Audited Financial Statements and Single Audit Reports

Maricopa County Special Health Care District
d/b/a Maricopa Integrated Health System
Year Ended June 30, 2012
With Report of Independent Auditors

Ernst & Young LLP

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Maricopa County Special Health Care District
d/b/a Maricopa Integrated Health System

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Year Ended June 30, 2012

Contents

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Report of Independent Auditors

Board of Directors
Maricopa County Special Health Care District
d/b/a Maricopa Integrated Health System

We have audited the accompanying financial statements of the business-type activities of the Maricopa County Special Health Care District d/b/a Maricopa Integrated Health System (the District) as of and for the years ended June 30, 2012 and 2011, which collectively comprise the District's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the District's management. Our responsibility is to express opinions on these financial statements based on our audits. We did not audit the financial statements of the Maricopa Health Plan (a division of the District), which represents 10% and 12% of the assets and 29% and 35% of the revenues of the District as of and for the years ended June 30, 2012 and 2011, respectively. Those financial statements were audited by other auditors whose report thereon has been furnished to us, and our opinion, insofar as it relates to the amounts included for the Maricopa Health Plan, is based on the report of the other auditors.

We conducted our audits in accordance with auditing standards generally accepted in the United States and the standards applicable to financial audits contained in *Government Auditing Standards,* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the District's internal control over financial reporting. Our audits included 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 District'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, and evaluating the overall financial statement presentation. We believe that our audits and the report of the other auditors provide a reasonable basis for our opinions.

In our opinion, based on our audits and the report of the other auditors, the financial statements referred to above present fairly, in all material respects, the respective financial position of the business-type activities of the District as of June 30, 2012 and 2011, and the respective changes in financial position and cash flows thereof for the years then ended in conformity with U.S. generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued our report dated November 29, 2012, on our consideration of the District'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.

Accounting principles generally accepted in the United States require that management's discussion and analysis on pages 3 through 11 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, which considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audits of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Our audit was performed for the purpose of forming our opinions on the financial statements that collectively comprise the District's financial statements. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by OMB Circular A-133 and is not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain other procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States. In our opinion, the schedule of expenditures of federal awards is fairly stated, in all material respects, in relation to the financial statements as a whole.

Ernst & Young LLP

November 29, 2012

Maricopa County Special Health Care District
d/b/a Maricopa Integrated Health System

Management's Discussion and Analysis

Years Ended June 30, 2012 and 2011

This management's discussion and analysis of the financial performance of Maricopa County Special Health Care District d/b/a Maricopa Integrated Health System (the District) provides an overview of the District's financial activities for the years ended June 30, 2012, 2011, and 2010. It should be read in conjunction with the accompanying financial statements of the District. The financial activities of the District for the years ended June 30, 2012, 2011, and 2010, include Maricopa Health Plan (MHP), a division of the District. There was also an equity method joint venture, Maricopa Care Advantage, which was sold to the joint venture partner on December 31, 2010.

Operating Highlights

During fiscal year 2012, the District continued sustaining the improvements in quality and regulatory compliance that have been achieved. The District completed the following:

- The patient centered medical homes project, and it achieved the National Committee for Quality Assurance's (NCQA) Level III designation for all 12 primary care health center sites
- Completed Phase II of Epic, a new clinical information system (ARK Project)
- Received re-verification by the American College of Surgeons (ACS) of the District's Level I Adult and Level II Pediatric Trauma Center designation
- Received Medicare recertification and Det Norske Veritas Healthcare, Inc. (DNV) reaccreditation through August 2015
- Received approval to join the Arizona Chapter of the American Academy of Pediatrics (AzAAP) pediatric emergency care system
- Opened the first four of the planned eight Integrated Health Homes (IHHs) in partnership with Magellan Health Services of Arizona and its provider sites

The patient-centered medical home project entered its final stages and the 12 Family Health Centers were certified at Level III, the highest level of certification by the NCQA. This concludes a two-year effort to achieve this distinction. The District is participating in the NCQA's nationally acclaimed Physician Practice Connections – Patient Centered Medical Home Recognition Program, which is an innovative program for improving primary care. It emphasizes systematic use of patient-centered, coordinated care management processes. Throughout the process, ambulatory leadership worked with Arizona Health Care Cost Containment System (AHCCCS), Arizona's Medicaid program, and its contracted acute care health plans on a variety of medical home pilot projects. These pilot projects focused on payment reform models and outcome improvement for distinct patient populations.

On March 1, 2012, Phase II of the ARK Project was complete and placed in operation. This included involvement of inpatient departments and a majority of the ancillary clinical departments such as lab, radiology, and pharmacy. The ARK Project was initiated to improve the health and wellness of the community served by the District through a carefully selected, planned, and integrated business process and technology transformation. Phase II completion allowed the District to achieve Stage 6 out of 7 on the electronic medical record (EMR) adoption model used by Healthcare Information and Management Systems Society, which is a not-for-profit organization focused on providing global leadership for the optimal use of information technology and management systems for the betterment of health care. Since inception, the District has expended a total of $47.2 million on the ARK Project. The District budgeted $11.2 million in fiscal year 2013 to complete the last clinical phase of the ARK Project and begin the financial systems replacement.

The District's Trauma Centers have been reverified by the ACS. The Maricopa Medical Center has been reverified for one year as a Level I Adult and Level II Pediatric Trauma Center by the Verification Review Committee, an ad hoc committee of the Committee on Trauma (COT) of ACS. The COT's Consultation/Verification Program for Hospitals, which was established in 1987, promotes the development of trauma centers in which participants provide the hospital resources necessary for trauma care, as well as for the entire spectrum of care to address the needs of all injured patients.

The District continues to demonstrate its commitment to quality and regulatory compliance. In July 2012, DNV returned for its annual survey and recertified the District for the Centers for Medicare and Medicaid Services (CMS) compliance and reaccredited the District through August 2015. The overall report reflected the hard work and commitment that all District employees show every day in providing quality health care to all its patients.

The AzAAP has approved the Arizona Children's Center (AzCC) Pediatric Emergency Department's (Pediatric ED) application to join a specialized pediatric emergency care system designed to improve outcomes for ill and injured children. Maricopa Medical Center is one of nine hospitals throughout the state to receive this certification. The certification includes three levels – Prepared, Prepared Plus Care, and Prepared Advanced. The AzCC Pediatric ED obtained certification as a Prepared Advance Center. The following is required to achieve this certification:

- The Pediatric ED must be staffed by physicians who are Board-eligible or Board-certified in emergency medicine or pediatric emergency medicine.

- The nurses must be licensed and have other advanced certifications for the stabilization and treatment of sick or injured children.

- The Pediatric ED must have specialized equipment, policies, and procedures specific to the pediatric population that it serves.

The District worked with the State of Arizona and Magellan Health Services of Arizona, the regional behavioral health administrator for Maricopa County (the County), on a pilot project to create integrated health homes for people with serious mental illness (SMI) who are enrolled in AHCCCS. Three-fourths of the 14,000 people with SMI in the County do not have a primary care doctor. The concept is to offer a one-stop location that is more comfortable for people to access services for both their physical and mental health needs. A central location for services facilitates data sharing and on-site coordination between health professionals, identifies untreated conditions, improves overall health care, reduces overall medical costs, and keeps people out of the hospital.

The District opened its first four IHHs at selected behavioral health provider sites. There were significant regulatory constraints to overcome, and cooperation and coordination with several state agencies were required before the sites could be licensed and become operable. The sites are staffed by nurse practitioners and are connected to a supporting Family Health Center for follow-up care and technical assistance. All sites are equipped with the District’s EMR and linked to the District’s laboratory and other specialty services. The District is continuing the development of IHHs to other locations, and four sites are planned to open during fiscal year 2013.

The District continued to invest capital to upgrade its systems, equipment, and physical plant. The District completed the renovation of the pediatric emergency department. The renovation included an expansion of the treatment rooms/beds and construction of a separate ambulance entrance, a critical care room, and a separate patient drop-off/pick-up and entrance. The District also completed its upgrade project for the common space and service areas of the Comprehensive Health Center (CHC). The CHC is a multi-specialty and primary care facility located on the main medical campus. Within the main hospital, the cafeteria and all the main hallways were updated with new flooring, wall coverings, paintings, and lighting as appropriate. Investments continue for such items as upgrading and replacing end-of-life clinical equipment and purchasing new equipment to improve patient care and delivery.

The District is also committed to improving the health outcomes of the community it serves. The District is investing in the infrastructure needed to support individuals in the community diagnosed with HIV/AIDS. The District has approved relocating its McDowell Healthcare Center (McDowell) to a new site. McDowell specializes in medical and dental care for HIV/AIDS patients. For the past five years, McDowell has averaged patient volume growth of 10% per year and no longer has the physical capacity to serve more patients. McDowell will move to the new Parsons Foundation Center and will continue to be co-located with the Southwest Center for HIV/AIDS. The two organizations provide complementary support services to the County’s HIV/AIDS population.

Financial Highlights

The economy continues to be a major concern of the District. The state of Arizona (the State), like most other states, is challenged by a significant gap in its revenue and the requests it receives for support of services and programs. The State has not increased Medicaid reimbursement rates since fiscal year 2008. In 2011, the State reduced the existing Medicaid rates by 10%: 5% effective April 1 and another 5% on October 1 to help close the budget gap. The difference between the District's actual cost to provide patient care services to Medicaid patients and the reimbursement the State provides continues to widen. The District is inordinately impacted by the Medicaid rate freezes and reductions due to its status as the Safety Net Hospital in the County and the significant utilization of its services by Medicaid and uninsured patients.

Last year, the State submitted to CMS its request for a five-year renewal of its Section 1115 waiver. CMS approved the waiver on October 21, 2011. The State's waiver included significant reductions in the population that would be eligible for Medicaid. In addition, the waiver reduced benefits provided to Medicaid beneficiaries. To help mitigate the negative impact by the approved waiver to the Safety Net Hospitals in Arizona, the State submitted a request to amend the waiver to create the Safety Net Care Pool (SNCP). The SNCP would provide a means to compensate Safety Net Hospitals for their uncompensated cost to provide services to Medicaid and uninsured/underinsured patients. The waiver request was approved by CMS in May 2012 and is retroactive to the beginning of the federal fiscal year beginning October 1, 2011. SNCP will expire on December 31, 2013. The District received its first SNCP payment of $50 million in June 2012 by providing the matching funds of approximately one-third to draw down the federal dollars. Therefore, the net reimbursement to the District was approximately $34 million. It is anticipated that, at a minimum, the District will receive a net of $55.4 million annually from SNCP.

The Arizona legislature is considering an expansion of AHCCCS as part of the federal overhaul of health care. A provision of the federal health care overhaul required that most states expand their Medicaid programs to provide coverage to more low-income people. The Supreme Court upheld most provisions of the federal health care overhaul; however, it struck down the provision that required states to expand their Medicaid program. The Governor is not expected to weigh in on the AHCCCS expansion issue until January 2013. The SNCP program expires on December 31, 2013. Without an expansion of the Medicaid program to restore, at a minimum, the Medicaid eligibility and benefit structure prior to October 2011, the District will be facing a new financial challenge.

Fiscal year 2012 is the first year that the District has received payments for Meaningful Use (MU). MU is defined as using certified electronic health record technology to improve quality, safety, and efficiency; reduce health disparities; engage patients and their families; improve care coordination, population, and public health; and maintain the privacy and security of patient health information. The completion of Phase II of ARK enabled the District to apply for hospital and professional MU incentives provided through the State's Medicaid program. The total amount received was approximately $7 million.

For fiscal year 2012, the financial results of the District declined over the prior years. The loss from operations was $48.0 million, which represents a $13.2 million increase from the loss from operations in fiscal year 2011 and a $3.6 million increase from the loss from operations in fiscal year 2010. Including nonoperating activities, the District realized an increase in net assets of $20.0 million in fiscal year 2012, an increase in net assets of $29.6 million in fiscal year 2011, and an increase in net assets of $20.5 million in fiscal year 2010. In fiscal year 2012, the District received $57.9 million in property tax revenues, provided $78.0 million to cover the cost of uncompensated care, and purchased $33.6 million of capital assets. Additionally, the District was able to train 233 new physicians; operate a leading trauma service facility; and continue to operate the State's only, and the nation's second largest, burn center. The District continues to strive to be an effective steward of the public monies designated for health care services in the County. Some financial highlights include the following:

- Total cash and short-term investments at June 30, 2012, 2011, and 2010, were $104,243,064, $130,437,877, and $123,894,322, respectively.

- The District's net assets at June 30, 2012, 2011, and 2010, were $255,037,360, $235,023,200, and $205,414,154, respectively.

- Net nonoperating revenues for the years ended June 30, 2012, 2011, and 2010, were $68,037,545, $64,406,920, and $64,985,447, respectively, and include property tax receipts of $57,895,470, $55,722,300, and $53,018,363, respectively.

Overview of the Financial Statements

The District's financial statements consist of three statements – a balance sheet; a statement of revenues, expenses, and changes in net assets; and a statement of cash flows. These statements provide information about the activities of the District, including resources held by the District that are restricted for specific purposes by creditors, contributors, grantors, or enabling legislation. The District is accounted for as a business-type activity and presents its financial statements using the economic resources measurement focus and the accrual basis of accounting.

The balance sheet and statement of revenues, expenses, and changes in net assets report the District's net assets and changes in them. The District's total net assets – the difference between assets and liabilities – is one measure of the District's financial health or financial position. Over time, increases or decreases in the District's net assets are an indicator of whether its financial health is improving or deteriorating. Other nonfinancial factors, such as changes in the District's patient base, changes in legislation and regulations, measures of the quantity and quality of services provided to its patients, and local economic factors, should also be considered to assess the overall financial health of the District.

The statement of cash flows reports cash receipts, cash payments, and net changes in cash and cash equivalents resulting from four defined types of activities. It provides answers to such questions as where did cash come from, what was cash used for, and what was the change in cash and cash equivalents during the reporting period.

The District's Net Assets

The District's net assets represent the difference between its assets and liabilities reported in the balance sheets. The District's net assets at June 30, 2012, 2011, and 2010, were $255,037,360, $235,023,200, and $205,414,154, respectively, as shown in Table 1.

Table 1: Assets, Liabilities, and Net Assets

	June 30		
	2012	**2011**	**2010**
Assets			
Current assets	**$ 222,586,304**	$ 234,219,902	$ 242,870,980
Other assets	**153,219**	275,794	398,369
Capital assets	**128,748,419**	113,821,861	96,051,098
Total assets	**$ 351,487,942**	$ 348,317,557	$ 339,320,447
Liabilities			
Current liabilities	**$ 75,658,485**	$ 93,263,815	$ 110,972,004
Long-term debt and capital leases	**20,792,097**	20,030,542	22,934,289
Total liabilities	**96,450,582**	113,294,357	133,906,293
Net assets			
Unrestricted	**133,056,524**	128,229,447	120,197,326
Invested in capital assets, net of related debt	**121,078,254**	106,207,860	84,664,496
Restricted for grants	**902,582**	585,893	552,332
Total net assets	**255,037,360**	235,023,200	205,414,154
Total liabilities and net assets	**$ 351,487,942**	$ 348,317,557	$ 339,320,447

The District's significant assets as of June 30, 2012, 2011, and 2010, were cash, short-term investments, patient accounts receivable, receivables from AHCCCS, receivables from others, and capital assets.

Operating Results and Changes in the District's Net Assets

For the years ended June 30, 2012, 2011, and 2010, the District's net assets increased $20,014,160, $29,609,046, and $20,523,610, respectively, as shown in Table 2. This increase is made up of several different components, as shown in the following table.

Table 2: Operating Results and Changes in Net Assets

	Year Ended June 30		
	2012	**2011**	**2010**
Operating revenues			
Net patient service revenue	**$ 290,059,337**	$ 343,530,405	$ 322,748,687
Capitation and reinsurance	**163,629,209**	214,520,588	219,283,827
AHCCCS medical education	**26,971,604**	24,667,137	22,491,799
Other	**81,144,297**	24,975,163	22,635,773
Total operating revenues	**561,804,447**	607,693,293	587,160,086
Operating expenses			
Salaries and wages	**208,978,043**	196,046,371	201,350,989
Employee benefits	**61,664,101**	57,871,560	58,908,890
Purchased services	**107,383,444**	102,969,916	103,844,979
Medical claims	**123,394,806**	177,825,218	160,584,923
Supplies and other	**89,783,300**	92,145,330	93,642,429
Depreciation	**18,624,138**	15,632,772	13,289,713
Total operating expenses	**609,827,832**	642,491,167	631,621,923
Operating loss	**(48,023,385)**	(34,797,874)	(44,461,837)
Nonoperating revenues (expenses)			
Property tax receipts	**57,895,470**	55,722,300	53,018,363
Noncapital grants	**6,414,432**	5,009,538	7,097,745
Noncapital subsidies from Maricopa County	**3,547,896**	3,547,896	3,547,896
Other nonoperating (expense) revenue	**(90,254)**	(583,048)	1,363,470
Investment income	**642,147**	1,263,754	1,477,496
Interest expense	**(372,146)**	(553,520)	(1,519,523)
Total nonoperating revenues	**68,037,545**	64,406,920	64,985,447
Increase in net assets	**20,014,160**	29,609,046	20,523,610
Net assets, beginning of year	**235,023,200**	205,414,154	184,890,544
Net assets, end of year	**$ 255,037,360**	$ 235,023,200	$ 205,414,154

Operating Losses

The first component of the overall change in the District's net assets is its operating income or loss – generally, the difference between total operating revenues and total operating expenses incurred to perform those services. Net patient service revenue for the year ended June 30, 2012, was $290,059,337, which includes both inpatient and outpatient services provided to patients. In addition, the District received capitation and supplemental revenue from its health plan operations of $163,629,209 based on total member months of 688,371. Other operating revenues included five significant sources of income during the year ended June 30, 2012: (1) the receipt of $4,202,000 of AHCCCS and Medicare disproportionate share funding to assist in providing sufficient resources to offset some of the costs to the facility of serving lower income and other residents of the County, (2) the receipt of $26,971,604 from AHCCCS for medical education support, (3) the receipt of $41,717,587 from AHCCCS and CMS for the Safety Net Care Pool program to help cover the increased cost of caring for patients with no medical coverage, (4) the receipt of $7,026,286 from AHCCCS for the EMR program initiative, and (5) the receipt of $18,199,423 in supplemental payments from AHCCCS for the District's Federally Qualified Health Centers.

The operating losses for the years ended June 30, 2012, 2011, and 2010, were $48,023,385, $34,797,874, and $44,461,837, respectively. The primary components of the operating losses for June 30, 2012, 2011, and 2010, were as follows:

- Net patient service revenue of $290,059,337, $343,530,405, and $322,748,687, respectively
- Capitation and reinsurance revenue of $163,629,209, $214,520,588, and $219,283,827, respectively
- Salaries and wages of $208,978,043, $196,046,371, and $201,350,989, respectively
- Employee benefit costs of $61,664,101, $57,871,560, and $58,908,890, respectively
- Purchased services of $107,383,444, $102,969,916, and $103,844,979, respectively
- Payments for medical services provided to patients of $123,394,806, $177,825,218, and $160,584,923, respectively

Nonoperating Revenues and Expenses

Nonoperating revenues and expenses consist primarily of property tax receipts, noncapital grants, and noncapital subsidies from the County. These amounts for the years ended June 30, 2012, 2011, and 2010, were $57,895,470, $55,722,300, and $53,018,363; $6,414,432, $5,009,538, and $7,097,745; and $3,547,896, $3,547,896, and $3,547,896, respectively.

The District's Cash Flows

Changes in the District's cash flows are consistent with changes in operating losses and nonoperating revenues and expenses discussed earlier. Net cash used in operating activities for the years ended June 30, 2012, 2011, and 2010, was $60,737,827, $20,607,975, and $19,838,698, respectively.

Capital Assets

As of June 30, 2012, the District had $128,748,419 invested in capital assets, net of accumulated depreciation. For the years ended June 30, 2012, 2011, and 2010, the District purchased new property and equipment costing $33,585,809, $33,411,261, and $26,305,887, respectively.

Debt

At June 30, 2012, 2011, and 2010, the District had notes payable of $15,443,000, $15,443,000, and $15,379,205, respectively, and capital lease obligations totaling $7,439,228, $7,470,951, and $11,386,601, respectively, to the County and various other entities. The District entered into new capital lease agreements for equipment purchases totaling $3,271,226, $13,671, and $4,736,023 for the years ended June 30, 2012, 2011, and 2010, respectively.

Contacting the District's Financial Management

This financial report is designed to provide the District's patients, suppliers, community members, and creditors with a general overview of the District's finances and to show the District's accountability for the money it receives. Questions about this report and requests for additional financial information should be directed to District Administration by telephoning (602) 344-8425.

Maricopa County Special Health Care District
d/b/a Maricopa Integrated Health System

Balance Sheets

	June 30 2012	June 30 2011
Assets		
Current assets:		
Cash	**$ 1,797,839**	$ 1,249,160
Short-term investments	**102,445,225**	129,188,717
Patient accounts receivable, net of allowances of $68,211,000 and $41,338,000 in 2012 and 2011, respectively	**49,763,325**	66,355,106
Receivable from AHCCCS for medical education	**26,971,604**	–
Other health plan rceivables from AHCCCS	**6,839,750**	9,610,135
Other receivables	**21,980,694**	12,325,945
Due from related parties	**1,681,362**	1,812,120
Supplies	**7,570,523**	8,032,254
Prepaid expenses	**3,535,982**	5,646,465
Total current assets	**222,586,304**	234,219,902
Capital assets:		
Land	**4,090,000**	4,090,000
Depreciable capital assets, net of accumulated depreciation	**124,658,419**	109,731,861
Total capital assets, net of accumulated depreciation	**128,748,419**	113,821,861
Other assets	**153,219**	275,794
Total assets	**$ 351,487,942**	$ 348,317,557
Liabilities and net assets		
Current liabilities:		
Current maturities of long-term debt	**$ 2,090,131**	$ 2,883,409
Accounts payable	**22,487,271**	26,027,149
Accrued payroll and expenses	**18,961,902**	22,166,701
Medical claims payable	**11,819,371**	22,131,406
Payable to AHCCCS for health plan premiums	**–**	3,192,359
Overpayments due to third-party payors	**15,313,720**	11,207,636
Other current liabilities	**4,986,090**	5,655,155
Total current liabilities	**75,658,485**	93,263,815
Long-term debt and capital leases	**20,792,097**	20,030,542
Total liabilities	**96,450,582**	113,294,357
Net assets:		
Unrestricted	**133,056,524**	128,229,447
Invested in capital assets, net of related debt	**121,078,254**	106,207,860
Restricted for grants	**902,582**	585,893
Total net assets	**255,037,360**	235,023,200
Total liabilities and net assets	**$ 351,487,942**	$ 348,317,557

See accompanying notes.

Maricopa County Special Health Care District
d/b/a Maricopa Integrated Health System

Statements of Revenues, Expenses, and Changes in Net Assets

	Year Ended June 30	
	2012	**2011**
Operating revenues:		
Net patient service revenue, net of provision for uncollectible accounts of $98,021,000 and $45,318,000 in 2012 and 2011, respectively	**$ 290,059,337**	$ 343,530,405
Capitation and reinsurance	**163,629,209**	214,520,588
AHCCCS medical education	**26,971,604**	24,667,137
Other	**81,144,297**	24,975,163
Total operating revenues	**561,804,447**	607,693,293
Operating expenses:		
Salaries and wages	**208,978,043**	196,046,371
Employee benefits	**61,664,101**	57,871,560
Purchased services	**107,383,444**	102,969,916
Medical claims	**123,394,806**	177,825,218
Supplies and other	**89,783,300**	92,145,330
Depreciation	**18,624,138**	15,632,772
Total operating expenses	**609,827,832**	642,491,167
Operating loss	**(48,023,385)**	(34,797,874)
Nonoperating revenues (expenses):		
Property tax receipts	**57,895,470**	55,722,300
Noncapital grants	**6,414,432**	5,009,538
Noncapital subsidies from Maricopa County	**3,547,896**	3,547,896
Other nonoperating expense	**(90,254)**	(583,048)
Investment income	**642,147**	1,263,754
Interest expense	**(372,146)**	(553,520)
Total nonoperating revenues	**68,037,545**	64,406,920
Increase in net assets	**20,014,160**	29,609,046
Net assets, beginning of year	**235,023,200**	205,414,154
Net assets, end of year	**$ 255,037,360**	$ 235,023,200

See accompanying notes.

Maricopa County Special Health Care District
d/b/a Maricopa Integrated Health System

Statements of Cash Flows

	Year Ended June 30	
	2012	**2011**
Operating activities		
Receipts from and on behalf of patients	**$ 470,280,327**	$ 534,582,649
Payments to suppliers and contractors	**(331,841,249)**	(373,043,413)
Payments to employees	**(273,846,943)**	(252,325,868)
Other operating receipts	**115,245,703**	91,206,483
Other operating payments	**(40,575,665)**	(21,027,826)
Net cash used in operating activities	**(60,737,827)**	(20,607,975)
Noncapital financing activities		
Property tax receipts	**57,895,470**	55,722,300
Noncapital contributions and grants received	**6,414,432**	5,009,538
Noncapital subsidies and other nonoperating receipts	**3,457,642**	2,964,848
Net cash provided by noncapital financing activities	**67,767,544**	63,696,686
Capital and related financing activities		
Issuance of long-term debt	**–**	63,795
Principal payments on long-term debt and capital leases	**(3,302,949)**	(3,929,324)
Purchase of capital assets	**(30,279,470)**	(33,389,861)
Interest paid on long-term debt	**(284,258)**	(553,520)
Net cash used in capital and related financing activities	**(33,866,677)**	(37,808,910)
Investing activities		
Sales (purchases) of investments, net	**26,743,492**	(7,810,963)
Interest from investments	**642,147**	1,263,754
Net cash provided by (used in) investing activities	**27,385,639**	(6,547,209)
Increase (decrease) in cash	**548,679**	(1,267,408)
Cash, beginning of year	**1,249,160**	2,516,568
Cash, end of year	**$ 1,797,839**	$ 1,249,160

Maricopa County Special Health Care District
d/b/a Maricopa Integrated Health System

Statements of Cash Flows (continued)

	Year Ended June 30	
	2012	**2011**
Reconciliation of operating loss to net cash used in operating activities		
Operating loss	**$ (48,023,385)**	$ (34,797,874)
Adjustments to reconcile operating loss to net cash used in operating activities:		
Depreciation	**18,624,138**	15,632,772
Provision for uncollectible accounts	**98,021,529**	45,318,188
Changes in operating assets and liabilities:		
Patient, other accounts receivables and other assets	**(115,163,141)**	(31,978,252)
Due from related parties	**130,758**	3,186,706
Supplies and prepaid expenses	**2,572,214**	(1,209,433)
Estimated amounts due from third-party payors	**913,725**	(18,714,911)
Medical claims payable	**(10,312,035)**	(2,382,910)
Accounts payable and accrued expenses	**(7,501,630)**	4,337,739
Net cash used in operating activities	**$ (60,737,827)**	$ (20,607,975)
Supplemental cash flow information		
Capital lease obligations for new equipment	**$ 3,271,226**	$ 13,671

See accompanying notes.

1. Nature of Operations and Summary of Significant Accounting Policies

Nature of Operations and Reporting Entity

Maricopa County Special Health Care District (the District) d/b/a Maricopa Integrated Health System (MIHS) is a health care district and political subdivision of the state of Arizona. The District is located in Phoenix, Arizona, and is governed by a five-member board of directors elected by voters within the District.

The District was created in November 2003 by an election of the voters of Maricopa County, Arizona (the County). In November 2004, the voters elected the District's governing board. An Intergovernmental Agreement (IGA) between the District and the County was entered into in November 2004, which, among other things, specified the terms by which the County transferred essentially all of the assets, liabilities, and financial responsibility of MIHS to the District effective January 1, 2005. MIHS operates a medical center facility (the Medical Center), which was formerly owned and operated by the County. The District has the authority to levy ad valorem taxes. The District had no significant operations prior to January 1, 2005.

The IGA between the County and the District describes the terms related to the transfer of MIHS to the District. In conjunction with the IGA, the County and the District entered into a 20-year lease for the Medical Center real estate. The terms of the IGA are effective as long as the District continues to operate the Medical Center and the lease remains in place.

Some of the key provisions of the IGA are noted below:

- Transfer of all assets and liabilities of MIHS to the District effective January 1, 2005
- Transfer of operations and fiscal responsibility of MIHS to the District effective January 1, 2005
- Medical Center lease for initial 20-year term (see Note 12)
- Scheduled rent payments for certain assets of MIHS between the County and the District (see Note 9)
- Rights and obligations of the County and the District under the IGA, including, but not limited to, services provided by the County and the District to each party, assignment of contracts and leases, and financial assistance from the County

1. Nature of Operations and Summary of Significant Accounting Policies (continued)

Effective October 1, 2005, the District assumed the operations and financial responsibility for the Maricopa Health Plan (MHP), a managed care plan previously operated by the County. MHP contracts with the Arizona Health Care Cost Containment System (AHCCCS) to arrange and provide health care services to Medicaid-eligible clients. MIHS has a management agreement with University Physicians Healthcare to provide day-to-day management of MHP, including providing all employees and infrastructure necessary to operate MHP. MHP is an operating division of the District.

The District primarily earns revenues by providing inpatient and outpatient medical and nursing services and operating a managed care plan for Medicaid-eligible patients. In addition, the District provides attendant care services in the same geographic area.

Basis of Accounting and Presentation

The District prepares its financial statements as a business-type activity in conformity with applicable pronouncements of the Governmental Accounting Standards Board. The financial statements of the District have been prepared on the accrual basis of accounting using the economic resources measurement focus. Revenues, expenses, gains, losses, assets, and liabilities from exchange and exchange-like transactions are recognized when the exchange transaction takes place, while those from government-mandated and voluntary non-exchange transactions (principally federal and state grants and appropriations from the County) are recognized when all applicable eligibility requirements are met. Operating revenues and expenses include exchange transactions and program-specific, government-mandated, non-exchange transactions. Government-mandated, non-exchange transactions that are not program-specific (such as appropriations from the County); investment income; and interest on capital assets-related debt are included in nonoperating revenues and expenses. The District first applies restricted net assets when an expense or outlay is incurred for purposes for which both restricted and unrestricted net assets are available.

1. Nature of Operations and Summary of Significant Accounting Policies (continued)

Cash

The District considers all liquid investments with original maturities of three months or less to be cash equivalents. At June 30, 2012 and 2011, the District had approximately $1,798,000 and $1,249,000 of cash and cash equivalents, respectively. Amounts held by the County Treasurer on behalf of the District are reported as short-term investments (see Note 3).

Risk Management

The District is exposed to various risks of loss from torts; theft of, damage to, and destruction of assets; business interruption; errors and omissions; employee injuries; medical malpractice; natural disasters; and employee health, dental, and accident benefits. The District is a participant in the County's self-insurance program and, in the opinion of the District's management, any unfavorable outcomes from these risks are covered by that self-insurance program. Accordingly, the District has no risk of loss, beyond adjustments to future premium payments to the County's self-insurance program. All estimated losses for unsettled claims and actions of the County are determined on an actuarial basis and are included in the Maricopa County Comprehensive Annual Financial Report.

MHP receives insurance coverage from the state of Arizona to reduce the risk of catastrophic loss on services provided under the AHCCCS program. The reinsurance expense is reflected as reduced capitation rates paid to MHP. Under the state program, risk of loss from inpatient claims is generally limited to an annual deductible of $20,000 per member, per policy year. Eligible claims in excess of the deductible are generally paid at 75% to 85%, with no maximum annual benefit. Eligible reinsurance claims are reported as a reduction of health care expenses at the amount expected to be collected from AHCCCS.

Investments

Investments in debt securities are measured at fair value. Interest and gains and losses, both realized and unrealized, on investments in debt securities are included in nonoperating revenue when earned.

1. Nature of Operations and Summary of Significant Accounting Policies (continued)

Patient Accounts Receivable

The District reports patient accounts receivable for services rendered at estimated net realizable amounts due from third-party payors, patients, and others. The District provides an allowance for uncollectible accounts based upon a review of outstanding receivables, historical collection information, and existing economic conditions. As a service to the patient, the District bills third-party payors directly and bills the patient when the patient's liability is determined. Patient accounts receivable are due in full when billed. Accounts are considered delinquent and subsequently written off as bad debts based on individual credit evaluation and specific circumstances of the account.

Supplies

Supply inventories are stated at the lower of cost, determined using the first-in, first-out method, or market.

Capital Assets

Capital assets are recorded at cost at the date of acquisition, or fair value at the date of donation if acquired by gift. The dollar threshold to capitalize capital assets is $2,500. Depreciation is computed using the straight-line method over the estimated useful life of each asset. Assets under capital lease obligations and leasehold improvements are amortized over the shorter of the lease term or the assets' respective estimated useful lives. The following estimated useful lives are being used by the District:

Land improvements	2–25 years
Buildings and leasehold improvements	5–40 years
Equipment	3–20 years

1. Nature of Operations and Summary of Significant Accounting Policies (continued)

Compensated Absences

District policies permit most employees to accumulate vacation and sick leave benefits (personal leave) that may be realized as paid time off or, in limited circumstances, as a cash payment. Expense and the related liability are recognized as personal leave benefits and are earned whether the employee is expected to realize the benefit as time off or as a cash payment. Employees may accumulate up to 240 hours of personal leave, depending on years of service, but any personal leave hours in excess of the maximum amount that are unused by the calendar year-end are converted to the employee's extended illness bank (EIB). Generally, EIB benefits are used by employees for extended illness or injury, or to care for an immediate family member with an extended illness or injury. EIB benefits are cumulative but do not vest with employees and, therefore, are not accrued. However, upon retirement, employees with accumulated EIB in excess of 1,000 hours are entitled to a $3,000 bonus. The total compensated absence liabilities are computed using the regular pay and termination pay rates in effect at the balance sheet date plus an additional amount for compensation-related payments such as social security and Medicare taxes, computed using rates in effect at that date.

Net Assets

Net assets of the District 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 outstanding balances of 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 donors external to the District. Unrestricted net assets are remaining assets less remaining liabilities that do not meet the definition of invested in capital assets, net of related debt or restricted net assets.

Net Patient Service Revenue

The District has agreements with third-party payors that provide for payments to the District at amounts different from its established rates. Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered and includes estimated retroactive adjustments and a provision for uncollectible accounts. Retroactive adjustments are considered in the recognition of revenue on an estimated

1. Nature of Operations and Summary of Significant Accounting Policies (continued)

basis in the period the related services are rendered, and such estimated amounts are revised in future periods as adjustments become known. The District participates in the Federally Qualified Health Center (FQHC) program and receives supplemental payments from AHCCCS. The payments are made based on information filed with AHCCCS on the Annual Reconciliation and Rebase Data report. The District recognized a $4,000,000 reduction in net revenue in 2011 based on additional information received.

Medical Claims Payable

The costs of hospital and medical services provided to enrollees served under contract are accrued in the period that the services are rendered. Provision has been made for claims in process of review and for claims incurred but not received at year-end. The amount of this liability is computed by an independent actuary using historical claims payment experience, coupled with a review of experience for similar plans. Estimates are adjusted based upon changes in experience, and such adjustments are reflected in current operations. Although considerable variability is inherent in such estimates, there is at least a possibility that recorded estimates will change by a material amount in the near term. Management believes that the medical claims payable is adequate.

Charity Care

The District provides services at amounts less than its established rates to patients who meet the criteria of its charity care policy. The criteria for charity care take into consideration the patient's family income in relation to the federal poverty guideline and type of service rendered.

The total net cost of charity care provided was approximately $77,956,000 and $54,586,000 for the years ended June 30, 2012 and 2011, respectively. Charity care cost is based on the percentage of total direct operating expenses less other operating revenue divided by the total gross revenue for the Medical Center. This percentage is applied to the amount written off as charity care to determine the total charity care cost. The net cost of charity care is total charity care cost less any payments received. Payments received were approximately $6,148,000 and $4,805,000 for the years ended June 30, 2012 and 2011, respectively.

1. Nature of Operations and Summary of Significant Accounting Policies (continued)

Property Taxes

On or before the third Monday in August, the County levies real property taxes and commercial personal property taxes on behalf of the District that become due and payable in two equal installments. The first installment is due on the first day of October and becomes delinquent after the first business day of November. The second installment is due on the first day of March of the next year and becomes delinquent after the first business day of May.

The County also levies mobile home personal property taxes on behalf of the District that are due the second Monday of the month following receipt of the tax notice and become delinquent 30 days later. A lien assessed against real and personal property attaches on the first day of January preceding assessment and levy.

Income Taxes

The District is generally exempt from federal and state income taxes under Section 115 of the Internal Revenue Code and a similar provision of state law. However, the District is subject to federal income tax on any unrelated business taxable income. The District had no unrelated business taxable income in 2012 or 2011.

Reclassifications

Certain reclassifications have been made to the 2011 financial statements to conform to the 2012 financial statement presentation in respect of presenting the medical claims payable separately in the balance sheets.

2. Net Patient Service Revenue

The District has agreements with third-party payors that provide for payments to the District at amounts different from its established rates. These payment arrangements include the following:

- Medicare – Inpatient acute care services, certain inpatient non-acute care services, and substantially all outpatient services rendered to Medicare program beneficiaries are paid at prospectively determined rates. These rates vary according to a patient classification system that is based on clinical, diagnostic, acuity, and other factors. Inpatient psychiatric services are paid based on a blended cost reimbursement methodology and prospectively determined rates. The District is reimbursed for certain services at tentative rates with final settlement determined after submission of annual cost reports by the District and audits thereof by the Medicare fiscal intermediary. The Medicare fiscal intermediary has audited the District's cost reports through June 30, 2009.

- AHCCCS inpatient services are paid on a per diem basis. Outpatient services rendered to AHCCCS program beneficiaries are primarily reimbursed under prospectively determined rates.

- Approximately 62% and 69% of net patient service revenues were from participation in the Medicare and state-sponsored AHCCCS programs for the years ended June 30, 2012 and 2011, respectively. Laws and regulations governing the Medicare and AHCCCS programs are complex and subject to interpretation and change. As a result, it is reasonably possible that recorded estimates will change materially in the near term.

Net patient service revenue increased by approximately $584,000 and $1,414,000 in 2012 and 2011, respectively, due to changes in estimates related to final settlements with the Medicare program and cost reports that are no longer subject to audits, reviews, or investigations.

The District has also entered into payment agreements with certain commercial insurance carriers, health maintenance organizations, and preferred provider organizations. The basis for payment to the District under these agreements includes prospectively determined rates per discharge, discounts from established charges, and prospectively determined daily rates.

3. Deposits, Pooled Funds, and Investment Income

Deposits

Custodial credit risk is the risk that, in the event of a bank failure, an entity's deposits may not be returned to it. The District's deposit policy for custodial credit risk requires compliance with the provisions of state law.

The District's deposits are held by the County in conjunction with other County funds and the District can draw them upon demand. The County has represented to the District that there is sufficient collateral to cover all of the County's deposits, including the District's deposits. The County issues a Comprehensive Annual Financial Report. Further information regarding County deposits and investments is contained within the basic financial statement notes to the Comprehensive Annual Financial Report. The most recent report can be obtained by writing to Maricopa County Department of Finance, 301 W. Jefferson, Suite 960, Phoenix, Arizona 85003, or at www.maricopa.gov. Due to the nature of the investments held as collateral, it is possible the County may not be able to immediately liquidate the securities held and as such the District has classified these funds as short-term investments.

District's Pooled Funds

Under the terms of the IGA, the District maintains its cash in pooled funds held by the County. By state statute, the County is required to ensure that all County funds are either insured by the Federal Deposit Insurance Corporation, collateralized by securities held by the cognizant Federal Reserve Bank, or invested in U.S. government obligations. The District's cash held by the County is pooled with the funds of other county agencies and then, in accordance with statutory limitations, placed in banks or invested as the County may determine. The District's pooled funds are reported as short-term investments.

At June 30, the District had the following invested funds with maturities of less than one year:

	Fair Value	
	2012	**2011**
Pooled funds held by the County	**$ 102,445,225**	$ 129,188,717

3. Deposits, Pooled Funds, and Investment Income (continued)

Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. The pooled funds held by the County are presented as an investment with a maturity of less than one year because they are redeemable in full immediately.

Credit Risk

Credit risk is the risk that the issuer or other counterparty to an investment will not fulfill its obligations. At June 30, 2012 and 2011, the District's pooled funds held by the County were not rated. At June 30, 2012, the District held no investments outside the County.

Investment Income

Investment income consisted of interest income of approximately $642,000 and $1,264,000 for the years ended June 30, 2012 and 2011, respectively.

4. Patient Accounts Receivable

The District grants credit without collateral to its patients, many of whom are area residents and are insured under third-party payor agreements. Patient accounts receivable consisted of the following at June 30:

	2012	2011
Medicare	**$ 10,698,593**	$ 7,643,650
AHCCCS	**9,936,417**	19,400,392
Other third-party payors	**63,578,263**	46,417,466
Patients	**33,760,742**	34,232,023
	117,974,015	107,693,531
Less allowance for uncollectible accounts	**68,210,690**	41,338,425
	$ 49,763,325	$ 66,355,106

Patient accounts receivable includes estimates of amounts due from the County for Correctional Health Services provided and from AHCCCS for services provided to patients in the FQHC program. These estimates are subject to change upon final settlement.

5. Other Receivables

Other receivables consist of various amounts due for non-patient-related accounts receivable. At June 30, 2012 and 2011, significant components of other receivables included amounts due from participation in the FQHC program of approximately $5,858,000 and $5,436,000, respectively, and amounts receivable from participation in the Safety Net Care Pool program of approximately $10,263,000 and $0, respectively. Additional amounts receivable at June 30, 2012, includes various grants receivable of approximately $1,700,000 and an amount receivable related to a trauma subsidy of approximately $921,000. Additional amounts receivable at June 30, 2012, include a Medicare settlement of approximately $1,445,000.

6. Receivables From AHCCCS for Medical Education

During the year ended June 30, 2012, MIHS entered into an intergovernmental agreement with AHCCCS such that AHCCCS provided available medical education funds from CMS. Available funds from CMS for medical education totaled approximately $40,077,000. The amount MIHS will receive is approximately $26,972,000, which is net of the $13,105,000 matching funds provided by MIHS. The total amount due from the state of Arizona for medical education funding was $26,972,000 and $0 at June 30, 2012 and 2011, respectively.

7. Capital Assets

Capital assets activity for the year ended June 30, 2012, was as follows:

	Beginning Balance	Additions	Disposals	Transfers	Ending Balance
Capital assets not being depreciated:					
Construction in progress	$ 1,089,274	$ 13,822,928	$ –	$ (14,583,729)	$ 328,473
Capitalized software in progress	9,302,664	19,762,881	–	(29,065,545)	–
Land	4,090,000	–	–	–	4,090,000
Capital assets being depreciated:					
Buildings and leasehold improvements	65,285,570	–	–	5,767,012	71,052,582
Capitalized software	18,099,412	–	–	29,047,689	47,147,101
Equipment	80,712,975	–	(89,759)	8,834,573	89,457,789
	178,579,895	33,585,809	(89,759)	–	212,075,945
Less accumulated depreciation:					
Buildings and leasehold improvements	12,962,265	5,990,004	–	–	18,952,269
Capitalized software	5,881,481	2,809,339	–	–	8,690,820
Equipment	45,914,287	9,824,796	(54,646)	–	55,684,437
	64,758,033	18,624,139	(54,646)	–	83,327,526
Capital assets, net	$ 113,821,862	$ 14,961,670	$ (35,113)	$ –	$ 128,748,419

7. Capital Assets (continued)

Capital assets activity for the year ended June 30, 2011, was as follows:

	Beginning Balance	Additions	Disposals	Transfers	Ending Balance
Capital assets not being depreciated:					
Construction in progress	$ 3,699,609	$ 23,152,748	$ –	$ (25,763,083)	$ 1,089,274
Capitalized software in progress	521,682	10,258,513	–	(1,477,531)	9,302,664
Land	4,090,000	–	–	–	4,090,000
Capital assets being depreciated:					
Buildings and leasehold improvements	52,175,860	–	–	13,109,710	65,285,570
Capitalized software	16,621,881	–	–	1,477,531	18,099,412
Equipment	69,887,504	–	(1,827,902)	12,653,373	80,712,975
	146,996,536	33,411,261	(1,827,902)	–	178,579,895
Less accumulated depreciation:					
Buildings and leasehold improvements	9,344,378	3,617,888	–	–	12,962,266
Capitalized software	1,526,965	4,354,516	–	–	5,881,481
Equipment	40,074,095	7,660,368	(1,820,176)	–	45,914,287
	50,945,438	15,632,772	(1,820,176)	–	64,758,034
Capital assets, net	$ 96,051,098	$ 17,778,489	$ (7,726)	$ –	$ 113,821,861

8. Medical Claims Payable

Medical claims liability consists of the following at June 30, 2012:

Claims payable or pending approval	$ 7,945,239
Provisions for claims incurred but not yet reported	3,874,132
	$ 11,819,371

The cost of health care services is recognized in the period in which care is provided and includes an estimate of the cost of services that has been incurred but not yet reported. Accrued claims payable is estimated based on historical claims payments and other relevant information. Unpaid claims adjustment expenses are an estimate of the cost to process the incurred but not reported claims and are included in medical claims payable. Estimates are continually monitored and reviewed, and as settlements are made or estimates adjusted, differences are reflected in current operations. Such estimates are subject to the impact of changes in the regulatory environment and economic conditions. Given the inherent variability of such estimates, the

8. Medical Claims Payable (continued)

actual liability could differ significantly from the amounts provided. While the ultimate amount of claims paid is dependent on future developments, management is of the opinion that the accrued medical claims payable is adequate.

The following is a reconciliation of the accrued claims liability as of and for the years ended June 30:

	2012	2011
Beginning balance	**$ 22,131,406**	$ 22,890,978
Incurred:		
Current	**131,508,214**	184,453,070
Prior	**(1,452,968)**	(1,227,382)
Total	**130,055,246**	183,225,688
Paid:		
Current	**119,783,458**	162,321,664
Prior	**20,583,823**	21,663,596
Total	**140,367,281**	183,985,260
Ending balance	**$ 11,819,371**	$ 22,131,406

Amounts incurred related to prior years vary from previously estimated liabilities as the claims are ultimately adjudicated and paid. Liabilities at any year-end are continually reviewed and re-estimated as information regarding actual claim payments becomes known. This information is compared to the originally established year-end liability. Negative amounts reported for incurred amounts related to prior years result from claims being adjudicated and paid for amounts less than originally estimated. Medical claims expense in the statements of revenue, expenses, and changes in net assets is recorded net of reinsurance revenue.

9. Long-Term Debt and Capital Leases

The following is a summary of long-term debt transactions for the District for the years ended June 30:

	Beginning Balance	Additions	Deductions	Ending Balance	Current Portion
2012					
Capital lease obligations	**$ 7,470,951**	**$ 3,271,226**	**$ (3,302,949)**	**$ 7,439,228**	**$ 2,090,131**
Note payable and credit facility, Maricopa County	**15,443,000**	**–**	**–**	**15,443,000**	**–**
Total long-term debt	**$ 22,913,951**	**$ 3,271,226**	**$ (3,302,949)**	**$ 22,882,228**	**$ 2,090,131**
2011					
Capital lease obligations	$ 11,386,604	$ 13,671	$ (3,929,324)	$ 7,470,951	$ 2,883,409
Note payable and credit facility, Maricopa County	15,379,205	63,795	–	15,443,000	–
Total long-term debt	$ 26,765,809	$ 77,466	$ (3,929,324)	$ 22,913,951	$ 2,883,409

Capital Lease Obligations

In connection with the IGA between the District and the County, the District entered into capital lease obligations with the County for various capital assets. The terms of these capital lease obligations are as follows:

- Capital lease – Desert Vista Psychiatric Center; due July 1, 2015, with lease payments due every six months

- Capital leases – Various equipment; due through 2015, with lease payments due monthly or every six months

The District is obligated under the leases noted above for buildings, building improvements, and equipment, which are accounted for as capital leases. Assets under capital leases at June 30, 2012 and 2011, had a total cost of approximately $28,919,000 and $25,648,000, respectively, with accumulated depreciation of approximately $15,425,000 and $12,469,000, respectively.

9. Long-Term Debt and Capital Leases (continued)

The following is a schedule by year of future minimum lease payments under the capital leases, including interest at varying rates together with the present value of the future minimum lease payments as of June 30, 2012:

	Principal	Interest
Years ending June 30:		
2013	$ 2,090,131	$ 289,828
2014	2,291,826	205,215
2015	1,957,201	120,223
2016	721,229	52,190
2017	378,841	7,493
	$ 7,439,228	$ 674,949

Note Payable and Credit Facility, Maricopa County

As part of the IGA, the District issued a note payable to the County for $443,000, which is due in June 2015. This amount relates to the cost incurred by the County on behalf of the District in relation to the election held in November 2004. This note payable to the County was interest-free for the first five years. The note now bears interest at competitive rates through its maturity in 2014. The balance for this note, including accrued interest, is approximately $449,000 and $447,000 at June 30, 2012 and 2011, respectively.

The County also agreed to extend the District a $15,000,000 credit facility in connection with the IGA. Any amounts borrowed under the credit facility are payable to the County in their entirety in June 2015. Borrowings under this credit facility are $15,000,000 and were interest-free for the first five years. The $15,000,000 was discounted at a rate of 6.4%, and the discounted amount of $3,990,500 was amortized over a five-year period beginning on August 1, 2005. Beginning August 1, 2010, the $15,000,000 bears interest at competitive rates through its maturity in 2014. The current rate of interest is approximately 1.0% and reflects the effective interest rate the County Treasurer earns on its investments. The balance for this credit facility, including accrued interest, is approximately $15,224,000 and $15,139,000 at June 30, 2012 and 2011, respectively.

10. Restricted Net Assets

Restricted net assets at June 30, 2012, consist of grant funds received for specific purposes that are expected to be expended during 2013, in the amount of approximately $902,000. Restricted net assets at June 30, 2011, consist of grant funds received for specific purposes that are expected to be expended during 2012, in the amount of approximately $586,000.

11. Pension Plan

Plan Description

The District contributes to a cost-sharing, multiple-employer, defined benefit pension plan administered by the Arizona State Retirement System (ASRS). Pension expense is recorded for the amount the District is contractually required to contribute for the period. Benefits are established by state statute and generally provide retirement, death, long-term disability, survivor, and health insurance premium benefits. ASRS is governed by the ASRS Board according to the provisions of Arizona Revised Statutes Title 38, Chapter 5, Article 2.

ASRS issues a Comprehensive Annual Financial Report that includes financial statements and required supplementary information. The most recent report may be obtained by writing the Arizona State Retirement System, 3300 North Central Avenue, P.O. Box 33910, Phoenix, Arizona 85067-3910, or by telephoning (602) 240-2000 or (800) 621-3778.

Funding Policy

The Arizona State Legislature establishes and may amend contribution rates for active plan members and the District. For the years ended June 30, 2012 and 2011, active plan members and the District were required by statute to contribute at the actuarially determined rate of 10.74% (10.50% retirement and 0.24% long-term disability) and 9.85% (9.60% retirement and 0.25% long-term disability), respectively, of the members' annual covered payroll. The District's contributions to ASRS were approximately $21,115,000 and $18,468,000 for the years ended June 30, 2012 and 2011, respectively, which were equal to the required contributions for the year.

12. Medical Center Lease

Under the terms of the IGA, the District entered into a 20-year lease agreement with the County for the real property of the Medical Center, including the Comprehensive Health Care Center Facility. The terms of the lease include an annual contingent rental amount of approximately $5,230,000, adjusted annually by inflation, less the annual fixed base rent of $12 per annum and the annual rental payments for the Comprehensive Health Care Center Facility. The contingent rental payments and the base annual fixed rent are deferred under the lease agreement pending the occurrence of a specific event (i.e., a DSH Triggering Event), as defined in the IGA, which, in the opinion of management, is considered remote and therefore no accrual has been recorded.

The Comprehensive Health Care Center Facility lease has been accounted for as an operating lease, and rental expense recognized was approximately $1,437,000 for both years ended June 30, 2012 and 2011.

13. Commitments and Contingencies

Capital Expenditure Commitments

In June 2007, the District Board approved a capital budget of $29,500,000 for fiscal year 2008, which included $12,500,000 for the implementation of the ARK Project. The ARK Project is a multi-year project that includes both an implementation of a clinical application system and a replacement of the District's enterprise resource planning (ERP) software. In August 2008, the District Board approved a contract with Epic Systems Corporation (Epic) for the purchase of a clinical application system. Phase I of the project began in October 2008 and was completed in fiscal year 2010. Phase II of the Epic project began in the latter part of fiscal year 2010 and was completed in March 2012. Certain costs for the implementation of this system are being capitalized. The total estimated expenditure to complete the project by fiscal year 2013 is approximately $3,308,000.

The District Board approved $11,158,000 in FY2013 capital expenditures related to ARK; $3,308,000 is designated for Epic as noted above and $7,850,000 was approved to begin the replacement of the District's ERP.

13. Commitments and Contingencies (continued)

Operating Leases

The District leases various equipment and facilities under operating leases expiring at various dates through June 2014. Total rental expense in 2012 and 2011 for all operating leases was approximately $3,156,000 and $2,833,000, respectively.

The following is a schedule, by year, of future minimum lease payments under operating leases as of June 30, 2012, that have initial or remaining noncancelable lease terms in excess of one year.

Years ending June 30:	
2013	$ 1,659,430
2014	1,660,258
2015	1,656,708
2016	1,660,838
2017	288,708

Litigation

In the normal course of business, the District is, from time to time, subject to allegations that may or do result in litigation. Some of these allegations are in areas not covered by the County's self-insurance program (see Note 1) or by commercial insurance; for example, allegations regarding employment practices or performance of contracts. The District evaluates such allegations by conducting investigations to determine the validity of each potential claim. Based upon the advice of legal counsel, management records an estimate of the amount of ultimate expected loss, if any, for each allegation. Events could occur that would cause the estimate of ultimate loss to differ materially in the near term.

Maricopa Health Plan

MHP's contract with AHCCCS requires the plan to be in compliance with certain financial and nonfinancial covenants as defined. At June 30, 2012, management believes MHP was in compliance with these covenants.

13. Commitments and Contingencies (continued)

For 2012 and 2011, substantially all of MHP's revenues were earned under its AHCCCS contract. Continuation of the AHCCCS program is dependent upon governmental policies. This contract is subject to periodic renewal. MHP has been awarded its AHCCCS contract renewal through September 30, 2013. The loss of this contract would have an adverse effect on MHP's future operations.

The District has secured an irrevocable letter of credit in the amount of $14,750,000 with JP Morgan Chase to fulfill the performance bond requirement of the AHCCCS contract at June 30, 2012.

14. Disproportionate Share Settlement

Section 1923 of the Social Security Act establishes federal requirements designed to aid entities that provide medical services to a disproportionate share of medically indigent patients. These requirements were met for the state fiscal years ended June 30, 2012 and 2011, through disproportionate share settlements established in Laws 2012, Arizona Second Regular Session, Chapter 31 and Laws 2011, Arizona Regular Session, Chapter 31, respectively. AHCCCS was directed to distribute such settlements based on various qualifying criteria and allocation processes. AHCCCS distributed approximately $4,202,000 in disproportionate share settlements to the District in fiscal years 2012 and 2011; such amounts are recorded in other operating revenue.

15. Related-Party Transactions

During the years ended June 30, 2012 and 2011, net patient service revenues included approximately $4,662,000 and $5,404,000, respectively, of payments received from Maricopa County Correctional Health for medical services rendered. In addition, transfers of approximately $3,548,000 in subsidies were received from the County General Fund in both fiscal years 2012 and 2011, and approximately $2,481,000 and $1,984,000 in grant funds were received from Maricopa County Department of Public Health in fiscal years 2012 and 2011, respectively.

The District also provided various other services to the County for the years ended June 30, 2012 and 2011, totaling approximately $164,000 and $219,000, respectively.

15. Related-Party Transactions (continued)

Per the terms of the IGA, the District purchased the following services from the County for the years ended June 30, 2012 and 2011: malpractice and property insurance for approximately $2,599,000 and $3,802,000, respectively; workers' compensation insurance for approximately $749,000 and $1,463,000, respectively; and unemployment insurance for approximately $154,000 and $257,000, respectively.

16. Subsequent Events

Effective July 1, 2012, the District elected to levy a secondary property tax on all taxable property in the defined surrounding area at the rate necessary to generate approximately $57,895,000 of annual tax revenue. The tax revenue is to be used to support operations of the District.

Single Audit Reports

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Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of the Financial Statements Performed in Accordance With *Government Auditing Standards*

Management and Board of Directors
Maricopa County Special Health Care District
d/b/a Maricopa Integrated Health System

We have audited the financial statements of the business-type activities of the Maricopa County Special Health Care District d/b/a Maricopa Integrated Health System (the District) as of and for the year ended June 30, 2012, which comprise the Maricopa County Special Health Care District d/b/a Maricopa Integrated Health System's basic financial statements and have issued our report thereon dated November 29, 2012. Our report was modified to include a reference to other auditors. We conducted our audit in accordance with auditing standards generally accepted in the United States and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Other auditors audited the financial statements of the Maricopa Health Plan (a division of the District), as described in our report on the District's financial statements. This report does not include the results of the other auditors' testing of internal control over financial reporting or compliance and other matters that are reported on separately by those auditors. The audit of the financial statements of the Maricopa Health Plan, audited by other auditors, was not performed under *Government Auditing Standards*.

Internal Control Over Financial Reporting

Management of the District is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered the District'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 District's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the District'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 entity'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 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.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the District'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 District in a separate letter dated November 29, 2012.

This report is intended solely for the information and use of management, the Board of Directors, others within the entity, federal awarding agencies, and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Ernst & Young LLP

November 29, 2012

Report of Independent Auditors on Compliance With Requirements That Could Have a Direct and Material Effect on Each Major Program and on Internal Control Over Compliance in Accordance With OMB Circular A-133

Management and Board of Directors
Maricopa County Special Health Care District
d/b/a Maricopa Integrated Health System

Compliance

We have audited Maricopa County Special Health Care District d/b/a Maricopa Integrated Health System's (the District) compliance with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) *Circular A-133 Compliance Supplement* that could have a direct and material effect on each of the District's major federal programs for the year ended June 30, 2012. The District's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of the District's management. Our responsibility is to express an opinion on the District's compliance based on our audit.

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

In our opinion, the District complied, in all material respects, with the compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended June 30, 2012.

Internal Control Over Compliance

The management of the District is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered the District's internal control over compliance with the requirements that could have a direct and material effect on a major federal program to determine the auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the District's internal control over compliance.

A *deficiency* in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. A *material weakness* in internal control over compliance is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses, as defined above.

This report is intended solely for the information and use of management, the Board of Directors, others within the entity, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Ernst & Young LLP

February 20, 2013

Supplemental Information

Maricopa County Special Health Care District
d/b/a Maricopa Integrated Health System

Schedule of Expenditures of Federal Awards

Year Ended June 30, 2012

Federal Grantor/Pass-Through Grantor/Program Title/Project Title	CFDA Number	Pass-Through Entity Identifying Number	Federal Expenditures
Direct Awards			
U.S. Department of Health and Human Services:			
Coordinated Services and Access to Research for Women, Infants, Children, and Youth	93.153		$ 659,317
Grants to Provide Outpatient Early Intervention Services with Respect to HIV Disease	93.918		683,478
Research and Development Cluster:			
U.S. Department of Health and Human Services:			
Research on Healthcare Costs, Quality and Outcomes	93.226		56,257
Total Direct Awards			**1,399,052**
Passed Through Awards			
Research and Development Cluster (continued):			
Passed Through Olive View UCLA Education & Research Institute (ERI):			
Clinical Trial for Community-Acquired Methicilin-Resistant			
Staphylococcus Aureus (CA-MRSA) Infections	93.HHSN272200700032C	NIH-NIAID-DMID-07-12	280,032
Passed Through University of Massachusetts, Worcester:			
Mental Health Research Grants	93.242	U01-MH088278	90,183
U.S. Department of Defense:			
Passed Through Translational Genomics Research Institute:			
Military Medical Research and Development	12.420	W81XWH-08-1-0386	61,023
Passed Through Avita Medical Americas, LLC:			
Military Medical Research and Development	12.420	W81XWH-08-2-0032	21,427
Passed Through The American Burn Association:			
Military Medical Research and Development	12.420	W81XWH-09-2-0194	9,177
Total Military Medical Research and Development			91,627
Passed Through Olive View UCLA Education & Research Institute (ERI):			
Centers for Disease Control and Prevention_Investigations and Technical Assistance	93.283	1U01CK000176-01	17,000
Passed Through Arizona Board of Regents for and on behalf of the University of Arizona:			
Extramural Research Programs in the Neurosciences and Neurological Disorders	93.853	3001300049-PIII	29,315
Passed Through University of Pittsburgh – Office of Research:			
Biomedical Research and Research Training	93.859	P50GM076659	32,660
Passed Through Rectors & Visitors of the University of Virginia – Office of Sponsored Programs:			
Biomedical Research and Research Training	93.859	R01GM081510-03	5,250
Total for Biomedical Research and Research Training			37,910
Passed Through University of Pittsburgh – Office of Research:			
Trans-NIH Recovery Act Research Support	ARRA 93.701	P50 GM076659	9,910
Passed Through Arizona Board of Regents for and on behalf of Arizona State University:			
Nursing Research	93.361	R01NR010356	8,382
Total Research and Development Cluster			**620,616**

Maricopa County Special Health Care District
d/b/a Maricopa Integrated Health System

Schedule of Expenditures of Federal Awards (continued)

Federal Grantor/Pass-Through Grantor/Program Title/Project Title	CFDA Number	Pass-Through Entity Identifying Number	Federal Expenditures
Passed Through Maricopa County Department of Human Health:			
HIV Emergency Relief Project Grants	93.914	H89HA00031-12-05/13-02	$ 2,353,245
Cooperative Agreements for State-Based Comprehensive Breast and Cervical Cancer Early Detection Programs	93.919	C86-07-044-2-0	128,247
Total Passed Through Maricopa County Department of Human Health			2,481,492
Passed Through Arizona Department of Health Services:			
National Bioterrorism Hospital Preparedness Program	93.889	HR954027	237,064
National Bioterrorism Hospital Preparedness Program	93.889	ADHS11-003886	31,362
Total National Bioterrorism Hospital Preparedness Program			268,426
Maternal and Child Health Services Block Grant to the States	93.994	HG761224	240,960
Epidemiologic Research Studies of Acquired Immunodeficiency Syndrome (AIDS) and Human Immunodeficiency Virus (HIV) Infection in Selected Population Groups	93.943	10-10138	258,767
HIV Prevention Activities_Health Department Based	93.940	10-10139	51,993
Total Passed Through Arizona Department of Health Services			820,146
U.S. Department of Transportation			
Passed Through National Highway Traffic Safety Administration:			
State and Community Highway Safety	20.600	HS-FY 2012	9,958
Total Passed Through Awards			**3,875,955**
Total Expenditures of Federal Awards			**$ 5,275,007**

See notes to Schedule of Expenditures of Federal Awards

Maricopa County Special Health Care District
d/b/a Maricopa Integrated Health System

Notes to Schedule of Expenditures of Federal Awards

Year Ended June 30, 2012

Note 1

Federal awards expended are reported on the accrual basis of accounting in conformity with accounting principles generally accepted in the United States as described in the notes to the financial statements.

Note 2

Federal expenditures of $5,275,007 are included in the financial statements as grant expenditures.

Note 3

The District received $4,642 in non-cash assistance. The non-cash assistance was received in the form of donated equipment from the Arizona Department of Health Services to be used for hospital preparedness for bioterrorism. The non-cash assistance is reflected in the Schedule of Expenditures of Federal Awards as part of the $237,064 in federal expenditures for CFDA 93.889.

Maricopa County Special Health Care District
d/b/a Maricopa Integrated Health System

Schedule of Findings and Questioned Costs

Year Ended June 30, 2012

Part I—Summary of auditor's results

Financial statements section

Type of auditor's report issued (unqualified, qualified, adverse, or disclaimer):	Unqualified

Internal control over financial reporting:

Material weakness(es) identified?	______	**Yes**	X	**No**
Significant deficiency(ies) identified?	______	**Yes**	X	**none reported**
Noncompliance material to financial statements noted?	______	**Yes**	X	**No**

Federal awards section

Internal control over major programs:

Material weakness(es) identified?	______	**Yes**	X	**No**
Significant deficiency(ies) identified?	______	**Yes**	X	**none reported**

Type of auditor's report issued on compliance for major programs (unqualified, qualified, adverse, or disclaimer):	Unqualified

Any audit findings disclosed that are required to be reported in accordance with section .510(a) of OMB Circular A-133?	______	**Yes**	X	**No**

Identification of major programs:

CFDA number(s)	Name of federal program or cluster
93.153	Coordinated Services and Access to Research for Women, Infants, Children, and Youth
93.914	HIV Emergency Relief Project Grants

Dollar threshold used to distinguish between Type A and Type B programs: $ 300,000

Auditee qualified as low-risk auditee? ______ **Yes** __X__ **No**

Part II—Financial statement findings section

This section identifies the significant deficiencies, material weaknesses, fraud, illegal acts, violations of provisions of contracts and grant agreements, and abuse related to the financial statements for which *Government Auditing Standards* require reporting in a Circular A-133 audit.

None noted.

Part III—Federal award findings and questioned costs section

This section identifies the audit findings required to be reported by Circular A-133 section .510(a) (for example, material weaknesses, significant deficiencies, and material instances of noncompliance, including questioned costs), as well as any abuse findings involving federal awards that are material to a major program.

None noted.

2011-01

Federal program information:	CFDA No. 93.889 – National Bioterrorism Hospital Preparedness Program Compliance finding related to timely payout of funds received for program purposes.
Criteria or specific requirement (including statutory, regulatory, or other citation):	CFR PART 85.20 (7), cash management, states that "Procedures for minimizing the time elapsing between the transfer of funds from the U.S. Treasury and disbursement by grantees and subgrantees must be followed whenever advance payment procedures are used. Grantees must establish reasonable procedures to ensure the receipt of reports on subgrantees' cash balances and cash disbursements in sufficient time to enable them to prepare complete and accurate cash transactions reports to the awarding agency. When advances are made by letter-of-credit or electronic transfer of funds methods, the grantee must make drawdowns as close as possible to the time of making disbursements. Grantees must monitor cash drawdowns by their subgrantees to assure that they conform substantially to the same standards of timing and amount as apply to advances to the grantees."
Condition:	The State of Arizona has advanced monies to Maricopa Integrated Health System (the District) to pay for future grant program expenditures. Although the District has placed the federal fund advances in a separate interest bearing account, the District has not expended the monies in a manner to minimize the time elapsing between the transfer and expenditure of the funds. The funds received by the State of Arizona are in excess of an amount needed by the District to meet immediate cash needs to carry out the grant program.
Questioned costs:	None.

Auditee status update:	The State of Arizona dictates both the payment mechanism and the timing of the payments relating to the program. The District has entered into an arrangement with the funding agency in fiscal year 2013 such that the funding agency will remit funds every six months. This arrangement will defer the timing of when the District will be reimbursed until after expenditures are incurred to ensure that the District is able to maintain compliance with the CFR PART 85.20 (7).

2010-01

Federal program information:	CFDA No. 93.889 – National Bioterrorism Hospital Preparedness Program Internal control weakness and noncompliance over the equipment process at the District related to the physical inventory of equipment and reconciliation to equipment records.
Criteria or specific requirement (including statutory, regulatory, or other citation):	2 CFR 215.34(f)(3) states that, "A physical inventory of equipment shall be taken and the results reconciled with the equipment records at least once every two years. Any differences between quantities determined by the physical inspection and those shown in the accounting records shall be investigated to determine the causes of the difference. The recipient shall, in connection with the inventory, verify the existence, current utilization, and continued need for the equipment."

Condition:	The District is responsible for maintaining appropriate equipment records, including documentation of physical inventory of equipment. During our testing over equipment, we noted that the District performed a physical inventory of equipment during the year, but did not maintain appropriate documentation to support the actual performance of the physical inventory or the reconciliation of the physical inventory with the equipment records, as required under 2 CFR 215.34.
Questioned costs:	None.
Auditee status update:	Corrective action plan has been implemented.

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