COUNTY OF SAN BERNARDINO
ARROWHEAD REGIONAL MEDICAL CENTER

FINANCIAL STATEMENTS

WITH AUDITORS' REPORT

JUNE 30, 2005 AND 2004

COUNTY OF SAN BERNARDINO
ARROWHEAD REGIONAL MEDICAL CENTER

JUNE 30, 2005 AND 2004

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Vavrinek, Trine, Day & Co., LLP
Certified Public Accountants & Consultants

VALUE THE DIFFERENCE

INDEPENDENT AUDITORS' REPORT

The Honorable Board of Supervisors
County of San Bernardino, California:

We have audited the accompanying financial statements of the Arrowhead Regional Medical Center (Medical Center), a fund of the County of San Bernardino (County), as of and for the years ended June 30, 2005 and 2004, as listed in the accompanying table of contents. These financial statements are the responsibility of the Medical Center's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits 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 of America. 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 audits provide a reasonable basis for our opinions.

As discussed in Note 1 of the notes to the financial statements, the financial statements present only the Medical Center and do not purport to, and do not, present fairly the financial position of the County as of June 30, 2005 and 2004, and the changes in its financial position and cash flows, where applicable, for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Medical Center as of June 30, 2005 and 2004, and the changes in its financial position and its cash flows 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 September 16, 2005 on our consideration of the Medical Center'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.

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The Medical Center has not presented management's discussion and analysis that accounting principles generally accepted in the United States of America has determined is necessary to supplement, although not required to be part of, the basic financial statements.

Vavrinek, Trine, Day & Co., LLP

Rancho Cucamonga, California
September 16, 2005

COUNTY OF SAN BERNARDINO
ARROWHEAD REGIONAL MEDICAL CENTER

STATEMENTS OF NET ASSETS

JUNE 30, 2005 AND 2004

(In Thousands)

	2005	2004
ASSETS		
Current Assets		
Cash and cash equivalents	$ 14,997	$ 14,472
Assets whose use is limited	135	200
Patient accounts receivable, net of estimated uncollectibles of $184,610 in 2005 and $197,818 in 2004	26,373	21,684
Due from third-party payors	3,839	4,340
Receivable from other governments	17,568	41,035
Due from County	2,184	1,119
Supplies inventories	1,471	1,349
Prepaid expenses and other assets	2,120	377
Total Current Assets	68,687	84,576
Assets whose use is limited, investments	60,913	58,205
Assets whose use is limited, interest receivable	769	771
Capital assets, net of accumulated depreciation of $150,353 in 2005 and $133,401 in 2004	458,637	474,268
Deferred issuance costs	9,089	9,718
Total Assets	598,095	627,538
LIABILITIES		
Current Liabilities		
Accounts payable	12,480	11,607
Accrued salaries and benefits	16,149	14,186
Other accrued liabilities	371	268
Capital lease obligations	366	354
Certificates of participation	24,350	23,060
Interest payable	13,140	13,653
Arbitrage payable	165	25
Due to County	10,843	28,907
Total Current Liabilities	77,864	92,060
Capital lease obligations, less current installments	940	1,305
Certificates of participation, less current installments (net of deferred amount of refunding and discount)	538,810	560,917
Total Liabilities	617,614	654,282
NET ASSETS (LIABILITIES)		
Invested in capital assets, net of related debt	(96,740)	(101,651)
Restricted for debt service	47,908	45,523
Unrestricted	29,313	29,383
Total Net Liabilities	$ (19,519)	$ (26,744)

See accompanying notes to basic financial statements.

COUNTY OF SAN BERNARDINO
ARROWHEAD REGIONAL MEDICAL CENTER

STATEMENTS OF REVENUE, EXPENSES, AND CHANGES IN NET ASSETS

YEARS ENDED JUNE 30, 2005 AND 2004

(In Thousands)

	2005	2004
OPERATING REVENUES		
Net patient service revenue	$ 427,102	$ 372,815
Premium revenue - managed care	8,732	9,164
Other	4,711	4,563
Total Operating Revenues	440,545	386,542
OPERATING EXPENSES		
Salaries and benefits	154,101	140,294
Medi-Cal matching fund expense	124,643	110,514
Medical claims expense	2,288	1,447
Supplies	56,630	52,827
Professional services	32,945	31,648
Purchased services	25,261	20,567
Insurance	5,176	4,107
Provision for bad debts	33,781	23,197
Utilities	6,442	6,333
Depreciation and amortization	18,368	23,328
Rent	2,904	2,996
Amortization related to debt	2,871	2,871
Other	2,990	3,810
Total Operating Expenses	468,400	423,939
Operating Loss	(27,855)	(37,397)
NONOPERATING REVENUES (EXPENSES)		
State debt service funding	20,259	22,166
State realignment funding	19,629	16,484
Tobacco tax	1,464	1,447
Investment income	5,486	440
Interest expense on debt	(31,907)	(33,129)
Other nonoperating revenues	-	6,720
Other nonoperating expenses	(859)	(946)
Total Nonoperating Revenues, Net	14,072	13,182
Loss Before Transfers	(13,783)	(24,215)
Transfers from the County, Net	21,008	20,674
Changes in Net Assets	7,225	(3,541)
Net Liabilities, Beginning of Year	(26,744)	(23,203)
Net Liabilities, End of Year	$ (19,519)	$ (26,744)

See accompanying notes to basic financial statements.

COUNTY OF SAN BERNARDINO
ARROWHEAD REGIONAL MEDICAL CENTER

STATEMENTS OF CASH FLOWS

YEARS ENDED JUNE 30, 2005 AND 2004

(In Thousands)

	2005	2004
CASH FLOWS FROM OPERATING ACTIVITIES		
Receipts from customers	$ 424,978	$ 357,364
Payments to suppliers	(278,091)	(222,839)
Payments to employees	(152,138)	(138,235)
Net Cash Used in Operating Activities	(5,251)	(3,710)
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
State realignment funding received	$ 19,629	16,484
Tobacco tax received	1,464	1,447
Transfers from the County	21,008	20,674
Other nonoperating income (expense)	(859)	5,774
Net Cash Provided by Noncapital Financing Activities	41,242	44,379
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
State debt service funding	20,259	22,166
Purchase of capital assets	(2,737)	(2,631)
Proceeds from capital lease obligations	-	1,791
Principal payments on capital lease obligations	(354)	(421)
Principal payments on certificates of participation	(23,060)	(21,890)
Interest paid on debt	(32,420)	(33,129)
Net Cash Used in Capital and Related Financing Activities	(38,312)	(34,114)
CASH FLOWS FROM INVESTING ACTIVITIES		
Interest on investments	5,486	440
Investment activity, net	(2,640)	2,418
Net Cash Provided by Investing Activities	2,846	2,858
Increase in Cash and Cash Equivalents	525	9,413
Cash and Cash Equivalents, Beginning of Year	14,472	5,059
Cash and Cash Equivalents, End of Year	$ 14,997	$ 14,472

See accompanying notes to basic financial statements.

COUNTY OF SAN BERNARDINO
ARROWHEAD REGIONAL MEDICAL CENTER

STATEMENTS OF CASH FLOWS, Continued

YEARS ENDED JUNE 30, 2005 AND 2004

(In Thousands)

	2005	2004
RECONCILIATION OF OPERATING LOSS TO NET CASH USED IN OPERATING ACTIVITIES		
Operating Loss	$ (27,855)	$ (37,397)
Adjustments to reconcile operating loss to net cash used in operating activities:		
Depreciation and amortization	18,368	23,328
Amortization related to debt	2,871	2,871
Provision for bad debts	33,781	23,197
Decrease (Increase) in:		
Patient accounts receivable	(38,470)	(13,914)
Due from third-party payors	501	512
Receivables from federal and state programs	23,467	(12,524)
Due from County	(1,065)	(369)
Supplies inventories	(122)	(114)
Prepaid expenses and other assets	(1,743)	104
Increase (Decrease) in:		
Accounts payable	874	(534)
Accrued salaries and benefits	1,963	2,059
Other accrued liabilities	103	(436)
Arbitrage payable	140	(82)
Due to County	(18,064)	9,589
Net Cash Used in Operating Activities	$ (5,251)	$ (3,710)

See accompanying notes to basic financial statements.

COUNTY OF SAN BERNARDINO
ARROWHEAD REGIONAL MEDICAL CENTER

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2005 AND 2004

(Dollar Amounts in Thousands)

NOTE #1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. General

The County of San Bernardino (County) Arrowhead Regional Medical Center (Medical Center) is classified as a level II trauma center with eight trauma bays and four additional "swing" trauma rooms that can be used during an emergency. In addition, the Medical Center provides 373 patient beds and has 24 private treatment rooms for diagnosis and treatment of urgent care patients. During fiscal year 2000, the Medical Center assumed the inpatient operations, consisting of 90 beds, from the previously separate Department of Behavioral Health.

The Medical Center is owned by the County, which is a legal subdivision of the state of California charged with governmental powers, and is reflected in the County's comprehensive annual financial report as an enterprise fund. The County's powers are exercised through the Board of Supervisors, which, as the governing body of the County, is responsible for the legislative and executive control of the County.

These financial statements present only the Medical Center and do not purport to, and do not, present fairly the financial position of the County and the changes in its financial position and cash flows, where applicable, in conformity with accounting principles generally accepted in the United States of America.

B. Basis of Accounting

The basic financial statements of the Medical Center are presented using the economic resources measurement focus and the accrual basis of accounting in conformity with accounting principles generally accepted in the United States of America. Revenues are recognized in the period in which they are earned and become measurable. Expenses are recognized in the period in which they are incurred.

Operating revenues include those generated from direct patient care and related support services. Operating expenses include the cost of providing patient care, administrative expenses, and depreciation on capital assets. Revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

C. Accounting Standards

Pursuant to Governmental Accounting Standards Board (GASB) Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting,* the Medical Center has elected not to apply the provisions of all relevant pronouncements of the Financial Accounting Standards Board (FASB) issued after November 30, 1989. The Medical Center applies all applicable GASB pronouncements, as well as statements and interpretations of FASB, the Accounting Principles Board (APB) Opinions, and Accounting Research Bulletins (ARBs) of the Committee on Accounting Procedure, issued on or before November 30, 1989, unless those pronouncements conflict or contradict GASB pronouncements.

NOTE #1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, Continued

D. Income Taxes

The Medical Center is owned and operated by the County and is exempt from federal and state income tax pursuant to IRC Section 115 and similar provisions of the California Franchise Tax Code and is also exempt from federal and state income tax filing requirements.

E. Charity Care

The Medical Center provides care to patients who meet certain criteria under its charity care policy without charge or at an amount less than its established rates. Because the Medical Center does not pursue collection of amounts determined to qualify as charity care, they are not reported as revenue. However, the Medical Center monitors the level of charity care provided. See Note # 5.

F. Net Patient Service Revenue

Net patient service revenue is recorded at established rates less contractual allowances from third-party payors, including estimated retroactive adjustments under reimbursement agreements with third-party payors. 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.

G. Premium Revenue - Managed Care

The Medical Center has agreements with Inland Empire Health Plan (IEHP) and Foundation Health to provide medical services to subscribing participants. Under these agreements, the Medical Center receives monthly capitation payments based on the number of participants, regardless of services actually performed by the Medical Center.

Premium revenue is recognized in the period in which participants are entitled to health care services.

H. Cash

The Medical Center maintains a certain portion of its cash on deposit with the County Treasurer.

I. Assets Whose Use is Limited

Assets whose use is limited represent funds held by a trustee which are legally restricted for bond reserve accounts. Assets whose use is limited that are required for obligations classified as current liabilities are reported as current assets.

NOTE #1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, Continued

J. Capital Assets

Buildings, improvements, and equipment with a historical cost over $5,000 are capitalized. Contributed capital assets are reported at their estimated fair value at the date of donation. Depreciation expense is provided using the straight-line method over the estimated useful lives of the respective classes of capital assets. Equipment under capitalized leases is amortized using the straight-line method over the lesser of minimum lease terms or estimated useful lives. The estimated useful lives for computing depreciation expense are as follows:

Buildings	40 Years
Improvements	3 to 25 Years
Equipment	5 to 20 years

K. Capitalized Interest

The Medical Center capitalizes net interest expense as a cost of property constructed. No amounts were capitalized for the years ended June 30, 2005 and 2004.

L. Supplies Inventories

Supplies inventories are recorded at the lower of average cost or market.

M. Net Assets

Net assets of the Medical Center are classified in three components. *Net assets invested in capital assets net of related debt* consist of capital assets net of accumulated depreciation and reduced by the balances of any outstanding borrowings used to finance the purchase or construction of those assets. *Restricted net assets* are noncapital assets that must be used for a particular purpose, as specified by creditors, grantors, or contributors external to the Medical Center. Restricted net assets are reduced by any liabilities payable from restricted assets. *Unrestricted net assets* are remaining net assets that do not meet the definition of invested in capital assets net of related debt or restricted.

N. Use of 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 disclosure of contingent assets and liabilities at the date of the basic financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

NOTE #1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, Continued

O. Reclassification of Prior Year Amounts

Certain prior year amounts in these financial statements were reclassified to conform to current year presentation.

P. New Accounting Pronouncements

On July 1, 2004, the Medical Center adopted, GASB Statement No. 40, *Deposit and Investment Risk Disclosures*. This Statement amends GASB Statement No.3, *Deposits with Financial Institutions, Investments (including Repurchase Agreements), and Reverse Repurchase Agreements* to address common deposit and investment risks related to credit risk, concentration of credit risk, interest rate risk and foreign currency risk. As an element of interest rate risk, this Statement requires certain disclosures of investments that have fair values, which are highly sensitive to changes in interest rates. Deposit and investment policies related to the risks identified in this Statement also should be disclosed. See Note #2.

NOTE #2 – CASH, CASH EQUIVALENTS, AND INVESTMENTS

The Medical Center maintains a certain portion of its cash with the County Treasury for investment purposes to maximize interest earnings. Interest on the pooled funds is allocated based on the Medical Center's average daily balance. The Medical Center's share of the investment activity in the pooled funds managed by the County is not material to the total held by the County. The equity in the County Treasury is carried at fair value based on the value of each participating dollar as provided by the County Treasurer. The fair value of the County Treasury pool was approximately $2,926,138 at June 30, 2005. The County Treasury pool did not include any derivative securities in 2005.

Investment policies and related credit, custodial credit, concentration of credit, interest rate and foreign currency risks applicable to the Medical Center's pooled funds are those of the County and are disclosed in the County's basic financial statements.

The Medical Center's cash and assets whose use is limited as of June 30, 2005, are classified in the accompanying financial statements as follows:

	2005	2004
Cash and cash equivalents	$ 14,997	$ 14,472
Assets whose use is limited	61,048	58,405
Total Cash and Investments	$ 76,045	$ 72,877

NOTE #2 – CASH, CASH EQUIVALENTS, AND INVESTMENTS, continued

The Medical Center's cash and investments as of June 30, 2005, consisted of the following:

	2005	2004
Deposits with County Treasury	$ 14,997	$ 14,472
Deposits with Fiscal Agent	91	-
Investments	60,957	58,405
Total Cash and Investments	$ 76,045	$ 72,877

Investments Authorized by Debt Agreements

Investment of debt proceeds and reserves held by bond trustees are governed by provisions of the trust agreements created in connection with the issuance of debt (see Note #9), rather than the general provisions of the California Government Code. The Medical Center's bond reserves are held in money market mutual funds, U.S. Treasury Securities, and guaranteed investment contracts.

Interest Rate Risk

Interest rate risk is the risk that changes in market interest rates will adversely affect the fair value of an investment. Generally, the longer the maturity of an investment, the greater the sensitivity of its fair value to changes in market interest rates. The Medical Center's investments held by bond trustees are monitored for interest rate risk by measuring the weighted average maturity.

Investment Type		Weighted Average Maturity (in years)
Held by bond trustee:		
Money market mutual funds	$ 1,388	daily
Guaranteed investment contracts	34,358	15.19
U.S. Treasury Bonds	24,927	7.28
U.S. Treasury Strips	284	0.08
Total	$ 60,957	

NOTE #2 – CASH, CASH EQUIVALENTS, AND INVESTMENTS, continued

Investments with Fair Values Highly Sensitive to Interest Rate Fluctuations

The Medical Center's investments held with bond trustees include the following investment that is highly sensitive to interest rate fluctuations (to a greater degree than already indicated in the information provided above):

Highly Sensitive Investments	Fair Value at Year End
Interest only Treasury strips. The fair value of these investments are closely associated with the present value of the expected stream of cash flows from interest payments made to maturity. Accordingly, the fair value of these securities are highly sensitive to change in market interest rates that might lead to dramatic changes in expected cash flows.	$ 284

Credit Risk

Generally, credit risk is the risk that an issuer of an investment will not fulfill its obligation to the holder of the investment. This is measured by the assignment of a rating by a nationally recognized statistical rating organization. Presented below is the minimum rating (where applicable) required by the California Government Code, the Medical Center's investment policy, or debt agreements, and the actual rating for each investment type:

		Rating as of June 30, 2005		
Investment Type		Aaa	Aa2	A1+
Held by bond trustee:				
Money market mutual funds	$ 1,388	$ 1,388		
Guaranteed investment contracts	34,358	12,109	$ 22,249	
U.S. Treasury Bonds	24,927			$ 24,927
U.S. Treasury Strips	284			284
Total	$ 60,957	$ 13,497	$ 22,249	$ 25,211

NOTE #2 – CASH, CASH EQUIVALENTS, AND INVESTMENTS, continued

Concentration of Credit Risk

Concentration of credit risk is the risk of loss attributed to the magnitude of investment in a single issuer. Investments in any one issuer that represent five percent or more of the Medical Center's total investments are shown below:

Issuer	Investment Type	Fair Value at Year End
AIG Matched Funding Corp.	Guaranteed Investment Contract	$ 12,542
CDC Funding Corp.	Guaranteed Investment Contract	12,109
MBIA Investment Management Corp.	Guaranteed Investment Contract	9,707
		$ 34,358

Custodial Credit Risk

Custodial credit risk for *deposits* is the risk that, in the event of the failure of a depository financial institution, a government will not be able to recover its deposits or will not be able to recover collateral securities that are in the possession of an outside party. The California Government Code and the Medical Center's investment policy do not contain legal or policy requirements that would limit the exposure to custodial credit risk for deposits or investments, other than the following provision for deposits: The California Government Code requires that a financial institution secure deposits made by state or local governmental units by pledging securities in an undivided collateral pool held by a depository regulated under state law. The market value of the pledged securities in the collateral pool must equal at least 110 percent of the total amount deposited by the public agencies. California law also allows financial institutions to secure deposits by pledging first trust deed mortgage notes having a value of 150 percent of the secured public deposits.

GASB Statement No. 40 requires that disclosure be made with respect to custodial credit risks relating to deposits. The Medical Center did not have any cash with fiscal agent in excess of federal depository insurance limits held in uncollateralized accounts at June 30, 2005.

NOTE #3 – STATE REALIGNMENT FUNDING

The State of California provides support to the Medical Center through a realignment fund. This realignment funding is provided from vehicle license fees and sales tax collected at the state level and allocated to California's counties. The realignment fund replaces state support previously given for specific purposes such as aid to local municipalities affected by decreased levels of tax support, aid to counties which provide services to medically indigent adults, and aid for unreimbursed medical costs of legalized indigent aliens. The amount to be received by the counties is dependent upon the actual change in sales tax and vehicle license fees. The Medical Center's share of these revenues for the years ended June 30, 2005 and 2004 was $19,629 and $16,484, respectively. Because the revenues received are not based upon services provided to patients, they have been classified as nonoperating revenue in the accompanying statements of revenues, expenses, and changes in net assets.

NOTE #4 – NET PATIENT SERVICE REVENUE

The Medical Center provides services to eligible patients under Medi-Cal and Medicare programs. For the fiscal years ended June 30, 2005 and 2004, the Medi-Cal program represented approximately 47 percent and 46 percent, respectively, and the Medicare program represented approximately 10 percent and 11 percent, respectively, of the Medical Center's net patient service revenue. Medi-Cal inpatient services are reimbursed at contractually agreed-upon per diem rates and outpatient services are reimbursed under a schedule of maximum allowances. Medicare inpatient services are reimbursed based upon pre-established rates for diagnostic-related groups. Effective August 1, 2000, outpatient services went from a cost reimbursement payment methodology to prospectively determined payments per procedure under a system called Ambulatory Payment Classifications. Certain defined capital and medical education costs related to Medicare beneficiaries continue to be paid based on a cost-reimbursement methodology. The Medical Center is reimbursed for cost-reimbursable items at a tentative rate, with final settlement determined after submission of annual cost reports by the Medical Center and audits thereof by the fiscal intermediary. The Medical Center's classification of patients under these programs and the appropriateness of their admissions are subject to an independent review by a peer review organization under contract with the Medical Center. Reports on the results of such audits have been received through June 30, 2001 for Medicare and June 30, 2002, for Medi-Cal. Adjustments as a result of such audits are recorded in the year the amounts can be determined.

Senate Bill 855 - California's Senate Bill 855 (SB-855) was passed by the State Legislature and signed into law in 1991. The bill provides for supplemental Medi-Cal payments to hospitals that serve a disproportionately high percentage of Medi-Cal and other low-income patients. SB-855 provides additional funds through a reimbursement rate increase at the Medical Center for each Medi-Cal patient day provided, up to a maximum number of days. The Medical Center received $122,906 and $116,162 in SB-855 funds for the years ended June 30, 2005 and 2004, respectively. Because the revenues generated are based upon services provided to patients, they have been classified as net patient service revenue in the accompanying statements of revenues, expenses, and changes in net assets. The program required the Medical Center to contribute matching funds of $85,643 and $81,114 for the years ended June 30, 2005 and 2004, respectively, which were recorded as operating expense in the accompanying statements of revenues, expenses, and changes in net assets. The Medical Center recorded receivables of $15,782 and $33,488 at June 30, 2005 and 2004, respectively, which were included in receivables from federal and state programs.

NOTE #4 – NET PATIENT SERVICE REVENUE, Continued

Senate Bill 1255 - California's Senate Bill 1255 (SB-1255) was passed by the California Legislature and signed into law in 1989. This bill provides a funding mechanism to assist disproportionate share hospitals to fund budget shortfalls. SB-1255 allows disproportionate share hospitals to make voluntary donations to the state. The state then matches the money received with federal funds and redistributes the funds to the eligible hospitals in the subsequent fiscal year. The Medical Center received $72,800 and $59,400 in SB-1255 funds for the years ended June 30, 2005 and 2004, respectively. Because the revenues generated are based upon services provided to patients, they have been classified as net patient service revenue in the accompanying statements of revenues, expenses, and changes in net assets. The Medical Center contributed matching funds of $39,000 and $29,400 for the years ended June 30, 2005 and 2004, respectively, which were recorded as operating expense in the accompanying statements of revenues, expenses, and changes in net assets. The Medical Center had no related receivables at June 30, 2005 and 2004.

Assembly Bill 915 - California's Assembly Bill 915 (SB-915) was passed by the State Legislature and signed into law in 2002. This bill provides for the payment of a supplemental reimbursement to acute care hospitals owned by certain public entities that provide outpatient services to Medi-Cal beneficiaries. The Medical Center recorded $15,562 and $6,513 in AB-915 funds for the years ended June 30, 2005 and 2004, respectively. Because the revenues generated are based upon services provided to patients, they have been classified as net patient service revenue in the accompanying statements of revenues, expenses, and changes in net assets. The Medical Center recorded receivables of $-0- and $6,513 for the years ended June 30, 2005 and 2004, respectively, which were included in receivable from other governments.

NOTE #5 – CHARITY CARE

The Medical Center maintains records to identify and monitor the level of charity care it provides. These records include the amount of charges foregone for services and supplies furnished under its charity care policy. The following information measures the level of charity care provided during the fiscal years ended June 30:

	2005	2004
Charges foregone based on established rates	$ 293,373	$ 279,956

NOTE #6 – CAPITAL CONTRIBUTIONS

In 1991, the County Board of Supervisors approved the construction and financing plan of the Arrowhead Regional Medical Center project. The Inland Empire Public Facilities Corporation (Corporation) financed the project through the issuance of Certificates of Participation. The Corporation is a nonprofit public benefit corporation formed on May 30, 1986 to serve the County, including the Medical Center, by financing, refinancing, acquiring, constructing, improving, leasing, and selling buildings, building improvements, equipment, land, land improvements, and any other real or personal property for the benefit of the residents of the County. The Corporation is included in the County's reporting entity as a blended component unit. In fiscal year 1999, the Medical Center Project assets and liabilities were contributed to the Medical Center.

In accordance with the master lease agreement, the County is obligated to make aggregate lease payments each year as consideration for the use and occupancy of the Medical Center in an amount designated to be sufficient to pay the annual principal and interest due with respect to any construction debt outstanding. Senate Bill 1732 (SB-1732) was passed by the California Legislature and signed into law in October 1998. The law permits qualifying medical centers to receive reimbursement, in addition to their Medi-Cal contract reimbursement, for a portion of the debt service of qualified projects. Under SB-1732, the Medical Center estimates that it will receive proceeds equal to 50 percent of the total debt service costs. Amounts received by the Medical Center in SB-1732 funds during fiscal year 2005 and 2004 amounted to $20,259 and $22,166, respectively, which are included as nonoperating revenues in the accompanying statements of revenues, expenses, and changes in net assets. The Medical Center had no related receivables at June 30, 2005 and 2004.

COUNTY OF SAN BERNARDINO
ARROWHEAD REGIONAL MEDICAL CENTER

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2005 AND 2004

(Dollar Amounts in Thousands)

NOTE #7 – CAPITAL ASSETS

A summary of capital assets activity for the years ended June 30, 2005 and 2004, is as follows:

	Beginning Balance	Additions	Deletions	Transfers	Ending Balance
June 30, 2005					
Land and improvements	$ 22,292	$ -	$ -	$ -	$ 22,292
Buildings and improvements	490,599	-	225	628	491,002
Equipment	94,756	1,498	1,367	192	95,079
Construction-in-progress	22	1,415	-	(820)	617
Total Capital Assets, Gross	607,669	2,913	1,592	-	608,990
Accumulated Depreciation:					
Land and improvements	(24)	(15)	-	-	(39)
Buildings and improvements	(65,134)	(12,305)	(225)	-	(77,214)
Equipment	(68,243)	(6,050)	(1,193)	-	(73,100)
Total Accumulated Depreciation	(133,401)	(18,370)	(1,418)	-	(150,353)
Capital Assets, Net	$ 474,268	$ (15,457)	$ 174	$ -	$ 458,637
June 30, 2004					
Land and improvements	$ 22,268	$ 24	$ -	$ -	$ 22,292
Buildings and improvements	490,581	18	-	-	490,599
Equipment	92,283	2,567	94	-	94,756
Construction-in-progress	-	22	-	-	22
Total Capital Assets, Gross	605,132	2,631	94	-	607,669
Accumulated Depreciation:					
Land and improvements	(9)	(15)	-	-	(24)
Buildings and improvements	(52,834)	(12,300)	-	-	(65,134)
Equipment	(57,324)	(11,013)	(94)	-	(68,243)
Total Accumulated Depreciation	(110,167)	(23,328)	(94)	-	(133,401)
Capital Assets, Net	$ 494,965	$ (20,697)	$ -	$ -	$ 474,268

NOTE #8 – TRANSACTIONS WITH THE COUNTY

The Medical Center uses the treasury function of the County and at times maintains a cash overdraft with the County which can be repaid only through collection of receivables. The Medical Center had no cash overdrafts as of June 30, 2005 and 2004.

The Medical Center is allocated a portion of the County's overhead costs. Such expenses totaled $2,111 and $2,883 for the years ended June 30, 2005 and 2004, respectively, and are included as operating expense in the accompanying statements of revenues, expenses, and changes in net assets.

The Medical Center is allocated a portion of the County's annual debt service requirement on the County's pension obligation revenue bonds. Such amounts totaled $27,372 and $10,679 for the years ended June 30, 2005 and 2004, respectively, and are included in transfers to the County in the accompanying statements of revenues, expenses, and changes in net assets.

The Medical Center also receives funds from the County of a fixed amount for care of the County's medically indigent patients.

NOTE #9 – LONG-TERM OBLIGATIONS

The following is a summary of changes in long-term obligations for the fiscal years ended June 30, 2005 and 2004:

	June 30, 2005				
	Beginning Balance	Additions	Reductions	Ending Balance	Due within One Year
Certificates of Participation					
Series 1994	$ 194,840	$ -	$ (3,965)	$ 190,875	$ 4,470
Series 1995	128,875	-	(5,840)	123,035	5,875
Series 1996	65,070	-	-	65,070	-
Series 1997	74,075	-	(13,255)	60,820	14,005
Series 1998	176,510	-	-	176,510	-
Total Certificates of Participation, Gross	639,370	-	(23,060)	616,310	24,350
Less					
Deferred amount on refunding	(41,467)	-	1,808	(39,659)	-
Discount on debt	(13,926)	-	435	(13,491)	-
Total Certificates of Participation	583,977	-	(20,817)	563,160	24,350
Capital lease obligations	1,659	-	(354)	1,306	366
Total	$ 585,636	$ -	$ (21,171)	$ 564,466	$ 24,716

NOTE #9 – LONG-TERM OBLIGATIONS, Continued

	June 30, 2004				
	Beginning Balance	Additions	Reductions	Ending Balance	Due within One Year
Certificates of Participation					
Series 1994	$ 199,460	$ -	$ (4,620)	$ 194,840	$ 3,965
Series 1995	133,570	-	(4,695)	128,875	5,840
Series 1996	65,070	-	-	65,070	-
Series 1997	86,650	-	(12,575)	74,075	13,255
Series 1998	176,510	-	-	176,510	-
Total Certificates of Participation, Gross	661,260	-	(21,890)	639,370	23,060
Less					
Deferred amount on refunding	(43,274)	-	1,807	(41,467)	-
Discount on debt	(14,361)	-	435	(13,926)	-
Total Certificates of Participation	603,625	-	(19,648)	583,977	23,060
Capital lease obligations	289	1,817	(447)	1,659	354
Total	$ 603,914	$ 1,817	$ (20,095)	$ 585,636	$ 23,414

A. Certificates of Participation

The Medical Center's certificates of participation were issued by the Inland Empire Public Facilities Corporation (Corporation).

Certificates of participation at June 30, 2005 consist of the following:

Series 1994

The Medical Center Series 1994 Certificates of Participation were dated February 1, 1994, in the amount of $283,245, with interest rates from 4.60 percent to 7.00 percent.

The Series 1994 Certificates maturing on August 1, 2005, August 1, 2006, August 1, 2019, August 1, 2024, August 1, 2026, and August 1, 2028, are subject to optional redemption in whole or in part on any date in such order of maturity as the Corporation shall determine and by lot within a maturity, on or after August 1, 2004, at the following premiums, plus interest accrued to the redemption date:

Redemption Dates	Premium
August 1, 2004 to July 31, 2005	2%
August 1, 2005 to July 31, 2006	1
August 1, 2006 and thereafter	-

NOTE #9 – LONG-TERM OBLIGATIONS, Continued

The Series 1994 Certificates maturing on August 1, 2009, August 1, 2017, August 1, 2020, and August 1, 2022, are not subject to optional redemption prior to maturity.

Series 1995

The Series 1995 Certificates of Participation were dated June 1, 1995, in the amount of $363,265, with interest rates from 4.80 percent to 7.00 percent.

The Series 1995 Certificates maturing on August 1, 2022, are subject to optional redemption, in whole or in part, on any date in such order of maturity as the Corporation shall determine and by lot within a maturity, on or after August 1, 2005, at the following premiums, plus interest accrued to the redemption date:

Redemption Dates	Premium
August 1, 2005 to July 31, 2006	2%
August 1, 2006 to July 31, 2007	1
August 1, 2007 and thereafter	-

The Series 1995 Certificates maturing on and prior to August 1, 2010 and on August 1, 2017, are not subject to optional redemption prior to maturity.

Series 1996

The Series 1996 Certificates of Participation were dated January 1, 1996, in the amount of $65,070, with interest rates from 5.00 percent to 5.25 percent.

The Series 1996 Certificates are subject to optional redemption, in whole or in part, on any date in such order of maturity as the Corporation shall determine and by lot within a maturity, on or after August 1, 2006, at the following premiums, plus interest accrued to the redemption date:

Redemption Dates	Premium
August 1, 2006 to July 31, 2007	2%
August 1, 2007 to July 31, 2008	1
August 1, 2008 and thereafter	-

Series 1997

The Series 1997 Certificates of Participation were dated September 1, 1997, in the amount of $121,095, with interest rates from 4.30 percent to 5.50 percent.

The Series 1997 Certificates are not subject to optional redemption prior to maturity.

NOTE #9 – LONG-TERM OBLIGATIONS, Continued

Series 1998

The Series 1998 Certificates of Participation were dated October 22, 1998, in the amount of $176,510. Interest with respect to the Certificates is payable at an adjustable weekly interest rate, which may be converted to a fixed interest rate at the option of the Corporation. The Corporation entered into an interest rate swap agreement with Merrill Lynch Capital Services, Inc., which provides that the Corporation will pay a fixed rate of 4.1895 percent to the Swap Provider on a notional amount equal to the principal amount of the Series 1998 Certificates, and the Swap Provider will pay interest to the Corporation at a variable rate of interest on such notional amount, such payments to be made on a net basis. See information below.

The Series 1998 Certificates are subject to optional redemption prior to their maturity at a redemption price equal to the principal amount thereof, plus accrued interest to the date of redemption as follows:

a) Prior to the Conversion Date, fixed interest rate, at a redemption price equal to the principal amount called for redemption without premium.

b) After the Conversion Date, at a redemption price of 100 percent of the principal amount plus a premium to be determined on or prior to the Conversion Date.

The proceeds from the Series 1998 Certificates of Participation (Certificates) were used for the advance refunding for $160,700 of previously issued Series 1995 Certificates of Participation. Government securities were purchased with the proceeds, and those securities were deposited in an irrevocable trust with an escrow agent to provide debt service until the remaining outstanding Certificates mature. The advance-refunding method met the requirements of an in-substance defeasance, and the remaining outstanding Certificates were removed as a liability of the Medical Center.

At both June 30, 2005 and 2004, the balance of defeased debt outstanding, but removed from the Medical Center's financial statements, was $276,770.

Interest Rate Swap

Objective of the interest rate swap. As a means to lower financing costs, and to reduce the risks to the Corporation associated with the fluctuation in market interest rates, the Corporation entered into an interest rate swap in connection with the Medical Center Series 1998 Certificates of Participation (Series 1998 Certificates) in the amount of $176,510. The intention of the swap was to effectively change the variable interest rate on the bonds to a synthetic fixed-rate of 4.1895 percent.

NOTE #9 – LONG-TERM OBLIGATIONS, Continued

Terms. The Series 1998 Certificates and the related swap agreement mature on August 1, 2026, and the swap's notional amount of $176,510 matches the $176,510 variable-rate COPs. The swap was effective at the same time the Series 1998 Certificates were issued on October 22, 1998. Starting in fiscal year 2008-09, the notional value of the swap and the principal amount of the associated debt decline. Under the swap agreement, through August 1, 2005, the Corporation pays Merrill Lynch a fixed rate of 4.1895 percent and Merrill Lynch pays the Corporation an amount equal to the variable rate interest payable on the outstanding Series 1998 Certificates. After August 1, 2005, the Corporation pays Merrill Lynch a fixed payment of 4.1895 percent and receives from Merrill Lynch a variable payment computed as 73 percent of the monthly London Interbank Offered Rate (LIBOR). Conversely, the Series 1998 Certificates variable-rate coupons have historically been similar to the Bond Market Association Municipal Swap Index (BMA).

Fair Value. Because interest rates have declined since execution of the swap, the swap had a negative fair value of $16,421 as of June 30, 2005. The swap's negative fair value may be countered by a reduction in total interest payments required under the variable-rate bonds, creating a lower synthetic interest rate. Because the coupons on the variable-rate Series 1998 Certificates adjust to changing interest rates, the Series 1998 Certificates do not have a corresponding fair value increase. The fair value was the quoted market price from Merrill Lynch at June 30, 2005.

Credit Risk. The swap counterparty was rated Aa3 by Moody's and A+ by Standard & Poor as of June 30, 2005. The swap agreement specifies that if the long-term senior unsecured debt rating of Merrill Lynch & Co. is withdrawn, suspended or falls below A- (Standard & Poor) or A3 (Moody's), a collateral agreement will be executed within 30 days or the swap agreement will terminate.

Basis Risk. The swap exposes the Corporation to basis risk should the relationship between LIBOR and BMA converge, changing the synthetic rate on the Series 1998 Certificates. If a change occurs that results in the rates moving to convergence, the expected cost savings may not be realized. As of June 30, 2005, the BMA rate was 2.28 percent, the actual variable interest rate was 2.10 percent, and 73 percent of LIBOR was 2.44 percent.

Termination Risk. The Corporation or the counterparty may terminate the swap if the other party fails to perform under the terms of the contract. The swap may be terminated by the Corporation if Merrill Lynch's credit quality rating falls below A- as issued by Standard & Poor or A3 by Moody's. If the swap is terminated, the variable-rate Series 1998 Certificates would no longer carry a synthetic interest rate. Also, if at the time of termination the swap has a negative fair value, the Corporation would be liable to Merrill Lynch for a payment equal to the swap's fair value.

NOTE #9 – LONG-TERM OBLIGATIONS, Continued

Swap payments and associated debt. Using rates as of June 30, 2005, debt service requirements of the variable-rate debt and net swap payments, assuming current interest rates remain the same for their term, were as follows. As rates vary, variable rate Series 1998 Certificates interest payments and net swap payments will vary.

Fiscal Year	Variable Rate Bonds Principal	Variable Rate Bonds Interest	Interest Rate Swaps, Net	Total
2006	$ -	$ 3,707	$ 3,091	$ 6,798
2007	-	3,707	3,091	6,798
2008	-	3,707	3,091	6,798
2009	1,000	3,696	3,083	7,779
2010	1,100	3,674	3,064	7,838
2011-2027	174,410	36,350	30,315	241,075
Totals	$ 176,510	$ 54,841	$ 45,735	$ 277,086

B. Debt Service Requirements

The total annual debt service requirements to maturity for the outstanding Certificates of Participation as of June 30, 2005 are summarized as follows:

Fiscal Year	Total Principal	Total Interest
2006	$ 24,350	$ 31,076
2007	25,735	29,694
2008	27,180	28,247
2009	29,795	26,670
2010	14,610	25,355
2011-15	87,280	112,992
2016-20	113,120	87,612
2021-25	147,270	53,879
2026-30	146,970	14,696
Totals	$ 616,310	$ 410,221

NOTE #9 – LONG-TERM OBLIGATIONS, Continued

C. Capital Lease Obligations

The Medical Center has various lease agreements with financial institutions and medical equipment manufacturers expiring at various dates through November 2009, providing for monthly payments at various interest rates. Equipment acquired under these agreements have been accounted for as capital leases.

Future minimum lease payments on capital leases as of June 30, 2005, are as follows:

Fiscal Year	
2006	$ 406
2007	406
2008	405
2009	169
Total minimum lease payments	1,386
Less Amount Representing Interest	(80)
Present value of net minimum lease payments	1,306
Less Current Portion of Capital Lease Obligations	(366)
Capital lease obligations, excluding current portion	$ 940

The net book value of equipment acquired under capitalized leases at June 30, 2005 and 2004 was $1,302 and $1,440 (net of accumulated amortization of $558 and $360), respectively.

NOTE #10 – ARBITRAGE PAYABLE

Interest earned in excess of interest expense related to tax-exempt debt issued for public purposes must be remitted to the federal government following the end of each period of five bond years of the Certificates of Participation. The amount of excess investment earnings calculated as of June 30, 2005 and 2004, totaled $165 and $25, respectively.

NOTE #11 – OPERATING LEASES

Rent expense for operating leases for the years ended June 30, 2005 and 2004, totaled $1,770 and $787, respectively.

NOTE #12 – RETIREMENT PLAN

Employees of the Medical Center participate in a cost-sharing multiple-employer defined benefit retirement plan (the Plan) administered by the San Bernardino County Employee's Retirement Association (SBCERA). The Plan is governed by the San Bernardino Board of Retirement under the California County Employees Retirement Act of 1937 (1937 Act). It provides retirement, death, and disability benefits to members. Employees become eligible for membership on their first day of regular employment and become fully vested after five years. SBCERA issues a stand-alone financial report, which may be obtained by contacting the Board of Retirement, 195 North Arrowhead Avenue, San Bernardino, California 92415-0014.

Participating members are required by statute Sections 31621, 31621.2, and 31639.25 of the California Code to contribute a percentage of covered salary based on certain actuarial assumptions and their age at entry into the Plan. Employee contribution rates vary according to age and classification (general or safety). Members are required to contribute 7.11 percent to 10.58 percent of their annual covered salary, of which the County pays approximately 7 percent. Employers are required to contribute 6.67 percent to 14.46 percent of the current year covered payroll from M-6.2. The Medical Center's pension cost for the fiscal years ended June 30, 2005 and 2004, was approximately $17,722 and $15,110, respectively. Employee contribution rates are established and may be amended pursuant to Articles 6.1 and 6.8 of the 1937 Act. Employer rates are determined pursuant to Section 31453 of the 1937 Act. The following table shows the County's required contributions and the percentage contributed for the current year and each of the two preceding years:

Year Ended June 30,	County's Annual Required Contributions	Percentage Contributed
2003	$ 68,361	100%
2004	590,661	100%
2005	141,450	100%

NOTE #13 – SELF-INSURANCE

The Medical Center participates in the County's self-insurance programs for general liability, unemployment insurance, employee dental insurance, medical malpractice, and workers' compensation claim-related risks.

The activities related to the self-insurance programs are accounted for in the County's Risk Management Funds, separate internal service funds of the County, except for unemployment insurance and employee dental insurance, which are accounted for in the General Fund of the County. The Medical Center participates in these plans through a premium based arrangement that consists of annual amounts not subject to adjustment for adverse claims. Insurance premium expense for the years ended June 30, 2005 and 2004, was $5,176 and $4,107, respectively.

NOTE #14 – LITIGATION

The Medical Center is the defendant in various lawsuits and other claims arising in the ordinary course of its operations. In the opinion of County Counsel and County officials, the ultimate outcome of these matters will have no significant effect on the financial condition or operations of the Medical Center.

NOTE #15 – MEDI-CAL STATE PLAN AMENDMENT

In May 2003, the Office of the Inspector General ("OIG"), U.S. Department of Health and Human Services, completed a review of the State of California's implementation of certain limits pertaining to the Medi-Cal disproportionate ("DSH") share hospital payments program for the fiscal year ended June 30, 1998. In the review, the OIG performed alternative calculations relating to the interpretation of the OBRA 1993 limits versus the State Plan methodology. Should the alternative calculations be deemed to supercede the State Plan methodology, it is possible that some portion of the DSH funds received by the hospital may be considered overpayments. While a Medi-Cal State Plan Amendment regarding the manner in which the OBRA 1993 limits are calculated and applied in California was approved by the Centers for Medicare and Medicaid Services ("CMS") in 1996, CMS also stated that estimates made under this amendment would be subject to future adjustment. It is unknown what impact this may have on the hospital.

NOTE #16 – SUBSEQUENT EVENTS

Investments

AIG Matched Funding Corporation (AIGMFC) elected to terminate the $12,542 guaranteed investment contract listed in Note #2 – Cash, Cash Equivalents, and Investments. This election was made pursuant to Section 2.1(d) of the agreement. On August 4, 2005, AIGMFC paid to the Trustee, J P Morgan, the outstanding principal amount of the investment plus accrued but unpaid interest.

Defeased Debt

On August 1, 2005, the 1995 Medical Center Certificates of Participation considered defeased at June 30, 2005 (Note #9) were called and paid in full. Principal called totaled $218,700.

Vavrinek, Trine, Day & Co., LLP
Certified Public Accountants & Consultants

VALUE THE DIFFERENCE

REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

The Honorable Members of the Board of Supervisors
The County of San Bernardino, California

We have audited the financial statements of the Arrowhead Regional Medical Center (Medical Center), a fund of the County of San Bernardino (County), as of and for the year ended June 30, 2005, and have issued our report thereon dated September 16, 2005. 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 Medical Center's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessary disclose all matters in the internal control that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses. However, we noted other matters involving internal control over financial reporting that we have reported to management of the Medical Center in a separate letter dated September 16, 2005.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Medical Center'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*.

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This report is intended solely for the information and use of the Board of Supervisors, management, Federal awarding agencies, pass-through entities and the Controller of the State of California and is not intended to be, and should not be, used by anyone other than these specified parties.

Vavrinek, Trine, Day & Co., LLP

Rancho Cucamonga, California
September 16, 2005