876,675)
Net decrease in the fair value of investments	181,360	—	—	181,360
Bad debt expense	15,559	—	—	15,559
Depreciation and amortization	—	335,330	—	335,330
Change in assets and liabilities:				
Decrease in fees receivable from institutions	330,808	—	—	330,808
Decrease in fees and other amounts receivable from trustee funds	132,745	—	—	132,745
Decrease in net resident accounts receivable	—	64,173	—	64,173
Increase in other assets	(1,500)	(10,115)	—	(11,615)
Increase in accounts payable	24,984	3,333	—	28,317
Decrease in estimated third-party payor settlements	—	(221,655)	—	(221,655)
Increase in accrued payroll and other expenses	—	58,423	—	58,423
Increase in deferred revenue	<u>—</u>	<u>2,657</u>	<u>—</u>	<u>2,657</u>
Net cash provided (used) by operating activities	<u>\$ 3,457,498</u>	<u>\$ (55,344)</u>	<u>\$ 567,946</u>	<u>\$ 3,970,100</u>

See accompanying notes.

MAINE HEALTH AND HIGHER EDUCATIONAL FACILITIES AUTHORITY

NOTES TO FINANCIAL STATEMENTS

June 30, 2004

1. Organization

Maine Health and Higher Educational Facilities Authority (the Authority) is constituted as an instrumentality and, for accounting purposes under Governmental Accounting Standards Board Statement No. 14, *The Financial Reporting Entity*, is considered a component unit of the State of Maine, organized and existing under and pursuant to M.R.S.A., Title 22, Chapter 413, Sections 2051 to 2074, inclusive and as amended by Chapter 584 of the Public Laws of 1991.

The purpose of the Authority, among others, is to assist Maine health care institutions and institutions for higher education (the institutions) in the undertaking of projects involving the acquisition, construction, improvement, reconstruction and equipping of health care and educational facilities and the refinancing of existing indebtedness. The Authority, pursuant to the Student Loan Corporations Act of 1983, also has the power to finance student loan programs of institutions for higher education.

Debt issued by the Authority is not debt of the State of Maine or any political subdivision within the State and the State is not obligated for such debt, nor is the full faith and credit of the State pledged for such debt. The Authority is exempt from federal and State of Maine income taxes.

Legislation enacted in 1991 permitted the Authority to establish a reserve fund which will benefit from a "moral obligation" reserve fund replenishment mechanism from the State of Maine. Although the legislation does not bind or obligate the State, it does permit the legislature to appropriate and pay the Authority the amount necessary to restore the reserve fund to the required amount in the event the fund goes below the statutorily established minimum balance of one year's debt service on outstanding bonds. The legislation also allows the Authority to implement a State funding intercept mechanism which permits the Authority to cause the Treasurer of the State of Maine to withhold funds in the Treasurer's custody that otherwise would be paid to a borrower that has failed or may fail to make a debt service payment and to direct the Treasurer to apply those funds as debt service to the applicable bonds or notes. The State funding intercept is applicable to all future borrowings as well as currently outstanding bond issues, whether or not secured by the "moral obligation" reserve fund replenishment mechanism.

The Authority's operating fund records the revenues and expenses generated from its daily operations, and also includes the operations of Portland Center for Assisted Living f/k/a Woodford Park Nursing Care Center, Inc. (the Center), which was acquired by the Authority in 1998 (see note 9). The Authority has a management agreement with Maine Municipal Bond Bank (the Bond Bank) resulting in an allocation of general overhead expenses from the operations of the Bond Bank to the Authority and payment of direct operating expenses by the Authority. The operating fund is not part of the Authority's resolutions and does not legally act as security for outstanding bonds.

The restricted and trustee funds represent various funds and accounts, established with respect to the applicable series bond documents, held by a trustee. The trustee completes the duties and obligations required by the applicable series resolution including investment of monies as set forth by the Series Resolution and Tax Regulatory Agreement and the application of bond proceeds and institution's deposits as received by the trustee in accordance with the applicable series bond documents.

MAINE HEALTH AND HIGHER EDUCATIONAL FACILITIES AUTHORITY

NOTES TO FINANCIAL STATEMENTS

June 30, 2004

1. Organization (Continued)

Presently, the Authority operates pursuant to four bond resolutions as follows:

General Resolution

These funds consist of funds and accounts established under the Authority's General Bond Resolution adopted June 5, 1973. Under this resolution, the Authority issues bonds exempt from federal and State of Maine income taxes and assists in financing health care institutions and institutions for higher education. Bonds issued under this resolution may be issued under the original Bond Resolution or under an individual Bond Indenture between the Authority and an institution. Loans to institutions made with proceeds of general resolution bonds are written for the entire amount of the bonds (including debt service reserve funds).

Reserve Fund

These funds and accounts are established under the Authority's Resolution establishing the Maine Health Facilities' Reserve Fund adopted December 6, 1991. Under this resolution, the Authority issues Bonds exempt from federal and State of Maine income taxes for the purpose of providing financing for Maine health and higher educational facilities. Bonds issued under this resolution benefit from the moral obligation reserve fund replenishment mechanism from the State of Maine. Loans to institutions made with proceeds of bonds issued under this resolution are generally written for the net amount of bond proceeds less debt service reserve funds retained by the Authority.

Taxable Financing Reserve Fund

These funds and accounts are established under the Authority's Resolution establishing the Maine Health Facilities' Taxable Financing Reserve Fund Resolution adopted December 15, 1992. Under this resolution, the Authority issues Bonds exempt from State of Maine income taxes. Bonds issued under this resolution benefit from the moral obligation reserve fund replenishment mechanism from the State of Maine. Loans to institutions made with proceeds of bonds issued under this resolution are generally written for the net amount of bond proceeds less debt service reserve funds retained by the Authority.

Taxable Financing Reserve Fund II

These funds and accounts are established under the Authority's Resolution establishing the Maine Health Facilities' Taxable Financing Reserve Fund II adopted July 11, 2003. Under this resolution, the Authority issues Bonds exempt from State of Maine income taxes, which proceeds are used for funding subordinated loans to certain nursing homes in the State of Maine. Bonds issued under this resolution benefit from the moral obligation reserve fund replenishment mechanism from the State of Maine.

MAINE HEALTH AND HIGHER EDUCATIONAL FACILITIES AUTHORITY

NOTES TO FINANCIAL STATEMENTS

June 30, 2004

1. Organization (Continued)

The following is a description of the various funds which are held by the trustee as required by the bond resolutions:

Construction/Program Funds

These funds are used to account for the payment of building construction, equipment costs, program expenditures and bond issuance costs. These funds are also used to account for the refunding of existing bond issues.

Expense Funds

These funds are used for the collection and payment of amounts related to expenses of the Authority, the trustee, the paying agent and the registrar. These funds are not subject to lien of the bond indentures.

Debt Service Funds

These funds are used to account for certain bond proceeds and the receipts of cash from the institutions and disbursements thereof for bond interest and principal. Generally, the debt service funds held in trust are restricted for payment of principal and interest.

Debt Service Reserve Funds

These funds are generally required to be maintained at an amount equal to the greatest aggregate amount of principal and interest required to be paid in the current or any future bond year. Funding is often provided directly from the bond proceeds. Generally, any debt service reserve funds held in trust are restricted for payment of debt, and in many cases such funds are used for the last debt payment.

Earnings Funds

Generally, all investment income or interest earnings on all funds and accounts are transferred upon receipt or recorded by ledger entry by the trustee to the earnings fund. Section 148(f) of the Internal Revenue Code requires the payment to the federal government of the excess of the amount earned on the investment of certain bond proceeds over the amount that would have been earned on such investments had the amount so invested been invested at a rate equal to the yield on the bonds, together with any income attributed to such excess. Amounts remaining in the earnings fund following the required rebate payments are returned to the originating fund and may be transferred or withdrawn in accordance with the bond documents.

Redemption Funds

These funds are used to account for the proceeds from the sale of certain assets by an institution, and are required to be held in trust until the underlying bonds are called, at which point the funds are used for repayment of outstanding principal.

MAINE HEALTH AND HIGHER EDUCATIONAL FACILITIES AUTHORITY

NOTES TO FINANCIAL STATEMENTS

June 30, 2004

2. Significant Accounting Policies

The Authority maintains books of accounts for its own operations (the operating fund, including the Center) and for the restricted and trustee funds (the funds) established in connection with each outstanding bond issue. The books of accounts are maintained in accordance with the principles of proprietary (operating fund) and fiduciary (the funds) fund accounting and the requirements of the bond issue documents. The accompanying financial statements are prepared on the accrual basis of accounting (operating fund) and modified accrual basis of accounting (restricted and trustee funds) and include the accounts of the operating fund and the accounts of all bond issues currently outstanding that have not been advance refunded (see note 7).

The Authority complies with Governmental Accounting Standards Board Statement (GASB) No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that use Proprietary Fund Accounting*. This Statement requires that the Authority apply all applicable GASB pronouncements as well as the following pronouncements issued on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements: Financial Accounting Standards Board (FASB) Statements and Interpretations, Accounting Principles Board (APB) Opinions, and Accounting Research Bulletins (ARB's). As permitted by GASB No. 20, the Authority has elected not to comply with the FASB Statements and Interpretations issued after November 30, 1989.

The financial statements are prepared in accordance with Governmental Accounting Standards Board Statements No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments*, No. 37, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments: Omnibus – an amendment of GASB Statement No. 21 and No. 34* and No. 38, *Certain Financial Statement Note Disclosures* (the Statements).

Cash and Cash Equivalents

The Authority considers all checking and savings deposits and highly liquid investments with original maturities of three months or less to be cash equivalents.

Investments

Investments are carried at fair value (the fair value of guaranteed investment contracts is assumed to equal contract value). Changes in fair value are recorded as net increase (decrease) in the fair value of investments on the statements of operations and changes in fund balances and funds held in trust.

Interfund Transactions

Transactions that constitute reimbursements to a fund for expenses initially made from it that are properly applicable to another fund are recorded as expenses in the reimbursing fund and as reductions of expenses in the fund that is reimbursed.

MAINE HEALTH AND HIGHER EDUCATIONAL FACILITIES AUTHORITY

NOTES TO FINANCIAL STATEMENTS

June 30, 2004

2. Significant Accounting Policies (Continued)

All other interfund transactions, except reimbursements, are reported as transfers. Nonrecurring or nonroutine permanent transfers of equity are reported as residual equity transfers. All other interfund transfers are reported as operating transfers.

Property and Equipment

Property and equipment from the acquisition of the Center is stated at cost. Depreciation expense has been computed using the straight-line method at rates intended to amortize the cost of the related assets over their estimated useful lives.

Estimated Third-Party Payor Settlements

Estimated third-party payor settlements with respect to the Center represent estimates of final settlements under cost-reimbursed programs (Medicare and Medicaid).

Amounts due under the cost reimbursement programs will become determinable and final only upon completion of cost reporting and subsequent audit as required under the terms of agreements with respective third-party reimbursing agencies.

Revenue Recognition and Resident Accounts Receivable

Net resident service revenue of the Center is reported at the estimated net realizable amounts from patients, third-party reimbursing agencies, and others for services rendered, including estimated retroactive adjustments under reimbursement formulas with third-party reimbursing agencies. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined.

Resident accounts receivable of the Center are carried net of an allowance for bad debts, if any is considered necessary by management after considering the nature and circumstances of past due accounts. Accounts are charged off when deemed uncollectible.

Amortization

Deferred financing costs of the Center are amortized using the straight-line method over the term of the respective loans. Financing costs in the restricted and trusteed funds are treated as expenditures as incurred.

Income Taxes

The Center has been granted tax-exempt status under IRS Code Section 501(c)(3) and, as such, is not subject to federal or state income taxes.

MAINE HEALTH AND HIGHER EDUCATIONAL FACILITIES AUTHORITY

NOTES TO FINANCIAL STATEMENTS

June 30, 2004

2. **Significant Accounting Policies (Continued)**

Principles of Consolidation

The accompanying consolidated column of the financial statements of the operating fund reflect the accounts of the Authority and its wholly-owned subsidiary, the Center. All intercompany transactions and balances have been eliminated in consolidation.

New Accounting Pronouncements

GASB issued Statement No. 40 in March 2003. This statement amends GASB Statement No. 3 by establishing new disclosure requirements related to investment risks, including credit risk, interest rate risk and foreign currency risk. The statement is expected to be applicable to the Authority beginning in fiscal 2005.

Management Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates.

Total Columns

The "total" columns for the restricted and trustee fund statements contain the totals of the similar accounts of the various funds. The combination of the accounts, including assets therein, is for convenience only and does not indicate that the combined assets are available in any manner other than that provided for in the separate funds.

3. **Cash and Cash Equivalents and Investments**

The Authority is authorized, under Maine statutes, to invest in obligations of the U.S. Treasury, certain U.S. Governmental Agencies and certain state and local governments, as well as certain investment contracts and collateralized repurchase agreements. The trustees invest available cash in accordance with Maine statutes, applicable Series Resolution and Tax Regulatory Agreement.

The Authority's and Trustees' policy is to invest all available funds at the highest possible rates, in conformance with legal and administrative guidelines. Generally, the funds are invested in securities whose maturities are planned to coincide with the cash needs for operating, debt service and arbitrage requirements.

The consolidated cash and cash equivalents of the Authority's operating fund at June 30, 2004 consist of \$300,000 insured and \$1,053,458 noninsured deposits with banks and \$6,351,931 of money market funds held by a trust company.

MAINE HEALTH AND HIGHER EDUCATIONAL FACILITIES AUTHORITY

NOTES TO FINANCIAL STATEMENTS

June 30, 2004

3. Cash and Cash Equivalents and Investments (Continued)

GASB Statement No. 3 requires investments to be classified into three categories to give an indication of the level of risk assumed by the Authority and the institutions; Category 1 includes investments insured or registered in the Authority's or institution's name or securities held by the Authority or institution or by the Authority's or the institution's agent in the Authority's or institution's name; Category 2 includes investments uninsured and unregistered with securities held by the financial institution's trust department or agent in the Authority's or institution's name; and Category 3 includes uninsured and unregistered, with securities held by the financial institution's trust department or its agent, but not in the Authority's or institution's name. There are no Category 1 or 3 investments held by the Authority or the trustees at June 30, 2004.

At June 30, 2004, cash and investments are categorized as follows (at fair value):

	Cash and Cash <u>Equivalents</u>	Guaranteed Investment <u>Contracts</u>	U.S. Government <u>Obligations</u>	<u>Total</u>
Restricted and trustee funds:				
General resolution	\$ 5,428,636	\$ 11,662,718	\$ 8,309,255	\$ 25,400,609
Reserve fund	64,181,521	110,842,739	360,237	175,384,497
Taxable financing reserve fund	4,055,789	4,383,212	—	8,439,001
Taxable financing reserve fund II	<u>839,527</u>	<u>—</u>	<u>—</u>	<u>839,527</u>
Total investments held in restricted and trustee funds	74,505,473	126,888,669	8,669,492	210,063,634
Operating fund:				
Authority's operating fund	7,245,584	—	8,558,586	15,804,170
Portland Center for Assisted Living	<u>1,165,324</u>	<u>—</u>	<u>—</u>	<u>1,165,324</u>
Total operating fund investments	<u>8,410,908</u>	<u>—</u>	<u>8,558,586</u>	<u>16,969,494</u>
	<u>\$ 82,916,381</u>	<u>\$ 126,888,669</u>	<u>\$ 17,228,078</u>	<u>\$ 227,033,128</u>

At June 30, 2004, approximately \$96,225,000 in guaranteed investment contracts within the reserve fund are with three institutions. Additionally, approximately \$8,800,000 and \$2,445,000 in guaranteed investment contracts within the general resolution and taxable financing reserve fund, respectively, are with two institutions.

MAINE HEALTH AND HIGHER EDUCATIONAL FACILITIES AUTHORITY

NOTES TO FINANCIAL STATEMENTS

June 30, 2004

4. Bonds Payable

Total General Resolution bonds payable consist of the following at June 30, 2004:

	<u>Maturity</u>	<u>Amount Issued</u>	<u>Amount Outstanding June 30, 2004</u>
General resolution:			
VHA of New England Capital Asset Financing Program, 1985 Series A through Series G, variable rate beginning at 6%, dated December 30, 1985	2025	\$ 26,100,000	\$ 18,700,000
Mt. Desert Island Hospital, Series A, variable interest rate equal to 80% of the prime rate of Bank of America, dated December 11, 1986	1988 – 2008	1,800,000	270,000
Southern Maine Medical Center, Series 1989, 5.9% – 7.3%, dated November 1, 1989	1990 – 2014	11,885,000	1,810,000
Mt. Desert Island Hospital, Series 1992, variable interest rate equal to 80% of the prime rate of Bank of America, dated July 15, 1992	1993 – 2012	1,300,000	780,000
Spurwink School, Series 1997, 6.5%, dated December 23, 1997	1998 – 2012	315,000	30,000
Piper Shores, Series 1999A, 7.5% – 7.55%, dated December 1, 1999	2006 – 2029	24,900,000	24,900,000
MidCoast, 2001 lease purchase, 4.95%, dated November 15, 2001	2008	5,865,635	3,933,616
Midcoast Geriatrics, Series 2002, 4.5% – 5.4%, dated July 1, 2002	2005 – 2043	<u>8,830,000</u>	<u>8,830,000</u>
		<u>\$ 80,995,635</u>	59,253,616
Current portion			<u>1,147,684</u>
Noncurrent portion			<u>\$ 58,105,932</u>

MAINE HEALTH AND HIGHER EDUCATIONAL FACILITIES AUTHORITY

NOTES TO FINANCIAL STATEMENTS

June 30, 2004

4. Bonds Payable

The outstanding General Resolution bonds payable will mature in each of the following years with interest payable semi-annually:

<u>Year Ending</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2005	\$ 1,147,684	\$ 2,875,168	\$ 4,022,852
2006	1,775,863	2,814,519	4,590,382
2007	1,766,228	2,718,492	4,484,720
2008	1,773,891	2,620,333	4,394,224
2009	1,094,950	2,530,760	3,625,710
2010 – 2014	5,000,000	11,720,166	16,720,166
2015 – 2019	5,050,000	9,970,007	15,020,007
2020 – 2024	7,180,000	7,851,633	15,031,633
2025 – 2029	28,945,000	4,220,394	33,165,394
2030 – 2034	1,405,000	1,326,607	2,731,607
2035 – 2039	1,885,000	894,240	2,779,240
2040 – 2043	<u>2,230,000</u>	<u>312,930</u>	<u>2,542,930</u>
	<u>\$ 59,253,616</u>	<u>\$ 49,855,249</u>	<u>\$ 109,108,865</u>

Total Reserve Fund bonds payable consist of the following at June 30, 2004:

	<u>Maturity</u>	<u>Amount Issued</u>	<u>Amount Outstanding June 30, 2004</u>
Reserve fund:			
Series 1992B, 3.0% – 5.875%, dated September 15, 1992	1993 – 2022	\$ 44,850,000	\$ 1,260,000
Series 1993B, 2.8% – 5.75%, dated May 1, 1993	1994 – 2023	20,000,000	5,495,000
Series 1993C, 2.65% – 5.0%, dated September 1, 1993	1994 – 2013	69,085,000	41,410,000
Series 1993D, 2.6% – 5.7%, dated December 1, 1993	1994 – 2023	93,540,000	21,940,000
Series 1994A, 3.3% – 6.0%, dated March 1, 1994	1994 – 2024	18,380,000	9,075,000
Series 1995A, 4.4% – 5.878%, dated April 11, 1995	1996 – 2025	33,285,000	795,000
Series 1995B, variable rate, dated August 2, 1995	1998 – 2025	17,535,000	15,735,000
Series 1995C, 3.875% – 6.2%, dated August 1, 1995	1996 – 2025	13,745,000	2,445,000
Series 1996A, 3.75% – 5.625%, dated August 15, 1996	1997 – 2026	28,515,000	22,160,000

MAINE HEALTH AND HIGHER EDUCATIONAL FACILITIES AUTHORITY

NOTES TO FINANCIAL STATEMENTS

June 30, 2004

4. Bonds Payable (Continued)

	<u>Maturity</u>	<u>Amount Issued</u>	<u>Amount Outstanding June 30, 2004</u>
Reserve fund (continued):			
Series 1996B, 4.5% – 5.75%, dated October 15, 1996	1997 – 2026	\$ 41,855,000	\$ 30,920,000
Series 1997A, 4.3% – 5.7%, dated June 1, 1997	2000 – 2027	8,310,000	7,705,000
Series 1997B, 4.25% – 5.0%, dated December 1, 1997	1998 – 2018	52,640,000	41,740,000
Series 1998A, 4.0% – 5.28%, dated March 18, 1998	1999 – 2028	76,800,000	65,730,000
Series 1998B, 3.7% – 5.0%, dated June 1, 1998	1999 – 2028	100,540,000	83,990,000
Series 1998C, 2.95% – 5.1%, dated November 1, 1998	1999 – 2029	30,585,000	28,475,000
Series 1999A, 3.5% – 5.25%, dated April 15, 1999	1999 – 2030	98,385,000	86,330,000
Series 1999B, 4.0% – 6.0%, dated December 1, 1999	2000 – 2029	41,505,000	39,830,000
Series 2000A, variable rate, dated January 27, 2000	2002 – 2022	11,755,000	11,055,000
Series 2000B, variable rate, dated January 27, 2000	2000 – 2019	12,685,000	10,405,000
Series 2000C, 4.375% – 5.75%, dated July 15, 2000	2001 – 2030	51,540,000	49,285,000
Series 2001A, 3.45% – 5.25%, dated February 15, 2001	2002 – 2031	66,585,000	63,655,000
Series 2001B, 3.25% – 5.20%, dated May 15, 2001	2002 – 2022	10,615,000	9,985,000
Series 2001C, 3.25% – 5.125%, dated May 15, 2001	2002 – 2031	27,565,000	25,605,000
Series 2001D, 3.0% – 5.0%, dated November 1, 2001	2002 – 2031	50,700,000	47,965,000
Series 2002A, 3.0% – 5.125%, dated July 1, 2002	2003 – 2032	56,040,000	54,640,000
Series 2002B, 3.0% – 5.125%, dated July 1, 2002	2003 – 2032	8,175,000	8,085,000
Series 2003A, 2.25% – 5.0%, dated January 15, 2003	2004 – 2032	63,080,000	63,080,000
Series 2003B, 2.0% – 5.0%, dated July 1, 2003	2004 – 2033	59,245,000	59,245,000
Series 2003C, 2.0% – 4.6%, dated July 1, 2003	2004 – 2033	7,050,000	7,050,000

MAINE HEALTH AND HIGHER EDUCATIONAL FACILITIES AUTHORITY

NOTES TO FINANCIAL STATEMENTS

June 30, 2004

4. Bonds Payable (Continued)

	<u>Maturity</u>	<u>Amount Issued</u>	<u>Amount Outstanding June 30, 2004</u>
Reserve fund (continued):			
Series 2003D, 2.0% – 5.0%, dated September 1, 2003	2004 – 2023	\$ 35,880,000	\$ 35,880,000
Series 2004A, 2.0% – 5.375%, dated June 3, 2004	2004 – 2025	<u>72,315,000</u>	<u>72,315,000</u>
		<u>\$ 1,322,785,000</u>	1,023,285,000
Current portion			<u>34,210,000</u>
Noncurrent portion			<u>\$ 989,075,000</u>

The outstanding Reserve Fund bonds payable will mature in each of the following years with interest payable semiannually:

<u>Year Ending</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2005	\$ 34,210,000	\$ 45,928,847	\$ 80,138,847
2006	37,335,000	45,996,342	83,331,342
2007	38,630,000	44,544,890	83,174,890
2008	39,550,000	43,000,494	82,550,494
2009	39,730,000	41,391,428	81,121,428
2010 – 2014	214,865,000	179,754,083	394,619,083
2015 – 2019	216,530,000	128,708,256	345,238,256
2020 – 2024	194,165,000	77,347,391	271,512,391
2025 – 2029	141,210,000	34,878,082	176,088,082
2030 – 2033	<u>67,060,000</u>	<u>5,837,887</u>	<u>72,897,887</u>
	<u>\$ 1,023,285,000</u>	<u>\$ 647,387,700</u>	<u>\$ 1,670,672,700</u>

MAINE HEALTH AND HIGHER EDUCATIONAL FACILITIES AUTHORITY

NOTES TO FINANCIAL STATEMENTS

June 30, 2004

4. Bonds Payable (Continued)

Taxable Financing Reserve fund bonds payable consist of the following at June 30, 2004:

	<u>Maturity</u>	<u>Amount Issued</u>	<u>Amount Outstanding June 30, 2004</u>
Taxable Financing Reserve fund:			
Series 1993A, variable interest rate, dated January 1, 1993	1993 – 2012	\$ 57,125,000	\$ 15,360,000
Series 1993B, variable interest rate, dated October 27, 1993	1994 – 2013	25,060,000	6,290,000
Series 1996A, 7.03% fixed interest rate, dated February 22, 1996	1996 – 2016	<u>16,440,000</u>	<u>7,330,000</u>
		<u>\$ 98,625,000</u>	28,980,000
Current portion			<u>2,210,000</u>
Noncurrent portion			<u>\$ 26,770,000</u>

The outstanding Taxable Financing Reserve Fund bonds payable will mature in each of the following years with interest payable semiannually:

<u>Year Ending</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2005	\$ 2,210,000	\$ 2,007,317	\$ 4,217,317
2006	2,360,000	1,842,391	4,202,391
2007	2,445,000	1,668,909	4,113,909
2008	2,595,000	1,486,848	4,081,848
2009	2,755,000	1,293,552	4,048,552
2010 – 2014	14,315,000	3,198,693	17,513,693
2015 – 2016	<u>2,300,000</u>	<u>249,917</u>	<u>2,549,917</u>
	<u>\$ 28,980,000</u>	<u>\$ 11,747,627</u>	<u>\$ 40,727,627</u>

Taxable Financing Reserve Fund II bonds payable consist of the following at June 30, 2004:

Series 2003A, variable interest rate, dated September 1, 2003	2014 – 2023	\$ 6,435,000	\$ 5,770,000
Current portion			<u>—</u>
			<u>\$ 5,770,000</u>

MAINE HEALTH AND HIGHER EDUCATIONAL FACILITIES AUTHORITY

NOTES TO FINANCIAL STATEMENTS

June 30, 2004

4. Bonds Payable (Continued)

The outstanding Taxable Financing Reserve Fund II bonds payable will mature in each of the following years with interest payable semiannually:

<u>Year Ending</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2005	\$ —	\$ 87,127	\$ 87,127
2006	—	87,127	87,127
2007	—	87,127	87,127
2008	—	87,127	87,127
2009	—	87,127	87,127
2010 – 2014	—	435,635	435,635
2015 – 2019	2,900,000	329,633	3,229,633
2020 – 2023	<u>2,870,000</u>	<u>92,563</u>	<u>2,962,563</u>
	<u>\$5,770,000</u>	<u>\$1,293,466</u>	<u>\$7,063,466</u>

Each of the above series of bonds of the Authority is payable solely from the revenues from, and is secured by, the project, program or resolution in respect of which it is issued and has no claim of payment from the security or revenues pledged for the payment of the other series of bonds.

The following summarizes bonds payable activity for the Authority for the year ended June 30, 2004:

	<u>General Resolution</u>	<u>Reserve Fund</u>	<u>Taxable Financing Reserve Fund</u>	<u>Taxable Financing Reserve Fund II</u>
Balance, beginning of year	\$ 60,350,202	\$ 1,000,195,000	\$ 41,665,000	\$ —
Issuances	—	174,490,000	—	6,435,000
Redemptions:				
Refundings – see note 7	—	118,760,000	—	—
Refinancings – see note 8	—	—	10,050,000	—
Principal payments	<u>1,096,586</u>	<u>32,640,000</u>	<u>2,635,000</u>	<u>665,000</u>
Balance, end of year	<u>\$ 59,253,616</u>	<u>\$ 1,023,285,000</u>	<u>\$ 28,980,000</u>	<u>\$ 5,770,000</u>

MAINE HEALTH AND HIGHER EDUCATIONAL FACILITIES AUTHORITY

NOTES TO FINANCIAL STATEMENTS

June 30, 2004

5. Reserve Funds

Three of the resolutions require the Authority to set up reserve funds as follows:

Reserve Fund

The Authority is required to maintain a debt service reserve which is equal to the maximum amount of principal installments and interest maturing and becoming due in any succeeding calendar year on all loan obligations then outstanding as of such date of calculation. At June 30, 2004, the required debt service reserve was \$83,331,342 and the fair value of the debt service reserve assets totaled \$91,842,778.

Taxable Financing Reserve Fund

The Authority is required to maintain a debt service reserve which is equal to the maximum amount of principal installments and interest maturing and becoming due in any succeeding calendar year on all loan obligations then outstanding as of such date of calculation. At June 30, 2004, the required debt service reserve was \$4,217,317 and the fair value of the debt service reserve assets totaled \$4,383,212.

Taxable Financing Reserve Fund II

The Authority is required to maintain a debt service reserve which is equal to the maximum amount of principal installments and interest maturing and becoming due in any succeeding calendar year on all loan obligations then outstanding as of such date of calculation. At June 30, 2004, the required debt service reserve was \$708,388 and the fair value of the debt service reserve assets totaled \$795,600.

6. Operating Expenses

The Authority has a management agreement with Maine Municipal Bond Bank (the Bond Bank) which allocates a portion of Bond Bank expenses to the Authority. The allocation is based on expenses specifically incurred on behalf of the Authority and the Authority's estimated portion of general overhead. The Authority recognized approximately \$570,000 of expense under this agreement in 2004.

7. Refunded Issues

On July 1, 2003, the Authority issued \$59,245,000 in 2003B revenue bonds with an average interest rate of 4.40%, a portion of which was used to advance refund \$10,810,000 of outstanding reserve resolution bonds with an average interest rate of 5.86%. Additionally, approximately \$474,000 in underwriting fees, insurance and other issuance costs were paid. The authority refunded the above bonds to reduce total interest payments over the next 22 years by approximately \$862,300.

On September 1, 2003, the Authority issued \$35,880,000 in 2003D revenue bonds with an average interest rate of 4.32% to currently refund \$36,155,000 of outstanding reserve resolution bonds with an average interest rate of 5.60%. Additionally, approximately \$652,000 in underwriting fees, insurance and other issuance costs were paid. The Authority refunded the above bonds to reduce total interest payments over the next 20 years by approximately \$5,117,700.

MAINE HEALTH AND HIGHER EDUCATIONAL FACILITIES AUTHORITY

NOTES TO FINANCIAL STATEMENTS

June 30, 2004

7. Refunded Issues (Continued)

On June 3, 2004, the Authority issued \$72,315,000 in 2004A revenue bonds with an average interest rate of 5.01% to currently refund \$46,910,000 and advance refund \$24,885,000 of outstanding reserve resolution bonds with an average interest rate of 5.72%. Additionally, approximately \$1,050,920 in underwriting fees, insurance and other issuance costs were paid. The Authority refunded the above bonds to reduce total interest payments over the next 22 years by approximately \$3,341,800.

The proceeds of any advance refunding bonds are primarily used to purchase U.S. Treasury obligations, the principal and interest on which will be sufficient to pay the principal and interest, when due, of the defeased bonds. Neither the U.S. Treasury obligations nor the advance refunded bonds are reflected on the accompanying financial statements. The U.S. Treasury obligations are placed in irrevocable trust accounts with the trustees of the defeased bonds. The gains, losses and economic benefits of these transactions inure to the respective institution and not the Authority, although the Authority may receive an administrative fee. At June 30, 2004, there were approximately \$134,285,000 of advance refunded bonds remaining outstanding with respect to all advance-refunded issues.

8. Nursing Home Loans

In 1994, the Maine Department of Human Services (DHS) substantially revised the eligibility criteria for Medicaid coverage of nursing facility services, causing a decline in occupancy in nursing facilities. The occupancy decline has not affected each nursing facility equally. In some instances, particularly in proprietary nursing homes borrowing under the taxable financing reserve fund resolution, which consists primarily of loans to nursing homes, these declines in occupancy have created cash flow problems.

In 2002, the owners of certain financially troubled nursing homes, with the Authority's concurrence, began refinancing portions of Authority loans and advances with the U.S. Department of Housing and Urban Development (HUD). Management of the Authority expects that these refinancings will reduce annual debt service requirements, thereby eliminating the Authority's exposure in its Taxable Financing Reserve Fund and reducing the Authority's overall exposure. Through June 30, 2004, HUD has completed refinancings for nine institutions which, at the time they were refinanced, had combined bond-related loans and advances due the Authority of approximately \$43,242,000 (including refinancings with HUD in 2004 totaling \$5,481,000 and refinancings with other parties totaling \$4,569,000). As part of the refinancing completed by HUD, the Authority agreed to issue 8% subordinated notes receivable to these nine institutions from its operating fund. These notes total \$6,659,716 at June 30, 2004 and are subordinate to all HUD loans. Interest is payable semi-annually and principal payments are due by April 30th of each year in amounts equal to 50% of the excess cash flow generated by the nine institutions based on the audited financial statements for the previous year. The Authority is recording interest income on a cash basis on these loans. Should these institutions fail to generate positive cash flow in future periods, it is likely that these notes will not be repaid. The proceeds from the HUD loans and the subordinated notes were used to pay off the related bonds.

MAINE HEALTH AND HIGHER EDUCATIONAL FACILITIES AUTHORITY

NOTES TO FINANCIAL STATEMENTS

June 30, 2004

8. Nursing Home Loans (Continued)

Management of the Authority expects that the owners of two other facilities will complete refinancings during fiscal 2005. These two nursing homes have combined loans and advances due the Authority of approximately \$6,050,000 at June 30, 2004. If these anticipated refinancings are not completed and the nursing home industry in Maine continues to suffer from the present reimbursement restrictions, it is likely that a number of nursing homes included in the taxable financing reserve fund resolution will have difficulty in fully meeting their debt service obligations to the Authority.

In addition to subordinated notes receivable from the nine institutions described above, the Authority has advanced approximately \$3,329,000 from the operating fund as of June 30, 2004 to other financially troubled institutions with outstanding loans owed to the Authority of approximately \$18,431,000 (including loans of \$10,492,000 in the reserve fund at June 30, 2004). These advances, upon which interest income is recognized only to the extent that cash payments are received, were primarily made to assist these institutions in meeting debt service requirements. At June 30, 2004, the Authority has established a \$2,050,270 reserve in the operating fund related to amounts which have been advanced or are expected to be advanced to troubled institutions.

During 2004, Birch Grove Nursing Center closed. The facility had outstanding amounts due the Authority totaling approximately \$373,000. Of this amount, the Authority recovered \$300,000 from the sale of certain assets of the facility in 2004, and expects to recover remaining amounts due during 2005 from the sale of real estate formerly owned by the facility.

9. Portland Center for Assisted Living f/k/a Woodford Park Nursing Care Center, Inc. (the Center)

Effective January 5, 1998, the Authority elected to purchase 100% of the issued and outstanding shares of common stock of the Center. No amounts were paid or are payable to former owners of the Center with respect to this transaction. The Center, as purchased, was a 126-bed facility which provided long-term nursing care to the elderly. The Center was subsequently converted to a 125-bed assisted living facility, which is eligible for reimbursements under the Maine Medicaid program. During fiscal 1998, the Authority recorded a loss of approximately \$3.5 million, representing the excess of the Center's liabilities over the estimated fair value of its assets.

Ultimate realization of recorded amounts with respect to the Center's assets is dependent upon continued operations of the Center, which in turn is dependent upon the Center's ability to meet its financing requirements and the success of its future operations. The Center is highly dependent upon regulatory authorities establishing reimbursement rates that are adequate to sustain the Center's operations. As discussed more fully in the following paragraphs, management believes that actions presently being taken to revise the Center's operating and financial requirements will allow the Center to continue as a going concern and, following such revisions, management plans to sell the Center's assets to an outside party.

MAINE HEALTH AND HIGHER EDUCATIONAL FACILITIES AUTHORITY

NOTES TO FINANCIAL STATEMENTS

June 30, 2004

9. **Portland Center for Assisted Living f/k/a Woodford Park Nursing Care Center, Inc. (the Center)**
(Continued)

In 2000, management completed the process of restructuring the Center so that it now qualifies as a nonprofit entity under Internal Revenue Service code section 501(c)(3). As a result, management may, at their discretion, refinance the existing Authority Revenue Bonds Series 1993A by issuing nontaxable bonds at a lower rate of interest, potentially resulting in interest savings to the Center. Additionally, management of the Authority has indicated their intent to provide resources needed to allow the Center to continue operations through the next fiscal year.

Relevant disclosures for the Center are summarized as follows:

Assets Whose Use is Limited

Assets whose use is limited consist of resident funds held in trust and funds required by the terms of the Authority's Revenue Bonds Series 1993A and are invested in cash and money market securities at June 30, 2004. A summary follows:

Principal and interest debt service balances	\$652,532
Resident funds	<u>52,987</u>
Total assets whose use is limited	<u>\$705,519</u>

The Center is required by the bond issue to make monthly principal and interest payments into debt service accounts which are held by the bond trustee. The funds in these accounts are used to make the semi-annual payments of interest and annual payments of principal to the bond holders.

Significant Concentration and Estimated Third-Party Payor Settlements

Upon the conversion of the Center to an assisted living facility in December 1998, the Center is no longer eligible for reimbursements under the Federal Medicare program. Approximately 93% of the residents served in 2004 were beneficiaries of the Maine Medicaid program. Under this program, the provider is reimbursed for the care of qualified residents at specified interim contractual rates during the year. Differences between these interim contractual rates and the "cost" of this care, as defined by the Principles of Reimbursement governing the respective programs, are determined and settled on a retroactive basis.

The Center's financial statements reflect the estimated settlements under the Medicaid program. Settlements do not become final until the cost reports are audited and approved by the Maine Department of Human Services (DHS). Differences between estimated and actual settlements are recorded as contractual adjustments in the year of final determination.

The estimated settlements to the Medicaid program include amounts which DHS has determined to be owed based on audited cost reports for years 1995 through 2003, plus an estimated settlement for 2004. Any change in the recorded estimated settlements which may be generated by the resolution of disputed issues or subsequent audits will be recorded as contractual adjustments in the year of final settlement.

MAINE HEALTH AND HIGHER EDUCATIONAL FACILITIES AUTHORITY

NOTES TO FINANCIAL STATEMENTS

June 30, 2004

9. Portland Center for Assisted Living f/k/a Woodford Park Nursing Care Center, Inc. (the Center) (Continued)

Following is a summary of net resident service revenue for the year ended June 30, 2004:

Room and board	\$ 5,896,695
Contractual adjustments under third-party reimbursement programs	<u>(1,648,262)</u>
Net resident service revenue	<u>\$ 4,248,433</u>

Due to the large concentration of residents who receive benefits from the Medicaid reimbursement program, the Center is highly dependent upon regulatory authorities establishing reimbursement rates that are adequate to sustain the Center's operations.

Fixed Assets

A summary of fixed assets follows:

	<u>2003</u>	<u>Additions</u>	<u>Deductions</u>	<u>2004</u>
Land	\$ 302,291	\$ —	\$ —	\$ 302,291
Building and improvements	7,116,129	74,164	—	7,190,293
Furniture, fixtures and equipment	887,029	41,392	—	928,421
Vehicles	<u>21,944</u>	<u>—</u>	<u>—</u>	<u>21,944</u>
	8,327,393	115,556	—	8,442,949
Less accumulated depreciation	<u>(4,290,247)</u>	<u>(315,245)</u>	<u>—</u>	<u>(4,605,492)</u>
Fixed assets, net	<u>\$ 4,037,146</u>	<u>\$ (199,689)</u>	<u>\$ —</u>	<u>\$ 3,837,457</u>

Loan Payable to Trusteed Funds

Loan payable to trusteed funds of \$4,723,013 at June 30, 2004 consists of amounts due under a portion of the Authority's Revenue Bonds Series 1993A, which is payable in monthly installments of principal and interest to the trustee sufficient to make semi-annual interest payments and annual principal payments sufficient to retire the bonds when due. The annual payments (including interest at 7.35% per annum) are approximately \$955,000, excluding letter of credit and authority fees.

Approximate annual maturities on this loan for the next five years are as follows:

2005	\$ 460,000
2006	495,000
2007	530,000
2008	570,000
2009	610,000
Thereafter	2,058,013

MAINE HEALTH AND HIGHER EDUCATIONAL FACILITIES AUTHORITY

NOTES TO FINANCIAL STATEMENTS

June 30, 2004

9. **Portland Center for Assisted Living f/k/a Woodford Park Nursing Care Center, Inc. (the Center)**
(Continued)

Management Agreement

First Atlantic Corp. provided all management and accounting services required by the Center throughout 2004. Based upon an executed management agreement, First Atlantic Corp. charges the Center an annual amount equal to the greater of 5% of net patient service revenues or \$150,000. Management and accounting expenses incurred by the Center under this management agreement for the year ended June 30, 2004 were approximately \$212,000.

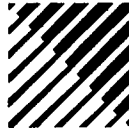
Employee Benefit Plan

The Center sponsors a discretionary contributory profit sharing plan and 401(k) plan which covers substantially all employees. The Center may elect to match employee contributions of up to 5% of the compensation of all eligible participants. The Center may also elect to make additional discretionary contributions. The Center contributed \$3,276 to the plan for the year ended June 30, 2004.

Commitments and Contingencies

The Center has obtained malpractice and general liability coverage from a commercial insurance company on a claims made basis. As of June 30, 2004, there were no known malpractice claims outstanding which, in the opinion of management, will be settled for amounts in excess of insurance coverage, nor are there any unasserted claims or incidents for which a loss accrual has not been made. The Center intends to continue coverage on a claims made basis with a commercial carrier and anticipates that such coverage will be available.

The Center is subject to complaints, claims and litigation which have arisen in the normal course of business. In addition, the Center is subject to compliance with laws and regulations of various government agencies. While no significant regulatory inquiries have been made at June 30, 2004, compliance with these laws and regulations is subject to future government review, interpretation or actions which are unknown and unasserted at this time.



BAKER NEWMAN & NOYES

LIMITED LIABILITY COMPANY

CERTIFIED PUBLIC ACCOUNTANTS

INDEPENDENT AUDITORS' REPORT

To the Members of
Maine Health and Higher Educational
Facilities Authority

We have audited, in accordance with auditing standards generally accepted in the United States of America, the financial statements of Maine Health and Higher Educational Facilities Authority for the year ended June 30, 2004, and have issued our report thereon dated October 8, 2004. We have also audited the balance sheet and statement of changes in funds held in trust of the Maine Health and Higher Educational Facilities Authority, Mt. Desert Island Hospital Issue, Series A for the year ended June 30, 2004. 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 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 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.

In connection with our audit, we have read the provisions of the General Bond Resolution adopted June 5, 1973 by the Authority and the Series Resolution adopted December 11, 1986 authorizing the issuance of \$1,800,000 Maine Health and Higher Educational Facilities Authority Revenue Bonds, Mt. Desert Island Hospital Issue, Series A, insofar as they relate to accounting matters solely, to identify any covenant violations or indications of default.

The following covenant violations were noted during our audit:

The annual report of all repairs, replacements and maintenance was not received within 120 days of the 2004 fiscal year end.

The budget for the operations and cash flow of the institution was not received prior to the beginning of fiscal year 2005.

To the Members of
Maine Health and Higher Educational
Facilities Authority

In accordance with Section 5.09 of the General Bond Resolution, we hereby state that, except for the covenant violations described in the preceding paragraph, during the course of our audit, we obtained no knowledge of any default in the fulfillment of any of the terms, covenants or provisions of the General Bond Resolution or the applicable Series Resolution. However, our audit was not directed primarily toward obtaining knowledge of such noncompliance.

Management has elected to omit substantially all of the disclosures required by accounting principles generally accepted in the United States of America. If the omitted disclosures were included in the financial statements, they might influence the user's conclusions about the entity's financial position and results of operations. Accordingly, these financial statements are not designed for those who are not informed about such matters.

In our opinion, except as noted above, the financial statements referred to above present fairly, in all material respects, the financial position of Maine Health and Higher Educational Facilities Authority, Mt. Desert Island Hospital Issue, Series A at June 30, 2004, and the results of its operations for the year then ended in conformity with accounting principles generally accepted in the United States of America.

This report is intended solely for the information and use of the Members of Maine Health and Higher Educational Facilities Authority and the Bond Trustees, and is not intended to be and should not be used by anyone other than these specified parties.



Portland, Maine
October 8, 2004

Limited Liability Company

**MAINE HEALTH AND HIGHER EDUCATIONAL FACILITIES AUTHORITY,
MT. DESERT ISLAND HOSPITAL ISSUE, SERIES A**

BALANCE SHEET

June 30, 2004

ASSETS

	<u>Debt Service Fund</u>	<u>Redemption Fund</u>	<u>Total</u>
Current assets:			
Principal payments receivable from Institution	\$ 90,000	\$ —	\$ 90,000
Investments, at market value	—	69,735	69,735
Due from redemption fund	2,160	—	2,160
Accrued investment income	<u>—</u>	<u>20</u>	<u>20</u>
Total current assets	92,160	69,755	161,915
Noncurrent assets:			
Principal payments receivable from Institution	<u>180,000</u>	<u>—</u>	<u>180,000</u>
Total assets	<u>\$272,160</u>	<u>\$69,755</u>	<u>\$341,915</u>

LIABILITIES AND FUNDS HELD IN TRUST

Current liabilities:			
Bonds payable	\$ 90,000	\$ —	\$ 90,000
Due to debt service fund	—	2,160	2,160
Accrued interest payable	<u>2,160</u>	<u>—</u>	<u>2,160</u>
Total current liabilities	92,160	2,160	94,320
Noncurrent liabilities:			
Bonds payable	<u>180,000</u>	<u>—</u>	<u>180,000</u>
Total liabilities	272,160	2,160	274,320
Funds held in trust	<u>—</u>	<u>67,595</u>	<u>67,595</u>
Total liabilities and funds held in trust	<u>\$272,160</u>	<u>\$69,755</u>	<u>\$341,915</u>

**MAINE HEALTH AND HIGHER EDUCATIONAL FACILITIES AUTHORITY,
MT. DESERT ISLAND HOSPITAL ISSUE, SERIES A**

STATEMENT OF CHANGES IN FUNDS HELD IN TRUST

Year Ended June 30, 2004

	<u>Debt Service Fund</u>	<u>Redemption Fund</u>	<u>Total</u>
Balances at beginning of year	\$ —	\$ 67,645	\$ 67,645
Additions:			
Received from Institution	—	99,360	99,360
Income from investments	—	193	193
Transfer from redemption fund	<u>99,360</u>	<u>—</u>	<u>99,360</u>
	99,360	167,198	266,558
Deductions:			
Principal payment	90,000	—	90,000
Interest expense	9,360	—	9,360
Other deductions	—	243	243
Transfer to debt service fund	<u>—</u>	<u>99,360</u>	<u>99,360</u>
	<u>99,360</u>	<u>99,603</u>	<u>198,963</u>
Balances at end of year	<u>\$ —</u>	<u>\$ 67,595</u>	<u>\$ 67,595</u>