

**COUNTY OF SAN BERNARDINO**  
**ARROWHEAD REGIONAL MEDICAL CENTER**  
(An Enterprise Fund of the  
County of San Bernardino, California)

Independent Auditors' Reports  
and Financial Statements

For the Years Ended June 30, 2011 and 2010

**COUNTY OF SAN BERNARDINO  
ARROWHEAD REGIONAL MEDICAL CENTER  
FOR THE YEARS ENDED JUNE 30, 2011 AND 2010  
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## INDEPENDENT AUDITORS' REPORT

To the Board of Supervisors,  
And the Management of Arrowhead Regional Medical Center  
County of San Bernardino, California

We have audited the accompanying financial statements of the Arrowhead Regional Medical Center (the "Medical Center"), an enterprise fund of the County of San Bernardino (the "County"), as of and for the years ended June 30, 2011 and 2010, 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. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Medical Center's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, 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 opinion.

As discussed in Note #1, the financial statements present only the Medical Center enterprise fund and do not purport to, and do not, present fairly the financial position of the County of San Bernardino, California, as of June 30, 2011 and 2010, and the changes in financial position and, cash flows 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, 2011 and 2010, and the changes in its financial position and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 5, 2011 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 audits.

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.

*Vawter, Tami, Day, Co., LLP*

Rancho Cucamonga, California  
December 5, 2011

**COUNTY OF SAN BERNARDINO  
ARROWHEAD REGIONAL MEDICAL CENTER**

**STATEMENTS OF NET ASSETS**

**JUNE 30, 2011 AND 2010**

**(In Thousands)**

	2011	2010
<b>ASSETS</b>		
Current Assets:		
Cash and cash equivalents	\$ 18,457	\$ 16,954
Restricted investments held with fiscal agent	25,175	19,032
Patient accounts receivable, net of estimated uncollectables of \$238,415 in 2011 and \$242,971 in 2010	34,517	32,523
Receivable from other governments	39,442	38,326
Due from County	431	276
Supplies inventories	1,378	1,379
Prepaid expenses and other assets	3,604	2,829
Total Current Assets	<u>123,004</u>	<u>111,319</u>
Noncurrent Assets:		
Restricted investments held with fiscal agent	24,913	32,794
Restricted investments held with fiscal agent - interest	269	413
Deferred issuance costs	5,087	5,422
Capital assets:		
Land and improvements	23,935	23,406
Buildings and improvements	540,845	491,750
Equipment	130,463	119,397
Construction-in-progress	923	50,279
Total capital assets	<u>696,166</u>	<u>684,832</u>
Less accumulated depreciation	<u>(262,369)</u>	<u>(242,168)</u>
Total capital assets, net of accumulated depreciation	<u>433,797</u>	<u>442,664</u>
Total Noncurrent Assets	<u>464,066</u>	<u>481,293</u>
Total Assets	<u>587,070</u>	<u>592,612</u>
<b>LIABILITIES</b>		
Current Liabilities:		
Accounts payable	15,435	13,969
Accrued salaries and benefits	17,395	18,131
Accrued termination benefits	112	112
Other accrued liabilities	950	1,625
Due to third-party payors	10,760	8,295
Capital lease obligations	436	429
Certificates of participation	17,370	17,380
Interest payable	10,787	12,679
Arbitrage payable	699	81
Due to County	549	28,929
Total Current Liabilities	<u>74,493</u>	<u>101,630</u>
Noncurrent Liabilities:		
Long-term compensated absences	4,245	2,027
Long-term termination benefits	223	335
Capital lease obligations, less current installments	1,013	101
Certificates of participation, less current installments (net of deferred amount on refunding and bond discount)	<u>446,753</u>	<u>461,518</u>
Total Noncurrent Liabilities	<u>452,234</u>	<u>463,981</u>
Total Liabilities	<u>526,727</u>	<u>565,611</u>
<b>NET ASSETS</b>		
Invested in capital assets, net of related debt	(26,688)	(31,342)
Restricted for debt service	39,570	39,560
Unrestricted	47,461	18,783
Total Net Assets	<u>\$ 60,343</u>	<u>\$ 27,001</u>

See accompanying notes to basic financial statements.

**COUNTY OF SAN BERNARDINO  
ARROWHEAD REGIONAL MEDICAL CENTER**

**STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS**

**YEARS ENDED JUNE 30, 2011 AND 2010**

**(In Thousands)**

	<u>2011</u>	<u>2010</u>
OPERATING REVENUES		
Net patient service revenue	\$ 380,357	\$ 380,954
Premium revenue - managed care	4	
Other	7,958	6,968
Total Operating Revenues	<u>388,319</u>	<u>387,922</u>
OPERATING EXPENSES		
Salaries and benefits	202,348	201,907
Medi-Cal matching fund expense	30,108	32,754
Supplies	63,785	62,280
Professional services	49,381	42,690
Purchased services	32,580	39,827
Insurance	7,442	8,979
Utilities	8,329	7,973
Depreciation and amortization	20,205	17,661
Rent	4,161	3,801
Amortization related to debt	2,939	2,881
Other	1,014	1,140
Total Operating Expenses	<u>422,292</u>	<u>421,893</u>
Operating Loss	<u>(33,973)</u>	<u>(33,971)</u>
NONOPERATING REVENUES (EXPENSES)		
State debt service funding	19,500	18,985
State realignment funding	974	39,863
Federal grants		60
Tobacco tax		2
Investment income	1,720	6,395
Interest expense on debt	(25,930)	(28,191)
DSRIP funding	31,501	
Direct grants - designated public hospital	28,685	
Other nonoperating revenues (expenses)	(689)	(1,869)
Total Nonoperating Revenues, Net	<u>55,761</u>	<u>35,245</u>
Income Before Transfers	21,788	1,274
Transfers from the County	15,488	22,838
Transfers to the County	(3,934)	(6,232)
Changes in Net Assets	33,342	17,880
Net Assets, Beginning of Year, as Restated	<u>27,001</u>	<u>9,121</u>
Net Assets, End of Year, as Restated	<u>\$ 60,343</u>	<u>\$ 27,001</u>

See accompanying notes to basic financial statements.

**COUNTY OF SAN BERNARDINO  
ARROWHEAD REGIONAL MEDICAL CENTER**

**STATEMENTS OF CASH FLOWS**

**YEARS ENDED JUNE 30, 2011 AND 2010**

**(In Thousands)**

	<u>2011</u>	<u>2010</u>
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Receipts from customers	\$ 387,519	\$ 361,512
Payments to suppliers	(224,545)	(170,495)
Payments to employees	(200,978)	(207,733)
Net Cash Used in Operating Activities	<u>(38,004)</u>	<u>(16,716)</u>
<b>CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES</b>		
State realignment funding received	974	39,863
Tobacco tax received		2
DSRIP funding received	31,501	
Transfers from the County	15,488	14,635
Transfers to the County	(3,934)	(5,028)
Other nonoperating income (expense)	(689)	(1,809)
Direct grants - designated public hospital	28,685	
Net Cash Provided by Noncapital Financing Activities	<u>72,025</u>	<u>47,663</u>
<b>CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES</b>		
Purchase of capital assets	(11,338)	(27,810)
State debt service funding	19,500	18,985
Termination of swap agreement		(26,735)
Principal payments on capital lease obligations	919	(829)
Principal payments on certificates of participation	(17,379)	12,118
Interest paid on debt	(27,822)	(26,203)
Net Cash Used in Capital and Related Financing Activities	<u>(36,120)</u>	<u>(50,474)</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Interest on investments	1,720	6,395
Investment activity, net	1,882	(3,818)
Net Cash Provided by Investing Activities	<u>3,602</u>	<u>2,577</u>
Increase in Cash and Cash Equivalents	1,503	(16,950)
Cash and Cash Equivalents, Beginning of Year	16,954	33,904
Cash and Cash Equivalents, End of Year	<u>\$ 18,457</u>	<u>\$ 16,954</u>

See accompanying notes to basic financial statements.

**COUNTY OF SAN BERNARDINO  
ARROWHEAD REGIONAL MEDICAL CENTER**

**STATEMENTS OF CASH FLOWS, Continued**

**YEARS ENDED JUNE 30, 2011 AND 2010**

**(In Thousands)**

	<u>2011</u>	<u>2010</u>
RECONCILIATION OF OPERATING LOSS TO NET CASH USED IN OPERATING ACTIVITIES		
Operating Loss	\$ (33,973)	\$ (33,971)
Adjustments to reconcile operating loss to net cash used in operating activities:		
Depreciation and amortization	20,205	17,661
Amortization related to debt	2,939	2,881
Decrease (Increase) in:		
Patient accounts receivable	(1,994)	(1,079)
Receivables from other governments	(1,116)	(26,067)
Due from County	(155)	692
Supplies inventories	1	175
Prepaid expenses and other assets	(775)	(809)
Increase (Decrease) in:		
Accounts payable	1,466	2,616
Accrued salaries and benefits	1,482	(5,562)
Accrued termination benefits	(112)	(264)
Other accrued liabilities	(675)	1,206
Due to third-party payors	2,465	44
Arbitrage payable	618	
Due to County	(28,380)	25,761
Net Cash Used in Operating Activities	<u>\$ (38,004)</u>	<u>\$ (16,716)</u>

See accompanying notes to basic financial statements.

**COUNTY OF SAN BERNARDINO  
ARROWHEAD REGIONAL MEDICAL CENTER**

**NOTES TO FINANCIAL STATEMENTS**

**JUNE 30, 2011 AND 2010  
(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 456 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 control of the County and the Medical Center.

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.

**COUNTY OF SAN BERNARDINO  
ARROWHEAD REGIONAL MEDICAL CENTER**

**NOTES TO FINANCIAL STATEMENTS**

**JUNE 30, 2011 AND 2010  
(In Thousands)**

*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 #7.

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 an agreement with Managed Care Provider to get reimbursement based on a Fee for Service arrangement to provide medical services to subscribing participants. Under this agreement, the Medical Center receives payments based on the number of participants and 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 and Cash Equivalents

For purposes of the Statement of Cash Flows, the Medical Center considered all highly liquid investments with a maturity of three months or less when purchased to be cash equivalents. The Medical Center maintains a certain portion of its cash on deposit with the County Treasurer.

I. Restricted investments held with fiscal agent

Restricted investments held with fiscal agent represent funds held by a trustee which are legally restricted for bond reserve accounts. Restricted investments held with fiscal agent that are required for obligations classified as current liabilities are reported as current assets.

**COUNTY OF SAN BERNARDINO  
ARROWHEAD REGIONAL MEDICAL CENTER**

**NOTES TO FINANCIAL STATEMENTS**

**JUNE 30, 2011 AND 2010  
(In Thousands)**

*NOTE #1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, (CONTINUED)*

J. Capital Assets

Buildings, improvements, and equipment with a historical cost over \$5 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	3 to 20 years

K. Capitalized Interest

The Medical Center capitalizes net interest expense as a cost of property constructed. \$539 and \$1,353 were capitalized for the years ended June 30, 2011 and 2010 respectively.

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.

**COUNTY OF SAN BERNARDINO  
ARROWHEAD REGIONAL MEDICAL CENTER**

**NOTES TO FINANCIAL STATEMENTS**

**JUNE 30, 2011 AND 2010  
(In Thousands)**

*NOTE #1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, (CONTINUED)*

O. New Accounting Pronouncements

*Governmental Accounting Standard No. 60*

On November 2010, GASB issued Statement No. 60, *Accounting and Financial Reporting for Service Concession Arrangements*. The objective of this Statement is to improve financial reporting by addressing issues related to service concession arrangements (SCAs), which are a type of public-private or public-public partnership. An SCA arrangement is considered to be between a transferor (a government) and an operator (another government or private entity) in which the transferor conveys to the operator the right and related obligation to provide services through the use of infrastructure or another public asset (a “facility”) in exchange for significant consideration and the operator collects and is compensated by fees collected from third parties. This statement is not effective until June 30, 2013. The Medical Center has not determined its effect on the financial statements.

*Governmental Accounting Standard No. 61*

On November 2010, GASB issued Statement No. 61, *The Financial Reporting Entity: Omnibus – an amendment of GASB Statement No. 14 and No. 34*. The objective of this Statement is to improve financial reporting for a governmental financial reporting entity and modifies certain requirements for inclusion of component units in the financial reporting entity. This statement is not effective until June 30, 2013. The Medical Center has not determined its effect on the financial statements.

*Governmental Accounting Standard No. 62*

On December 2010, GASB issued Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*. The objection of this Statement is to incorporate into the GASB’s authoritative literature certain accounting and financial reporting guidance that is included in the Financial Accounting Standards Board (FASB) Statements and Interpretations, Accounting Principles Board Opinions and Accounting Research Bulletins of the American Institute of Certified Public Accountants’ (AICPA) Committee on Accounting Procedures that were issued on or before November 30, 1989, which does not conflict with or contradict GASB pronouncements. This statement is not effective until June 30, 2012. The Medical Center has not determined its effect on the financial statements.

**COUNTY OF SAN BERNARDINO  
ARROWHEAD REGIONAL MEDICAL CENTER**

**NOTES TO FINANCIAL STATEMENTS**

**JUNE 30, 2011 AND 2010  
(In Thousands)**

*NOTE #1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, (CONTINUED)*

O. New Accounting Pronouncements, (Continued)

*Governmental Accounting Standard No. 63*

On June 2011, GASB issued Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*. This Statement provides financial reporting guidance for deferred outflows of resources and deferred inflows of resources and amends the net asset reporting requirements in Statement No. 34, *Basic Financial Statements – and Management’s Discussion and Analysis – for State and Local Governments*, and other pronouncements by incorporating deferred outflows of resources and deferred inflows of resources into the definitions of the required components of the residual measure and by renaming that measure as net position, rather than net assets. This statement is not effective until June 30, 2012. The Medical Center has not determined its effect on the financial statements.

*Governmental Accounting Standard No. 64*

On June 2011, GASB issued Statement No. 64, *Derivative Instruments: Application of Hedge Accounting Termination Provisions – an amendment of GASB Statement No. 53*. The objective of this Statement is to clarify whether an effective hedging relationship continues after the replacement of a swap counterparty or a swap counterparty’s credit support provider. This Statement sets forth criteria that establish when the effective hedging relationship continues and hedge accounting should continue to be applied. This statement is not effective until June 30, 2012. The Medical Center has not determined its effect on the financial statements.

*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 \$4,112,203 at June 30, 2011. The County Treasury pool did not include any derivative securities in 2011.

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.

**COUNTY OF SAN BERNARDINO  
ARROWHEAD REGIONAL MEDICAL CENTER**

**NOTES TO FINANCIAL STATEMENTS**

**JUNE 30, 2011 AND 2010  
(In Thousands)**

*NOTE #2 – CASH, CASH EQUIVALENTS, AND INVESTMENTS, (CONTINUED)*

The Medical Center’s cash and restricted investments held with fiscal agent as of June 30, 2011 and 2010 are classified in the accompanying financial statements as follows:

	2011	2010
Cash and cash equivalents	\$ 18,457	\$ 16,954
Held with fiscal agent for debt service - current	25,175	19,032
Held with fiscal agent for debt service - noncurrent	24,913	32,794
Total Cash and Investments	<u>\$ 68,545</u>	<u>\$ 68,780</u>

The Medical Center’s cash and investments as of June 30, 2011 and 2010 consisted of the following:

	2011	2010
Deposits with County Treasury	\$ 18,457	\$ 16,954
Investments	50,088	51,826
Total Cash and Investments	<u>\$ 68,545</u>	<u>\$ 68,780</u>

**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 #10), 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.

Weighted average maturity of the Medical Center’s Investments Held with Bond Trustee as of June 30, 2011:

Investment Type	Fair Value at June 30, 2011	Weighted Average Maturity (in years)
Held by bond trustee:		
Money market mutual funds	\$ 25,175	daily
Guaranteed investment contracts	4,751	17.07
U.S. Treasury Notes	20,162	11.38
Total	<u>\$ 50,088</u>	

**COUNTY OF SAN BERNARDINO  
ARROWHEAD REGIONAL MEDICAL CENTER**

**NOTES TO FINANCIAL STATEMENTS**

**JUNE 30, 2011 AND 2010  
(In Thousands)**

*NOTE #2 – CASH, CASH EQUIVALENTS, AND INVESTMENTS, (CONTINUED)*

Weighted average maturity of the Medical Center’s Investments Held with Bond Trustee as of June 30, 2010:

<u>Investment Type</u>	<u>Fair Value at June 30, 2010</u>	<u>Weighted Average Maturity (in years)</u>
Held by bond trustee:		
Money market mutual funds	\$ 2,456	daily
Federal Agencies Securities	19,032	0.99
Guaranteed investment contracts	9,706	18.09
U.S. Treasury Notes	20,632	12.39
Total	<u>\$ 51,826</u>	

**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 Medical Center’s debt agreements and the actual rating for each investment type as of June 30, 2011 and 2010:

<u>Investment Type</u>	<u>Rating as of June 30, 2011</u>	
	<u>B-</u>	<u>AAA</u>
Held by bond trustee:		
Money market mutual funds	\$ 25,175	\$ 25,175
Guaranteed investment contracts	4,751	\$ 4,751
Total	<u>\$ 29,926</u>	<u>\$ 25,175</u>

<u>Investment Type</u>	<u>Rating as of June 30, 2010</u>	
	<u>BB-</u>	<u>AAA</u>
Held by bond trustee:		
Money market mutual funds	\$ 2,456	\$ 2,456
Federal Agencies Securities	19,032	19,032
Guaranteed investment contracts	9,706	\$ 9,706
Total	<u>\$ 31,194</u>	<u>\$ 21,488</u>

**COUNTY OF SAN BERNARDINO  
ARROWHEAD REGIONAL MEDICAL CENTER**

**NOTES TO FINANCIAL STATEMENTS**

**JUNE 30, 2011 AND 2010  
(In Thousands)**

*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 as of June 30, 2011 and 2010:

Issuer	Investment Type	Fair Value at June 30, 2011
MBIA Investment Management Corp.	Guaranteed Investment Contract	\$ 4,751

Issuer	Investment Type	Fair Value at June 30, 2010
MBIA Investment Management Corp.	Guaranteed Investment Contract	\$ 9,706
Federal Home LN MTG	Federal Agency Securities	19,032

**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 County Treasurer’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, 2011 and 2010.

**COUNTY OF SAN BERNARDINO  
ARROWHEAD REGIONAL MEDICAL CENTER**

**NOTES TO FINANCIAL STATEMENTS**

**JUNE 30, 2011 AND 2010  
(In Thousands)**

*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 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, 2011 and 2010 was \$974 and \$39,863, 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, 2011 and 2010, the Medi-Cal program represented approximately 48 percent and 47 percent, respectively, and the Medicare program represented approximately 20 percent and 21 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, 2004 for Medicare and June 30, 2009, for Medi-Cal. Adjustments as a result of such audits are recorded in the year the amounts can be determined.

**Medi-Cal Waiver** – The federal Medicaid program is referred to as Medi-Cal in California. Effective July 1, 2005 Medi-Cal fee-for-service (FFS) inpatient hospital payments are made in accordance with the federal Medicaid hospital financing waiver and State of California Senate Bill 1100 (SB 1100). Medi-Cal Outpatient FFS services are reimbursed based on a fee schedule. SB 1100 is designed to protect baseline Medi-Cal funding for the Medical Center over the next five years – at a minimum the Medical Center will receive the Medi-Cal inpatient hospital payments they received in 2004-05 adjusted for future utilization changes.

SB 1100 also allows the Medical Center to receive additional waiver growth funding subject to the availability of funds. The total payments made to the Medical Center under SB 1100 will include a combination of Medi-Cal inpatient FFS payments, Medi-Cal Disproportionate Share (DSH) payments, and Safety Net Care Pool (SNCP). The SNCP is a federal allotment available under the waiver. For the year ended June 30, 2011 and 2010, the Medical Center recorded total Medi-Cal inpatient and outpatient net revenue of \$109,726 and \$111,530 respectively and related receivable of \$4,709 and \$3,817, respectively. The waiver approved under SB 1100 expired August 2010. See note #5.

**COUNTY OF SAN BERNARDINO  
ARROWHEAD REGIONAL MEDICAL CENTER**

**NOTES TO FINANCIAL STATEMENTS**

**JUNE 30, 2011 AND 2010  
(In Thousands)**

*NOTE #4 – NET PATIENT SERVICE REVENUE, (CONTINUED)*

**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 \$13,273 and \$11,108 in AB-915 funds for the years ended June 30, 2011 and 2010, 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.

*NOTE #5 – DELIVERY SYSTEM REFORM INCENTIVE POOL*

On November 2, 2010 the federal government approved California’s five-year, \$10 billion “Bridge to Reform” Section 1115 waiver proposal. Through Section 1115 waiver, California has seized this moment in the history of health care reform to advance Medi-Cal program changes that will help the state transition to the federal reforms that is expected to take effect in January 2014. The new waiver promotes a public hospital delivery system transformation, which implements a series of improvements to public hospitals delivery system to strengthen their infrastructure, prepare them for full implementation of reform and test strategies to slow the rate of growth in health care costs throughout the state. Within the SNCP (Safety Net Care Pool), a Delivery System Reform Incentive Pool has been established to support the ability of California’s public hospitals efforts to enhance the quality of care and health of the patients and families they serve. The processes for distribution of these funds have been developed jointly by the state, public hospitals systems and the federal Centers for Medicare and Medicaid Services. The four areas for which funding may be available under the Delivery System Reform Incentive Program are 1) Infrastructure Development 2) Innovation and Redesign 3) Population-Focused Improvement, and 4) Urgent Improvement in Care.

The amount to be received by the hospitals is dependent upon certain milestones. The Medical Center's share of these revenues for the years ended June 30, 2011 and 2010 were \$31,501 and \$0, 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 #6 – HOSPITAL FEE PROGRAM*

AB 1383 of 2009, as amended by AB 1653 on September 8, 2010, established a series of Medicaid supplemental payments funded through a "Quality Assurance Fee" and a "Hospital Fee Program", which are imposed on certain California hospitals. The effective date of the Hospital Fee Program is April 1, 2009 through December 31, 2010 and is predicated in part on the enhanced Federal Medicaid Assistance Percentage ("FMAP") contained in the American Reinvestment and Recovery Act ("ARRA"). The Hospital Fee Program made supplemental payments to hospitals for various health care services and support the State's effort to maintain health care coverage for children. The Medical Center, as a designated public hospital, is exempt from paying the "Quality Assurance Fee"; however, the Medical Center's was eligible to receive supplemental payments under the Hospital Fee Program.

**COUNTY OF SAN BERNARDINO  
ARROWHEAD REGIONAL MEDICAL CENTER**

**NOTES TO FINANCIAL STATEMENTS**

**JUNE 30, 2011 AND 2010  
(In Thousands)**

*NOTE #6 – HOSPITAL FEE PROGRAM, (CONTINUED)*

Under the Hospital Fee Program, designated public hospitals were eligible to receive a total of \$295 million in direct grants (Direct Grants) for each approved federal fiscal year. For the fiscal year ended June 30, 2011, the Medical Center received \$28,685 on direct grants.

*NOTE #7 – 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:

	2011	2010
Charges foregone based on established rates	<u>\$ 466,481</u>	<u>\$ 359,988</u>

*NOTE #8 – 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 51.27 percent of the total debt service costs. Amounts received by the Medical Center in SB-1732 funds during fiscal years 2011 and 2010 amounted to \$19,500 and \$18,985 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, 2011 and 2010.

**COUNTY OF SAN BERNARDINO  
ARROWHEAD REGIONAL MEDICAL CENTER**

**NOTES TO FINANCIAL STATEMENTS**

**JUNE 30, 2011 AND 2010  
(In Thousands)**

*NOTE #9 – CAPITAL ASSETS*

A summary of capital assets activity for the years ended June 30, 2011 and 2010 is as follows:

	Beginning Balance	Additions	Deletions	Ending Balance
<b>June 30, 2011</b>				
Land and improvements	\$ 23,406	\$ 529		\$ 23,935
Buildings and improvements	491,750	49,095		540,845
Equipment	119,397	11,071	\$ 5	130,463
Construction-in-progress	50,279	7,271	56,627	923
Total Capital Assets, Gross	684,832	67,966	56,632	696,166
<b>Accumulated Depreciation:</b>				
Land and improvements	(464)	(201)		(665)
Buildings and improvements	(139,814)	(14,462)		(154,276)
Equipment	(101,890)	(5,542)	4	(107,428)
Total Accumulated Depreciation	(242,168)	(20,205)		(262,369)
Capital Assets, Net	\$ 442,664	\$ 47,761	\$ 56,632	\$ 433,797
	Beginning Balance	Additions	Deletions	Ending Balance
<b>June 30, 2010</b>				
Land and improvements	\$ 23,241	\$ 165		\$ 23,406
Buildings and improvements	491,750			491,750
Equipment	113,525	5,872		119,397
Construction-in-progress	28,507	21,772		50,279
Total Capital Assets, Gross	657,023	27,809		684,832
<b>Accumulated Depreciation:</b>				
Land and improvements	(288)	(176)		(464)
Buildings and improvements	(126,472)	(13,342)		(139,814)
Equipment	(97,748)	(4,142)		(101,890)
Total Accumulated Depreciation	(224,508)	(17,660)		(242,168)
Capital Assets, Net	\$ 432,515	\$ 10,149	\$ -	\$ 442,664

**COUNTY OF SAN BERNARDINO  
ARROWHEAD REGIONAL MEDICAL CENTER**

**NOTES TO FINANCIAL STATEMENTS**

**JUNE 30, 2011 AND 2010  
(In Thousands)**

*NOTE #10 – 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, 2011 and 2010.

The Medical Center is allocated a portion of the County's overhead costs. Such expenses totaled \$3,934 and \$5,027 for the years ended June 30, 2011 and 2010, 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 \$6,972 and \$8,274 for the years ended June 30, 2011 and 2010, respectively, and are included in salaries and benefits 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 #11 – LONG-TERM OBLIGATIONS*

The following is a summary of changes in long-term obligations for the fiscal years ended June 30, 2011 and 2010:

	June 30, 2011				
	Beginning Balance	Additions	Reductions	Ending Balance	Due within One Year
Certificates of Participation					
Series 1994	\$ 127,715		\$ (3,570)	\$ 124,145	\$ 3,775
Series 1995	38,440		(10,525)	27,915	3,245
Series 1996	64,685		(340)	64,345	360
Series 2009 A	243,980		(2,075)	241,905	9,990
Series 2009 B	44,750		(870)	43,880	
Total Certificates of Participation, Gross	519,570		(17,380)	502,190	17,370
Less:					
Deferred amount on refunding	(36,167)		2,379	(33,788)	
Discount on debt	(4,505)		226	(4,279)	
Total Certificates of Participation	478,898		(14,775)	464,123	17,370
Capital lease obligations	530	\$ 1,473	(554)	1,449	436
Total	\$ 479,428	\$ 1,473	\$ (15,329)	\$ 465,572	\$ 17,806

**COUNTY OF SAN BERNARDINO  
ARROWHEAD REGIONAL MEDICAL CENTER**

**NOTES TO FINANCIAL STATEMENTS**

**JUNE 30, 2011 AND 2010  
(In Thousands)**

*NOTE #11 – LONG-TERM OBLIGATIONS, (CONTINUED)*

	June 30, 2010				
	Beginning Balance	Additions	Reductions	Ending Balance	Due within One Year
Certificates of Participation					
Series 1994	\$ 175,520		\$ (47,805)	\$ 127,715	\$ 3,570
Series 1995	93,210		(54,770)	38,440	10,525
Series 1996	65,010		(325)	64,685	340
Series 1998	175,510		(175,510)		
Series 2009 A		\$ 243,980		243,980	2,075
Series 2009 B		44,750		44,750	870
Total Certificates of Participation, Gross	509,250	288,730	(278,410)	519,570	17,380
Less:					
Deferred amount on refunding	(32,430)	(5,806)	2,069	(36,167)	
Discount on debt	(11,578)	6,654	419	(4,505)	
Total Certificates of Participation	465,242	289,578	(275,922)	478,898	17,380
Capital lease obligations	1,359		(829)	530	429
Total	\$ 466,601	\$ 289,578	\$ (276,751)	\$ 479,428	\$ 17,809

**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, 2010 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, 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, plus interest accrued to the redemption date.

The Series 1994 Certificates maturing through August 1, 2009, August 1, 2017, August 1, 2020, and August 1, 2022, are not subject to optional redemption prior to maturity. On December 17, 2009 the Corporation issued the 2009 Series B Refunding Certificates and used the proceeds of the 2009 Series B Certificates along with other available funds to refund \$44,325,000 of the Series 1994 Certificates.

**COUNTY OF SAN BERNARDINO  
ARROWHEAD REGIONAL MEDICAL CENTER**

**NOTES TO FINANCIAL STATEMENTS**

**JUNE 30, 2011 AND 2010  
(In Thousands)**

*NOTE #11 – LONG-TERM OBLIGATIONS, (CONTINUED)*

A. Certificates of Participation, (Continued)

**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, plus interest accrued to the redemption date.

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. On December 17, 2009 the Corporation issued the 2009 Series A Refunding Certificates and used the proceeds of the 2009 Series A Certificates along with other available funds to refund \$45,065,000 of the Series 1995 Certificates.

**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, plus interest accrued to the redemption date.

**Series 2009 A**

The Medical Center Series 2009 A Refunding Certificates of Participation were issued on December 17, 2009, in the amount of \$243,980. The proceeds were used to refund a portion of the Certificate of Participation, Series 1995 and all of the outstanding Certificate of Participation, Series 1998 and fund a payment with respect to the termination of a Swap agreement entered into in connection with the execution and delivery of the Certificate of Participation, Series 1998. Interest rates on the 2009 A series range from 3 percent to 5.5 percent.

**Series 2009 B**

The Medical Center Series 2009 B Refunding Certificates of Participation were issued on December 17, 2009, in the amount of \$44,750. The proceeds were used to refund a portion of the outstanding Certificate of Participation, Series 1994. Interest rates on the 2009 B series range from 3 percent to 5.25 percent.

**COUNTY OF SAN BERNARDINO  
ARROWHEAD REGIONAL MEDICAL CENTER**

**NOTES TO FINANCIAL STATEMENTS**

**JUNE 30, 2011 AND 2010  
(In Thousands)**

*NOTE #11 – LONG-TERM OBLIGATIONS, (CONTINUED)*

**B. Debt Service Requirements**

The total annual debt service requirements to maturity for the outstanding Certificates of Participation as of June 30, 2011 are summarized as follows:

<u>Fiscal Year</u>	<u>Total</u>	
	<u>Principal</u>	<u>Interest</u>
2012	\$ 17,370	\$ 25,694
2013	18,140	24,849
2014	19,100	23,858
2015	20,225	22,813
2016	21,270	21,711
2017-2021	124,925	89,856
2022-2026	165,095	51,127
2027-2029	116,065	8,630
Totals	<u>\$ 502,190</u>	<u>\$ 268,538</u>

**C. Capital Lease Obligations**

The Medical Center has various lease agreements with financial institutions and medical equipment manufacturers expiring at various dates through fiscal year ending 2015, 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, 2011, are as follows:

<u>Fiscal Year</u>	
2012	\$ 454
2013	338
2014	332
2015	332
Total minimum lease payments	<u>1,456</u>
Less Amount Representing Interest	<u>(7)</u>
Present value of net minimum lease payments	1,449
Less Current Portion of Capital Lease Obligations	<u>(436)</u>
Capital lease obligations, excluding current portion	<u>\$ 1,013</u>

The net book value of equipment acquired under capitalized leases at June 30, 2011 and 2010 was \$1,369 and \$1,260, net of accumulated amortization of \$10,412 and \$9,045, respectively.

**COUNTY OF SAN BERNARDINO  
ARROWHEAD REGIONAL MEDICAL CENTER**

**NOTES TO FINANCIAL STATEMENTS**

**JUNE 30, 2011 AND 2010  
(In Thousands)**

*NOTE #12 – 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, 2011 and 2010, totaled \$699 and \$81, respectively.

*NOTE #13 – OPERATING LEASES*

Rent expense for operating leases for the years ended June 30, 2011 and 2010, totaled \$3,709 and \$3,376, respectively.

*NOTE #14 – 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, 348 W. Hospitality Lane, 3<sup>rd</sup> Floor, San Bernardino, California 92415-0014.

Participating members are required by statute (Sections 31621.6 and 31639.25 of the California Government 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 7.42 percent to 12.96 percent of their annual covered salary, of which the County pays approximately 7 percent. Employers are required to contribute 12.32 percent to 26.82 percent of the current year covered payroll. The Medical Center's pension cost for the fiscal years ended June 30, 2011 and 2010, was approximately \$29,627 and \$30,004, respectively. Employee contribution rates are established and may be amended pursuant to Articles 6 and 6.8 of the 1937 Act. Employer rates are determined pursuant to Section 31453 and 31454 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:

<u>Year Ended June 30,</u>	<u>County's Annual Required Contributions</u>	<u>Percentage Contributed</u>
2009	\$ 200,300	100%
2010	197,097	100%
2011	213,311	100%

**COUNTY OF SAN BERNARDINO  
ARROWHEAD REGIONAL MEDICAL CENTER**

**NOTES TO FINANCIAL STATEMENTS**

**JUNE 30, 2011 AND 2010  
(In Thousands)**

*NOTE #15 – 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, 2011 and 2010 was \$7,442 and \$8,979, respectively.

*NOTE #16 – RESTATEMENT OF NET ASSETS*

Net assets as of June 30, 2010 for the Medical Center have been restated to account for the termination of the interest rate swap agreement.

	<u>Balance at June 30, 2010</u>
Beginning net assets, as previously reported	\$ 34,000
Due from county	<u>(6,999)</u>
Beginning net assets, as restated	<u>\$ 27,001</u>

*NOTE #17 – TERMINATION BENEFITS*

In March 2009, the County offered a Retirement Incentive Program to employees as a salary savings measure for the upcoming years. Under this program, employees retiring between March 3, 2009 and June 30, 2009 were eligible to receive \$250 (not expressed in thousands) for each completed quarter of continuous regular County service (\$1,000 dollars per year of service, (not expressed in thousands)), payable annually over a five-year period, and the position would have to remain vacant.

Approximately 304 (County-wide) employees, which included employees from the Medical Center accepted the incentive and retired during the eligible period, resulting in a Medical Center termination benefit payable at June 30, 2011 of \$335.

*NOTE #18 – 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.

**COUNTY OF SAN BERNARDINO  
ARROWHEAD REGIONAL MEDICAL CENTER**

**NOTES TO FINANCIAL STATEMENTS**

**JUNE 30, 2011 AND 2010  
(In Thousands)**

*NOTE #19 – SUBSEQUENT EVENT*

On September 16, 2011, the Governor signed SB 335 by Senator Ed Hernandez (D-Baldwin Park) and Senate President Pro Tem Darrell Steinberg (D-Sacramento). The law will provide supplemental Medi-Cal and other payments to hospitals and protect health care services for low-income, vulnerable patients and children by implementing a 30-month Hospital Quality Assurance Fee for July 1, 2011, to December 31, 2013. SB 335 will increase payments to hospitals by \$5.2 billion, and will save the state's General Fund more than \$900 million. The state is currently seeking approval from the Centers for Medicare & Medicaid Services (CMS). CMS review will likely take several months, and the program will be subject to significant scrutiny before the program can be implemented.

**OTHER REPORT**



**INDEPENDENT AUDITORS' 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**

To the Board of Supervisors,  
And the Management of Arrowhead Regional Medical Center  
County of San Bernardino, California

We have audited the financial statements of Arrowhead Regional Medical Center (the "Medical Center"), an enterprise fund of the County of San Bernardino, California, as of and for the years ended June 30, 2011 and have issued our report thereon dated December 5, 2011. 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**

Management of the Medical Center is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered the Medical Center's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Medical Center's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Medical Center's internal control over financial reporting.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the Medical Center's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above. However, we identified a deficiency in internal control over financial reporting, described in the accompanying schedule of findings and responses that we consider to be a significant deficiency in internal control over financial reporting and listed as item 2011-1. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

## 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*.

We noted certain matters that we reported to management of the Medical Center, in a separate letter dated December 5, 2011.

The Medical Center's response to the finding identified in our audit is described in the accompanying schedule of findings and responses. We did not audit the Medical Center's response and, accordingly, we express no opinion on it.

This report is intended solely for the information and use of the Board of Supervisors, Audit Committee, Medical Center management, and others within the organization and is not intended to be and should not be used by anyone other than these specified parties.

*Vawter, Tami, Day, Co., LLP*

Rancho Cucamonga, California  
December 5, 2011

**COUNTY OF SAN BERNARDINO  
ARROWHEAD REGIONAL MEDICAL CENTER**

**SCHEDULE OF FINDINGS AND RESPONSES**

**JUNE 30, 2011**

**Finding 2011-1**

**CAPITAL ASSETS**

**Criteria or Specific Requirement:**

All projects that are listed as construction in progress and which have been finalized at year-end are required to be removed out of construction in progress, and properly classified into one of the categories under capital assets.

**Condition Found:**

*Significant Deficiency* – As a result of our testwork performed at year-end over capital assets, we became aware that certain projects that were recorded as construction in progress had been finalized and placed into service during the fiscal year. We noted that several finalized projects had not been removed from the construction in progress listing as of year-end.

**Context:**

The above condition was discovered through testwork performed over the Medical Center's capital assets.

**Effect:**

We proposed audit adjustments to properly record the ending balance of construction in progress in the general ledger and to properly present capital assets on the Medical Center's financial statements. Additionally, the footnote disclosure related to capital assets was affected, and as such the footnote required correction.

**Cause:**

Management's year end closing procedures did not include a detail and timely review of the construction in progress account to identify which projects had been completed as of year-end.

**Recommendation:**

Management should develop year end procedures designed to ensure the construction in progress account is properly reviewed and completed assets are properly classified to the appropriate capital assets account.

**Views of Responsible Officials and Planned Corrective Action:**

Medical Center will make sure going forward that entries related to reconciliation of Construction-in-Progress (CIP) account is done on a quarterly basis and Capitalized Interest allocation done on a yearly basis. We will call Architecture & Engineering department and our Facilities department for closing of the projects on a quarterly basis also. We reconciled our CIP account for quarter ending September 2011 and based on that we will prepare entries to close projects after verifying from Architecture & Engineering department and our Facilities department.