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, 2012 and 2011

COUNTY OF SAN BERNARDINO
ARROWHEAD REGIONAL MEDICAL CENTER

FOR THE YEARS ENDED JUNE 30, 2012 AND 2011

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INDEPENDENT AUDITORS' REPORT

To the Board of Supervisors, Audit Committee,
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, 2012 and 2011, 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, 2012 and 2011, 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 previously present fairly, in all material respects, the respective financial position of the Medical Center, as of June 30, 2012 and 2011, and the respective changes in its financial position and cash flows thereof 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 3, 2012 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.

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The Medical Center has not presented management's discussion and analysis that governmental accounting principles generally accepted in the United States of America require to be presented to supplement the basic financial statements. Such missing information, although not a part of the basic financial statements, is required by the Governmental Accounting Standard Board, who considers it to be an essential part of financial reporting and placing the basic financial statements in an appropriate operational, economic, or historical context. Our opinion on the basic financial statements is not affected by this missing information.

Vavrinek, Trine, Day & Co., LLP

Rancho Cucamonga, California
December 3, 2012

COUNTY OF SAN BERNARDINO
ARROWHEAD REGIONAL MEDICAL CENTER

STATEMENTS OF NET ASSETS

JUNE 30, 2012 AND 2011

(In Thousands)

	2012	2011
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 43,903	$ 18,457
Restricted investments held with fiscal agent	27,416	25,175
Patient accounts receivable, net of estimated uncollectables of $229,441 in 2012 and $203,897 in 2011	38,012	34,517
Receivable from other governments	51,847	39,442
Due from County	1,182	431
Supplies inventories	1,587	1,378
Prepaid expenses and other assets	3,286	3,604
Total Current Assets	167,233	123,004
Noncurrent Assets:		
Restricted investments held with fiscal agent	24,909	24,913
Restricted investments held with fiscal agent - interest	271	269
Deferred issuance costs	4,661	5,087
Capital assets:		
Land and improvements	24,335	23,935
Buildings and improvements	542,582	540,845
Equipment	137,557	130,463
Construction-in-progress	852	923
Total capital assets	705,325	696,166
Less accumulated depreciation	(281,681)	(262,369)
Total capital assets, net of accumulated depreciation	423,644	433,797
Total Noncurrent Assets	453,485	464,066
Total Assets	620,718	587,070
LIABILITIES		
Current Liabilities:		
Accounts payable	21,142	15,435
Accrued salaries and benefits	20,054	17,395
Accrued termination benefits	111	112
Other accrued liabilities	9,032	950
Due to third-party payors	8,914	10,760
Capital lease obligations	1,264	436
Certificates of participation	18,140	17,370
Interest payable	10,552	10,787
Arbitrage payable	699	699
Due to County	17,807	549
Total Current Liabilities	107,715	74,493
Noncurrent Liabilities:		
Long-term compensated absences	5,695	4,245
Long-term termination benefits	112	223
Capital lease obligations, less current installments	3,445	1,013
Certificates of participation, less current installments (net of deferred amount on refunding and bond discount)	431,217	446,753
Total Noncurrent Liabilities	440,469	452,234
Total Liabilities	548,184	526,727
NET ASSETS		
Invested in capital assets, net of related debt	(25,761)	(26,688)
Restricted for debt service	42,044	39,570
Unrestricted	56,251	47,461
Total Net Assets	$ 72,534	$ 60,343

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, 2012 AND 2011

(In Thousands)

	2012	2011
OPERATING REVENUES		
Net patient service revenue	$ 376,004	$ 380,357
Premium revenue - managed care	85	4
Other	9,322	7,958
Total Operating Revenues	385,411	388,319
OPERATING EXPENSES		
Salaries and benefits	215,835	202,348
Medi-Cal matching fund expense	29,862	30,108
Supplies	62,565	63,785
Professional services	56,011	49,381
Purchased services	46,819	32,580
Insurance	7,106	7,442
Utilities	8,427	8,329
Depreciation and amortization	19,367	20,205
Rent	5,002	4,161
Amortization related to debt	427	334
Other	1,296	1,014
Total Operating Expenses	452,717	419,687
Operating Loss	(67,306)	(31,368)
NONOPERATING REVENUES (EXPENSES)		
State debt service funding	18,820	19,500
State realignment funding	37,358	974
Investment income	3,907	1,720
Interest expense on debt	(28,071)	(28,535)
DSRIP funding	32,768	31,501
Direct grants - designated public hospital	5,713	28,685
Other nonoperating revenues (expenses)	(102)	(689)
Total Nonoperating Revenues, Net	70,393	53,156
Income Before Transfers	3,087	21,788
Transfers from the County	14,707	15,488
Transfers to the County	(5,603)	(3,934)
Changes in Net Assets	12,191	33,342
Net Assets, Beginning of Year	60,343	27,001
Net Assets, End of Year	$ 72,534	$ 60,343

See accompanying notes to basic financial statements.

COUNTY OF SAN BERNARDINO
ARROWHEAD REGIONAL MEDICAL CENTER

STATEMENTS OF CASH FLOWS

YEARS ENDED JUNE 30, 2012 AND 2011

(In Thousands)

	2012	2011
CASH FLOWS FROM OPERATING ACTIVITIES		
Receipts from customers	$ 366,914	$ 387,519
Payments to suppliers	(185,932)	(224,545)
Payments to employees	(211,838)	(200,978)
Net Cash Used in Operating Activities	(30,856)	(38,004)
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
State realignment funding received	37,358	974
DSRIP funding received	32,768	31,501
Transfers from the County	14,707	15,488
Transfers to the County	(5,603)	(3,934)
Other nonoperating income (expense)	(102)	(689)
Direct grants - designated public hospital	5,657	28,685
Net Cash Provided by Noncapital Financing Activities	84,785	72,025
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Purchase of capital assets	(4,507)	(9,865)
State debt service funding	18,820	19,500
Principal payments on capital lease obligations	(1,392)	(554)
Principal payments on certificates of participation	(17,370)	(17,379)
Interest paid on debt	(25,702)	(27,822)
Net Cash Used in Capital and Related Financing Activities	(30,151)	(36,120)
CASH FLOWS FROM INVESTING ACTIVITIES		
Interest on investments	3,907	1,720
Investment activity, net	(2,239)	1,882
Net Cash Provided by Investing Activities	1,668	3,602
Increase in Cash and Cash Equivalents	25,446	1,503
Cash and Cash Equivalents, Beginning of Year	18,457	16,954
Cash and Cash Equivalents, End of Year	$ 43,903	$ 18,457

See accompanying notes to basic financial statements.

COUNTY OF SAN BERNARDINO
ARROWHEAD REGIONAL MEDICAL CENTER

STATEMENTS OF CASH FLOWS, Continued

YEARS ENDED JUNE 30, 2012 AND 2011

(In Thousands)

	2012	2011
RECONCILIATION OF OPERATING LOSS TO NET CASH USED IN OPERATING ACTIVITIES		
Operating Loss	$ (67,306)	$ (31,368)
Adjustments to reconcile operating loss to net cash used in operating activities:		
Depreciation and amortization	19,367	20,205
Amortization related to debt	427	334
Decrease (Increase) in:		
Patient accounts receivable	(3,495)	(1,994)
Receivables from other governments	(12,405)	(1,116)
Due from County	(751)	(155)
Supplies inventories	(209)	1
Prepaid expenses and other assets	318	(775)
Increase (Decrease) in:		
Accounts payable	5,707	1,466
Accrued salaries and benefits	4,109	1,482
Accrued termination benefits	(112)	(112)
Other accrued liabilities	8,082	(675)
Due to third-party payors	(1,846)	2,465
Arbitrage payable	-	618
Due to County	17,258	(28,380)
Net Cash Used in Operating Activities	$ (30,856)	$ (38,004)
NONCASH CAPITAL AND FINANCING ACTIVITIES:		
Lease Purchase of Capital Assets	$ 4,652	$ 1,473

See accompanying notes to basic financial statements.

NOTE #1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. General

The County of San Bernardino (the "County") Arrowhead Regional Medical Center (the "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.

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.

(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; $0 and $539 were capitalized for the years ended June 30, 2012 and 2011, respectively. Total interest expense incurred for the fiscal year ended June 30, 2012 and 2011was $25,479 and $25,930, 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.

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

O. Deferred Charges

Deferred charges consist of costs incurred for the issuance of long-term obligations. Amortization of deferred charges is computed using the straight-line method, which approximated the effective interest method, over the life of the related obligation.

P. Future Accounting Pronouncements

Governmental Accounting Standard No. 60

On November 2011, 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 2011, 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 2011, 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, 2013. The Medical Center has not determined its effect on the financial statements.

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

P. Future 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, 2013. The Medical Center has not determined its effect on the financial statements.

Governmental Accounting Standard No. 65

On March 2012, GASB issued Statement No. 65 – *Items Previously Reported as Assets and Liabilities.* This Statement establishes accounting and financial reporting standards that reclassify, as deferred outflows of resources or deferred inflows of resources, certain items that were previously reported as assets and liabilities and recognizes, as outflows of resources or inflows of resources, certain items that were previously reported as assets and liabilities. This Statement also provides other financial reporting guidance related to the impact of the financial statement elements deferred outflows of resources and deferred inflows of resources, such as changes in the determination of the major fund calculations and limiting the use of the term *deferred* in financial statement presentations. The requirements of this Statement are effective for the fiscal year ending June 30, 2014.

Governmental Accounting Standard No. 66

On March 2012, GASB issued Statement No. 66 – *Technical Corrections – 2012 - an Amendment of GASB Statements No. 10 and No. 62* The objective of this Statement is to resolve conflicting guidance that resulted from the issuance of two pronouncements, Statements No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions,* and No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements.* The requirements of this Statement are effective for the fiscal year ending June 30, 2013.

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

P. Future Accounting Pronouncements, (Continued)

Governmental Accounting Standard No. 67

On June 2012, GASB issued Statement No. 67 – *Accounting and Financial Reporting for Pensions—an Amendment of GASB Statement No. 25.* This Statement establishes accounting and financial reporting requirements related to pensions for governments whose employees are provided with pensions through pension plans that are covered by the scope of this Statement, as well as for nonemployer governments that have a legal obligation to contribute to those plans. This Statement and Statement No. 68 establish a definition of a pension plan that reflects the primary activities associated with the pension arrangement - determining pensions, accumulating and managing assets dedicated for pensions, and paying benefits to plan members as they come due. The scope of this Statement addresses accounting and financial reporting for the activities of pension plans that are administered through trusts. The requirements of this Statement are effective for the fiscal year ending June 30, 2014.

Governmental Accounting Standard No. 68

On June 2012, GASB issued Statement No. 68 – *Accounting and Financial Reporting for Pensions - an Amendment of GASB Statement No. 27.* This Statement establishes standards for measuring and recognizing liabilities, deferred outflows of resources, deferred inflows of resources, and expense/expenditures. For defined benefit pensions, this Statement identifies the methods and assumptions that should be used to project benefit payments, discount projected benefit payments to their actuarial present value, and attribute that present value to periods of employee service. The requirements of this Statement are effective for the fiscal year ending June 30, 2015.

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 County Treasury pool did not include any derivative securities in 2012.

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.

(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, 2012 and 2011 are classified in the accompanying financial statements as follows:

	2012	2011
Cash and cash equivalents	$ 43,903	$ 18,457
Held with fiscal agent for debt service - current	27,416	25,175
Held with fiscal agent for debt service - noncurrent	24,909	24,913
Total Cash and Investments	$ 96,228	$ 68,545

The Medical Center's cash and investments as of June 30, 2012 and 2011 consisted of the following:

	2012	2011
Deposits with County Treasury	$ 43,903	$ 18,457
Investments	52,325	50,088
Total Cash and Investments	$ 96,228	$ 68,545

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, 2012:

Investment Type	Fair Value at June 30, 2012	Weighted Average Maturity (in years)
Held by bond trustee:		
Money market mutual funds	$ 24,909	daily
Guaranteed investment contracts	4,751	16.08
U.S. Treasury Notes	22,665	10.37
Total	$ 52,325	

(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, 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	$ 50,088	

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, 2012 and 2011:

		Rating as of June 30, 2012	
Investment Type		*	AAA
Held by bond trustee:			
Money market mutual funds	$ 24,909		$ 24,909
Guaranteed investment contracts	4,751	$ 4,751	
Total	$ 29,660	$ 4,751	$ 24,909

* the company with whom the Medical Center has the guaranteed investment contract received long-term ratings of B2 / B- from Moody's / Standard & Poor's.

		Rating as of June 30, 2011	
Investment Type		*	AAA
Held by bond trustee:			
Money market mutual funds	$ 25,175		$ 25,175
Guaranteed investment contracts	4,751	$ 4,751	
Total	$ 29,926	$ 4,751	$ 25,175

* the company with whom the Medical Center has the guaranteed investment contract received long-term ratings of Ba3 / B- from Moody's / Standard & Poor's.

(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, 2012 and 2011:

Issuer	Investment Type	Fair Value at June 30, 2012
MBIA Investment Management Corp.	Guaranteed Investment Contract	$ 4,751

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

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, 2012 and 2011.

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, 2012 and 2011 was $37,358 and $974, 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, 2012 and 2011, the Medi-Cal program represented approximately 46 percent and 48 percent, respectively, and the Medicare program represented approximately 24 percent and 20 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. Outpatient services are reimbursed based on 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, 2007 for Medicare and June 30, 2010, 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, 2012 and 2011, the Medical Center recorded total Medi-Cal inpatient and outpatient net revenue of $101,934 and $109,726 respectively and related receivable of $18,077 and $35,513, respectively. The waiver approved under SB 1100 expired August 2010. See Note #5.

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 $11,232 and $13,273 in AB-915 funds for the years ended June 30, 2012 and 2011, 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.

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.

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 establish 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, 2012 and 2011 were $32,768 and $31,501, 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.

(In Thousands)

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.

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, 2012 and 2011, the Medical Center received direct grants totaling $5,713 and $28,685 respectively.

NOTE #7 – CHARITY CARE

Charity Care is that portion of patient care services provided by the Medical Center for which a third-party payer is not responsible and a patient does not have the ability to pay. Eligibility for Charity Care is considered for those individuals, who are uninsured, underinsured, ineligible for any governmental health care benefit program, and unable to pay for their care, based upon a determination of financial need. Charity Care is made in accordance with the patient's financial need as determined by the Federal Poverty Level (FPL) in effect at the time of financial determination. 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:

	2012	2011
Cost of caring for Charity Care patients	$ 87,558	$ 61,071

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 Thousands)

NOTE #8 – CAPITAL CONTRIBUTIONS, (CONTINUED)

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 2012 and 2011 amounted to $18,820 and $19,500, 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, 2012 and 2011.

NOTE #9 – CAPITAL ASSETS

A summary of capital assets activity for the years ended June 30, 2012 and 2011 is as follows:

	Beginning Balance	Additions	Deletions	Ending Balance
June 30, 2012				
Land and improvements	$ 23,935	$ 400		$ 24,335
Buildings and improvements	540,845	1,737		542,582
Equipment	130,463	7,150	$ (56)	137,557
Construction-in-progress	923	1,109	(1,180)	852
Total Capital Assets, Gross	696,166	10,396	(1,236)	705,325
Accumulated Depreciation:				
Land and improvements	(665)	(201)		(866)
Buildings and improvements	(154,276)	(14,301)		(168,577)
Equipment	(107,428)	(4,863)	53	(112,238)
Total Accumulated Depreciation	(262,369)	(19,365)	53	(281,681)
Capital Assets, Net	$ 433,797	$ (8,969)	$ (1,183)	$ 423,644

(In Thousands)

NOTE #9 – CAPITAL ASSETS, (CONTINUED)

	Ending Balance	Additions	Deletions	Ending Balance
June 30, 2011				
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
Accumulated Depreciation:				
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

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, 2012 and 2011.

The Medical Center is allocated a portion of the County's overhead costs. Such expenses totaled $2,457 and $3,934 for the years ended June 30, 2012 and 2011, 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 $7,354 and $6,972 for the years ended June 30, 2012 and 2011, 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.

Transfers from the County in the amount of $14,707 related mostly to cover debt service payments. The transfers to the County in the amount of $5,603 related mostly to excess funds that had to be return to the County and to cover County cost allocation costs charged to the Medical Center.

(In Thousands)

NOTE #10 – TRANSACTIONS WITH THE COUNTY, (CONTINUED)

The $17,807 due to the County of San Bernardino represents amounts due to various departments in the amount of $1,062 which include the Public Health, Behavioral Health, Purchasing, Architecture & Engineering and other departments related to services provided. However, the largest portion of the amount is due to the County's general fund in the a amount of $16,745 the amount represents payments made by the County on behalf of the Medical Center to the State in order for the Medical Center to receive its funding for DSH IGT (Intergovernmental Transfer) and DSRIP IGT.

The $1,182 due from the County represents amounts due from the County's Central Collection, Probation, Sherriff, Public and Behavioral Health Departments for services provided or as in the case of Central Collection for cash collected on behalf of the Medical Center.

The year end balances noted above for due to / due from are expected to be received and repaid within the next fiscal year

NOTE #11 – LONG-TERM OBLIGATIONS

The following is a summary of changes in long-term obligations for the fiscal years ended June 30, 2012 and 2011:

	June 30, 2012				
	Beginning Balance	Additions	Reductions	Ending Balance	Due within One Year
Certificates of Participation					
Series 1994	$ 124,145		$ (3,775)	$ 120,370	$ 3,990
Series 1995	27,915		(3,245)	24,670	3,465
Series 1996	64,345		(360)	63,985	380
Series 2009 A	241,905		(9,990)	231,915	10,305
Series 2009 B	43,880			43,880	
Total Certificates of Participation, Gross	502,190		(17,370)	484,820	18,140
Less:					
Deferred amount on refunding	(33,788)		2,378	(31,410)	
Discount on debt	(4,279)		226	(4,053)	
Total Certificates of Participation	464,123		(14,766)	449,357	18,140
Capital lease obligations	1,449	$ 4,652	(1,392)	4,709	1,264
Total	$ 465,572	$ 4,652	$ (16,158)	$ 454,066	$ 19,404

(In Thousands)

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

	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

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, 2012 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.

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, 2011 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 3.00 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 3.00 percent to 5.25 percent.

(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, 2012 are summarized as follows:

Fiscal Year	Total Principal	Total Interest
2013	$ 18,140	$ 24,849
2014	19,100	23,858
2015	20,225	22,813
2016	21,270	21,711
2017	22,380	20,540
2018-2022	132,045	82,896
2023-2027	174,340	42,334
2028-2029	77,320	3,843
Totals	$ 484,820	$ 242,844

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, 2012, are as follows:

Fiscal Year	
2013	$ 1,334
2014	1,301
2015	1,301
2016	948
Total minimum lease payments	4,884
Less Amount Representing Interest	(175)
Present value of net minimum lease payments	4,709
Less Current Portion of Capital Lease Obligations	(1,264)
Capital lease obligations, excluding current portion	$ 3,445

The gross value of equipment acquired under capitalized leases at June 30, 2012 and 2011 was $16, 433 and $11,781, net of accumulated amortization of $11,097 and $10,412, respectively.

(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, 2012 and 2011, totaled $699 and $699, respectively.

NOTE #13 – OPERATING LEASES

Rent expense for operating leases for the years ended June 30, 2012 and 2011, totaled $4,474 and $3,709, respectively.

NOTE #14 – RETIREMENT PLAN

Employees of the Medical Center participate in the County's 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, 3rd 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 7.00 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, 2012 and 2011, was approximately $32,893 and $29,627, 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:

Year Ended June 30,	County's Annual Required Contributions	Percentage Contributed
2010	$ 197,097	100%
2011	213,311	100%
2012	229,169	100%

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, 2012 and 2011 was $7,106 and $7,442, respectively.

NOTE #16 – 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 (not expressed in thousands) per year of service), 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, 2012 and 2011 of $223 and $335 respectively.

NOTE #17 – CONTINGENCIES

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.

The healthcare industry is subject to numerous laws and regulations of federal, state and local governments. Compliance with these laws and regulations is subject to periodic government review, interpretation and audits, as well as regulatory actions unknown and unasserted at this time.

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, Audit Committee,
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 year ended June 30, 2012 and have issued our report thereon dated December 3, 2012. 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, 2012 and 2011, 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. 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 previously. However, we identified certain deficiencies in internal control over financial reporting, described in the accompanying schedule of findings and responses that we consider to be significant deficiencies in internal control over financial reporting and listed as items 2012-01 through 2012-02. 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.

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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 3, 2012.

The Medical Center's responses to the findings identified in our audit are described in the accompanying schedule of findings and responses. We did not audit the Medical Center's responses 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.

Vavrinek, Trine, Day & Co., LLP

Rancho Cucamonga, California
December 3, 2012

COUNTY OF SAN BERNARNDINO
ARROWHEAD REGIONAL MEDICAL CENTER

SCHEDULE OF FINDINGS AND RESPONSES

FOR THE YEAR ENDED JUNE 30, 2012

Finding 2012-01

PHYSICAL INVENTORY OF CAPITAL ASSETS

Criteria or Specific Requirement:

In accordance with the County of San Bernardino code of ordinance Title I, Division 1, Chapter 4 "administrative regulations" on or before April 10 of each year the governing body (Medical Center) shall file with the County Auditor/Controller, according to the procedures prescribed by the Board, an inventory under oath, showing in detail all County property in his possession or in his charge at the close of business on the preceding March 31. In order to comply with this ordinance a physical inventory count is required to ensure the detail listing is complete and accurate. Also, in accordance with the County's Standard Practice No. 11-04 SP3, sensitive equipment is defined as all equipment purchased at cost of less than $5,000 and utilized by departments in the delivery of programs and services. Departments are required to maintain inventory control and assignment location and disposition of sensitive equipment items. Additionally, a department's inventory list shall be updated on an annual basis and filed with the County Clerk by June 30 of each year.

Condition Found:

Significant Deficiency – As a result of our testwork performed at year-end over capital assets, we noted a complete physical inventory over the Medical Center's capital assets has not been performed in accordance with County policy. However, the Medical Center continues to perform an annual physical inventory over its vehicles. We also noted a physical inventory over the Medical Center's "sensitive" assets as defined in County Standard Practice No. 11-04 SP3 did not occur. Management of the Medical Center is working on the procedures to be implemented.

Context:

The Medical Center maintains capital assets with a historical cost totaling $705 million. Of this amount, approximately $138 million is classified as equipment, including approximately $92 million in moveable equipment.

Effect:

The Medical Center's current internal controls over its capital assets may not detect whether its capital assets are properly safeguarded or exist.

Cause:

The Medical Center was not aware that the County ordinance required a complete physical inventory over all assets, including sensitive equipment. The Medical Center only performs an annual physical inventory over its vehicles.

Recommendation:

We recommend that the Medical Center implement internal controls and procedures that will address the yearend physical inventory count related to its fixed assets in order to comply with County policies.

COUNTY OF SAN BERNARNDINO
ARROWHEAD REGIONAL MEDICAL CENTER

SCHEDULE OF FINDINGS AND RESPONSES

FOR THE YEAR ENDED JUNE 30, 2012

Views of Responsible Officials and Planned Corrective Action:

For the past 5 years ARMC has not taken an inventory of Major Movable Equipment (MME). We have a list of all major movable equipment by department but we have not verified and reconciled the list to physical assets on premises.

ARMC management will be developing plan to take a physical inventory of MME within the next six months, prior to year end.

ARMC provided Inventory of Vehicles and Sensitive Equipment (includes Wireless devices, Spectra link devices and cellphones) every year to County.

Going forward we can implement policy. ARMC has unique issues related to the implementation of this policy that will be discussed with appropriate county personnel.

Finding 2012-02

YEAR END CLOSING / FINANCIAL REPORTING

Criteria or Specific Requirement:

Effective internal control over the yearend closing is necessary to properly record and report financial data reliably in accordance with generally accepted accounting principles (GAAP). The yearend closing process should include adequate resources to ensure that a comprehensive closing of the general ledger can be performed by staff with sufficient knowledge and proper oversight. The process should include the reconciliation and/or closing of all accounts including but not limited to capital assets and other receivables.

Additionally, FASB codification 840-10-25 provides the criteria for determining if a lease is a capital lease. To be classified as a capital lease a lessee and a lessor shall consider whether a lease meets any of the specified criteria as part of classifying the lease as a capital lease at its inception.

Condition Found:

Significant Deficiency - During our fieldwork we noted that the closing procedures did not include sufficient review over certain balance sheet accounts, including capital assets, capital leases, and other receivables. As such, during our audit procedures over these balance sheet accounts, we proposed audit adjustments to properly state their yearend account balances in accordance with GAAP.

Context:

The above condition was identified during our audit procedures over the Medical Center's yearend account balances.

Effect:

Adjustments were proposed and posted to the Medical Center's financial statements for the year ended June 30, 2012. All adjustments that were proposed during the current year audit were presented to management and subsequently posted to the financial statements, which contributed to delays in finalizing the audit. Additionally, the footnote disclosures related to capital assets and capital leases were affected, and as such the footnotes required correction.

Cause:

The Medical Center yearend closing procedures did not detect misstatements in capital assets, capital leases, and other receivables as of June 30 2012.

Recommendation:

We recommend that the Medical Center continue to implement stronger year end closing procedures to continue to ensure a comprehensive closing of the general ledger is performed and that sufficient knowledgeable resources and adequate oversight is available to oversee the year-end closing process.

View of responsible official and planned corrective action:

ARMC will implement stronger internal procedures to record capital leases, disposal of assets and review of backup to support assets. We will reconcile and co-ordinate timing of Board approved items for leases with department Directors who purchase leased equipment. The Information Management department has already provided a list of leases due in FYE 13 to the Accounting department.

We will also make sure that when the Material Management department disposes of any equipment, Accounting will get a copy of "FAS Property Transfer Request" form and prepare proper entry.

The year-end closing procedures require additional review but for the most part are more than sufficient. On a monthly basis we have list of standard journal entries that we make sure we prepare and we prepare adjusting entries to take care of any items that was not booked properly in general ledger. On a monthly basis we conduct a balance sheet reconciliation of all the accounts. Every month we prepare financial binder that contains contractual analysis, expense analysis, payroll analysis, accounts payable analysis, statistical analysis and accounts receivable analysis. The books are not closed until all the balance sheet accounts and expense accounts are analyzed and reconciled.

COUNTY OF SAN BERNARNDINO
ARROWHEAD REGIONAL MEDICAL CENTER

SCHEDULE OF PRIOR YEAR FINDINGS

JUNE 30, 2012

Summarized below is the current status of all audit findings reported in the prior year audit's schedule of findings and responses.

Finding No.	Description	Status
2011-01	Capital Assets	Partially Implemented, see Current Year Finding 2012-02