

**CENCAL HEALTH**  
**THE REGIONAL**  
**HEALTH AUTHORITY**  
JUNE 30, 2011 AND 2010  
FINANCIAL STATEMENTS



**BARTLETT, PRINGLE & WOLF, LLP**  
CERTIFIED PUBLIC ACCOUNTANTS AND CONSULTANTS

**CenCal Health**  
**The Regional Health Authority**

---

**TABLE OF CONTENTS**

	<u>Page</u>
Independent Auditors' Report.....	1 - 2
Management's Discussion and Analysis.....	3 - 9
Balance Sheets .....	10
Statements of Revenues, Expenses and Changes in Net Assets .....	11
Statements of Cash Flows.....	12
Notes to the Financial Statements.....	13 - 24
Additional Information:	
Schedule 1 - Schedule of Revenues and Expenses per Member per Month.....	25
Schedule 2 - Schedule of Medical Related Expenses – Actual and Budget .....	26
Schedule 3 - Schedule of General and Administrative Expenses – Actual and Budget .....	27
Independent Auditors' Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards.....	28 – 29
Schedule of Findings and Responses.....	30



BARTLETT, PRINGLE & WOLF, LLP  
CERTIFIED PUBLIC ACCOUNTANTS AND CONSULTANTS

October 4, 2011

## **INDEPENDENT AUDITORS' REPORT**

### **To the Board of Directors of CenCal Health**

We have audited the accompanying balance sheets of CenCal Health - The Regional Health Authority (CenCal Health) as of June 30, 2011 and 2010, and the related statements of revenues, expenses and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of CenCal Health's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of CenCal Health at June 30, 2011 and 2010, and the results of its operations, changes in net assets and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 4, 2011, on our consideration of CenCal Health'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 internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Management's discussion and analysis on pages 3 through 9 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. This supplementary information is the responsibility of CenCal Health's management. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit such information and we do not express an opinion on it.

Our audit was conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The additional information included on pages 25 to 27 is presented for the purpose of additional analysis and is not a required part of the basic financial statements. This additional information is the responsibility of CenCal Health's management. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects when considered in relation to the basic financial statements taken as a whole.

*Bartlett, Pringle & Wolf, LLP*

# **CENCAL HEALTH, THE REGIONAL HEALTH AUTHORITY**

## **MANAGEMENT'S DISCUSSION AND ANALYSIS**

---

The management discussion and analysis of CenCal Health, The Regional Health Authority ("CenCal Health") is intended to provide readers and interested parties with an overview of the organization's financial activities for the fiscal years ended June 30, 2011 and 2010. It should be reviewed in conjunction with CenCal Health's financial statements and accompanying notes to enhance the reader's understanding of CenCal Health's financial performance.

### **ORGANIZATION**

CenCal Health is an independent public agency organized by the County of Santa Barbara and the County of San Luis Obispo to operate a capitated, or prepaid, health care system for residents of both counties. CenCal Health was originally established in Santa Barbara County, but during 2005-06, services were expanding into San Luis Obispo County for the Healthy Kids and Healthy Families programs; and the Medi-Cal program in March of 2008. CenCal Health administers and operates the following health care programs: Medi-Cal (Santa Barbara Health Initiative "SBHI" and San Luis Obispo Health Initiative "SLOHI"), Access to Infants and Mothers ("AIM"), Healthy Families Program ("HFP"), Healthy Kids ("HK"), In-Home Support Services Healthcare ("IHSS"), and Multipurpose Senior Service Program ("MSSP").

### **OVERVIEW OF THE FINANCIAL STATEMENTS**

This annual report consists of three parts: management's discussion and analysis, financial statements, and additional information. The financial statements include notes that explain in more detail some of the information presented in the financial statements.

### **REQUIRED FINANCIAL STATEMENTS**

The financial statements of CenCal Health report financial information about CenCal Health using accounting methods in accordance with accounting principles generally accepted (GAAP) in the United States of America and governmental accounting and financial reporting standards.

The balance sheet includes CenCal Health's assets and liabilities, and provides information about the nature and amounts of investments in resources (assets) and the obligations to CenCal Health's creditors (liabilities). It also provides the basis for evaluating the capital structure and assessing the liquidity and financial flexibility of CenCal Health.

Revenues and expenses are accounted for in the statement of revenue, expenses and changes in net assets. This statement measures the success of CenCal Health's operations over the past year and can be used to determine whether CenCal Health has successfully recovered all its costs through its capitation from the State of California, insurance premiums, other revenue sources, and the investment of funds.

The final required financial statement is the statement of cash flows. The primary purpose of this statement is to provide information about CenCal Health's cash receipts and cash payments during the reporting period. The statement reports cash receipts, cash payments, and net changes in cash resulting from operations, capital and related financing and investing activities, and provides answers to questions such as, where did the cash come from, what was the cash used for, and what was the change in the cash balance during the year?

**CENCAL HEALTH, THE REGIONAL HEALTH AUTHORITY**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS**

**FINANCIAL ANALYSIS OF CENCAL**

**Financial Highlights**

The following are the significant highlights of CenCal Health's financial performance for the fiscal year ended June 30, 2011, representing fluctuations from June 30, 2010 to June 30, 2011:

- Combined financial results from all programs and activities show a year-to-date gain of \$6.7 million compared to the anticipated flexible budget surplus of \$886,000.
- Net assets increased by \$6.7 million or 47%.
- Operating revenues increased 27% from \$292.5 million to \$371.3 million.
- Operating expenses increased 22% from \$299.1 million to \$364.8 million. Within this amount, medical related expenses increased 23% from \$276.6 million to \$339.2 million and general and administrative expenses increased 14% from \$22.5 million to \$25.6 million.
- Available cash and cash equivalents increased 131% from \$20.5 million to \$47.5 million.
- Member enrollment increased by 3,895 resulting in 105,309 covered lives as of June 30, 2011.

**Net Assets**

Over time, increases or decreases in CenCal Health's net assets are one indicator of whether its financial health is improving or deteriorating. However, other non-financial factors such as changes in economic conditions, population growth, and new or changed government legislation should also be considered for such analysis. A summary of CenCal Health's balance sheet is presented in Table A-1.

**Table A-1**  
**Condensed Balance Sheet**  
(In millions)

	FY 2011	FY 2010	FY 2009	2011-2010 Variance		2010-2009 Variance	
				Dollar Change	Percent Change	Dollar Change	Percent Change
<b>Assets:</b>							
Current and other assets	\$ 74.8	\$ 57.3	\$ 70.4	\$ 17.5	30.5%	\$ (13.1)	-18.4%
Capital assets	1.0	0.7	0.7	0.3	42.9%	0.0	0.0%
<b>Total assets</b>	<b>75.8</b>	<b>58.0</b>	<b>71.1</b>	<b>17.8</b>	<b>30.7%</b>	<b>(13.1)</b>	<b>-18.4%</b>
<b>Liabilities:</b>							
Medical claims payable	39.8	33.0	42.0	6.8	20.6%	(9.0)	-21.4%
Other liabilities	15.1	10.8	8.6	4.3	39.8%	2.2	25.6%
<b>Total liabilities</b>	<b>54.9</b>	<b>43.8</b>	<b>50.6</b>	<b>11.1</b>	<b>25.3%</b>	<b>(6.8)</b>	<b>-13.4%</b>
<b>Net Assets:</b>							
Invested in capital assets	1.0	0.7	0.7	0.3	42.9%	0.0	0.0%
Unrestricted	19.6	13.2	19.5	6.4	48.5%	(6.3)	-32.3%
Restricted	0.3	0.3	0.3	0.0	0.0%	0.0	0.0%
<b>Total net assets</b>	<b>20.9</b>	<b>14.2</b>	<b>20.5</b>	<b>6.7</b>	<b>47.2%</b>	<b>(6.3)</b>	<b>-30.7%</b>
<b>Total liabilities and net assets</b>	<b>\$ 75.8</b>	<b>\$ 58.0</b>	<b>\$ 71.1</b>	<b>\$ 17.8</b>	<b>30.7%</b>	<b>\$ (13.1)</b>	<b>-18.4%</b>

**CENCAL HEALTH, THE REGIONAL HEALTH AUTHORITY**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS**

---

**Current and other assets** increased by \$17.5 million as a result of the following significant events:

- Actual cash inflows were higher than the cash outflows for operations and CenCal recorded an additional receivable of \$9.3 million for the hospital fee. The hospital fee was established under Assembly Bill 1653 and Senate Bill 90, authorizing the State to assess a fee on California hospitals to generate new matching federal funds for the Medi-Cal program which are then reinvested into hospital payments via the managed care plans.

**Capital assets** increased by approximately \$300,000 primarily due to costs associated with leasehold improvements on new building.

**Medical claims liabilities** increased by \$6.8 million due to timing of provider payments at year end.

**Other liabilities** increased by \$4.3 million as a result of the following:

- An increase of \$9.3 million due to a liability for the hospital fee which is to be distributed to hospitals upon receipt of the capitation payments from the State.
- A decrease of \$3.1 million due to a liability recorded last year for a retroactive decrease in 09/10 State capitation rates.
- A decrease of \$1.1 due to liabilities recorded in the prior year for a provider agreement and legal fees.

While the balance sheet shows the change in financial position of net assets, the statement of revenue, expenses and changes in net assets provides answers as to the nature and scope of these changes. Table A-2 indicates the increase in net assets during 2011 is attributable to income exceeding expenses by \$6.7 million.

**CENCAL HEALTH, THE REGIONAL HEALTH AUTHORITY**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS**

**TABLE A-2**  
**Condensed Statements of Revenues,**  
**Expenses and Changes in Net Assets**  
(In millions)

	FY 2011	FY 2010	FY 2009	2011-2010 Variance		2010-2009 Variance	
				Dollar Change	Percent Change	Dollar Change	Percent Change
<b>REVENUES:</b>							
Capitation and premiums	\$ 371.2	\$ 292.4	\$ 269.9	\$ 78.8	26.9%	\$ 22.5	8.3%
Other revenue	0.1	0.1	0.2	0.0	0.0%	(0.1)	-50.0%
Interest income	0.2	0.3	1.0	(0.1)	-33.3%	(0.7)	-70.0%
<b>Total revenues</b>	<b>371.5</b>	<b>292.8</b>	<b>271.1</b>	<b>78.7</b>	<b>26.9%</b>	<b>21.7</b>	<b>8.0%</b>
<b>EXPENSES:</b>							
Medical related	339.2	276.6	248.2	62.6	22.6%	28.4	11.4%
General and administrative	25.6	22.5	17.9	3.1	13.8%	4.6	25.7%
<b>Total expenses</b>	<b>364.8</b>	<b>299.1</b>	<b>266.1</b>	<b>65.7</b>	<b>22.0%</b>	<b>33.0</b>	<b>12.4%</b>
<b>Revenues greater (less) than expenses</b>	<b>6.7</b>	<b>(6.3)</b>	<b>5.0</b>	<b>13.0</b>	<b>206.3%</b>	<b>(11.3)</b>	<b>226.0%</b>
<b>Beginning - net assets</b>	<b>14.2</b>	<b>20.5</b>	<b>15.5</b>	<b>(6.3)</b>	<b>-30.7%</b>	<b>5.0</b>	<b>32.3%</b>
<b>Ending - net assets</b>	<b>\$ 20.9</b>	<b>\$ 14.2</b>	<b>\$ 20.5</b>	<b>\$ 6.7</b>	<b>47.2%</b>	<b>\$ (6.3)</b>	<b>-30.7%</b>

**Capitation and premium revenue** increased \$78.8 million as a result of the following:

- An increase of \$47.6 million for the intergovernmental transfer and hospital fee which is pass-through income to be distributed to the applicable providers.
- An increase of \$28.8 million primarily due to an increase in the capitation rates and membership for the Medi-Cal programs.

**Medical related expenses** increased by \$62.6 million of which \$47.6 million is due to the intergovernmental transfer and the hospital fee. The balance of the increase is primarily due to increases in Medi-Cal membership. On a per member per month basis, the medical expense remained relatively consistent with an increase of less than 1%.

**General and administrative expenses** increased by \$3.1 million, of which, \$1.7 million is attributable to the MCO tax. An additional \$0.7 million was due to increased rent and occupancy costs associated with the move to a new building. There was also an increase of approximate \$0.5 million for annual increases to salaries and wages, and fringe benefits.

**CENCAL HEALTH, THE REGIONAL HEALTH AUTHORITY**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS**

A summary of CenCal Health's per member per month revenue and expenses by health care program is presented in Table A-3.

**TABLE A-3**  
**Program Revenue and Expense**  
**(Per Member Per Month)**

	<b>Fiscal Year 2010-11</b>						
	<b>SBHI</b>	<b>SLOHI</b>	<b>HFP</b>	<b>AIM</b>	<b>IHSS</b>	<b>HK</b>	<b>MSSP</b>
Program revenue	\$ 320.53	\$ 312.60	\$ 100.93	\$ 1,211.08	\$ 368.00	\$ 75.78	\$ 375.79
Medical related	291.27	294.85	83.18	1,283.96	198.08	63.86	105.07
Administrative	21.02	20.83	13.22	13.22	13.22	13.22	248.99
Total program expenses	312.29	315.68	96.40	1,297.18	211.30	77.08	354.06
Revenue greater (less) than program expenses	\$ 8.24	\$ (3.08)	\$ 4.53	\$ (86.10)	\$ 156.70	\$ (1.30)	\$ 21.73
Member months	770,398	349,044	101,103	813	5,181	18,277	2,111
	<b>Fiscal Year 2009-10</b>						
	<b>SBHI</b>	<b>SLOHI</b>	<b>HFP</b>	<b>AIM</b>	<b>IHSS</b>	<b>HK</b>	<b>MSSP</b>
Program revenue	\$ 260.55	\$ 264.09	\$ 95.52	\$ 828.12	\$ 343.53	\$ 77.31	\$ 340.27
Medical related	243.10	259.38	87.65	1,075.26	314.94	71.14	112.00
Administrative	18.74	19.75	13.12	13.12	13.12	13.12	230.06
Total program expenses	261.84	279.13	100.77	1,088.38	328.06	84.26	342.06
Revenue greater (less) than program expenses	\$ (1.29)	\$ (15.04)	\$ (5.25)	\$ (260.26)	\$ 15.47	\$ (6.95)	\$ (1.79)
Member months	738,087	330,008	90,586	773	4,972	18,002	1,987
	<b>Fiscal Year 2008-09</b>						
	<b>SBHI</b>	<b>SLOHI</b>	<b>HFP</b>	<b>AIM</b>	<b>IHSS</b>	<b>HK</b>	<b>MSSP</b>
Program revenue *	\$ 241.35	\$ 257.47	\$ 76.12	\$ 934.16	\$ 335.00	\$ 76.70	\$ 334.85
Medical related	235.38	253.26	88.25	1,135.46	247.01	64.90	79.00
Administrative	16.75	16.86	13.72	13.74	13.72	13.72	225.53
Total program expenses	252.13	270.12	101.97	1,149.20	260.73	78.62	304.53
Revenue greater (less) than program expenses	\$ (10.78)	\$ (12.65)	\$ (25.85)	\$ (215.04)	\$ 74.27	\$ (1.92)	\$ 30.32
Member months	687,918	308,831	55,491	661	4,812	19,227	1,405

\*Note: Does not include the Premium Deficiency Reserve.

**CENCAL HEALTH, THE REGIONAL HEALTH AUTHORITY**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS**

---

**Program revenue** was significantly changed by the following:

- SBHI and SLOHI program revenue increased on a per member per month (“PMPM”) basis due to rate increases from the State, of which, a significant portion was for the intergovernmental transfer and hospital fee pass-through.
- HFP revenue increased by \$5.41 PMPM due to a rate increase effective October 2010.
- AIM increased by \$382.96 PMPM due to a rate increase effective October 2010 and a change in the methodology for capitation in the prior year. The monthly per member per month rate is lower and CenCal Health is reimbursed a rate for the birth. CenCal Health expected the revenue to be higher this year, as more mothers’ enrolled during fiscal year 09-10 gave birth.
- IHSS revenue on a PMPM basis increased due to a rate increase effective April 2010.
- HK remained relatively consistent with the prior year.
- MSSP program revenue increased on a PMPM due to prior year revenue being reduced for a write off of fiscal year 08/09 revenue.

**Medical related** expenses were largely affected by the following:

- SBHI and SLOHI medical expenses on a PMPM basis increased primarily due to the intergovernmental transfer and hospital fee.
- HFP, IHSS, and HK medical expenses decreased due to changes in utilization.
- AIM medical expenses increased due to changes in utilization.
- MSSP medical expenses on a PMPM basis decreased because as enrollment increases, the available pool of funds for services must be distributed between more members.

**Administrative expenses** increased slightly for SBHI and SLOHI primarily due to the increase in the MCO tax associated with the intergovernmental transfer and hospital fee. HFP, HK, AIM and IHSS increased slightly due to costs associated with the move to a new building and salary and benefit increases. MSSP increased due to a salary increase effective March 2010 and annual increases to the cost of benefits.

**CENCAL HEALTH, THE REGIONAL HEALTH AUTHORITY**  
**MANAGEMENT’S DISCUSSION AND ANALYSIS**

---

**SUMMARY OF CASH FLOW ACTIVITIES**

Table A-4 below shows a summary of the major sources and uses of cash and cash equivalents for the current and prior fiscal year. Cash and cash equivalents are considered highly liquid investments.

**TABLE A-4**  
**Summary of Cash Flow Activities**  
**(In millions)**

	FY 2011	FY 2010	FY 2009	2011-10 Change	2010-09 Change
Cash flow from operating activities	\$ 27.5	\$ (23.8)	\$ (4.9)	\$ 51.3	\$ (18.9)
Cash flow from capital and related financing activities	(0.7)	(0.4)	(0.2)	(0.3)	(0.2)
Cash flow from investing activities	0.2	0.3	1.3	(0.1)	(1.0)
Net increase (decrease) in cash and cash equivalents	27.0	(23.9)	(3.8)	50.9	(20.1)
Cash and cash equivalents:					
Beginning of year	20.5	44.4	48.2	(23.9)	(3.8)
End of year	<u>\$ 47.5</u>	<u>\$ 20.5</u>	<u>\$ 44.4</u>	<u>\$ 27.0</u>	<u>\$ (23.9)</u>

There was a significant increase in cash flow provided from operations. CenCal received the June 2011 Medi-Cal capitation payment at the end of June, and in prior years it was received during the month of July.

At year end, the cash on hand was 48 days. CenCal Health’s excess cash funds (the amount above which is needed to meet immediate operational needs) are invested in the State of California’s Local Agency Investment Fund (“LAIF”) and a money market account with Rabobank, which offer competitive market interest rate returns with minimal risk.

**ECONOMIC FACTORS, NEXT YEAR’S BUDGET AND RATES**

CenCal Health has been below the minimum tangible net equity (TNE) required by the Department of Managed Healthcare for the past couple years, however, the additional revenue from rate increases this fiscal year increased the TNE above this minimum threshold by year end.

CenCal Health has received the draft capitation rates for Medi-Cal effective July 1, 2011 which indicate a slight increase; however, these do not include the potential Medi-Cal reductions currently in State budget and pending approval by the Centers for Medicare and Medicaid Services. CenCal’s challenge as it moves into fiscal year 2011-12 includes limiting the impact the statewide Medi-Cal program cuts have on the provider network and members while continuing to build reserves back to a strong financial position.

**CENCAL HEALTH**  
**THE REGIONAL HEALTH AUTHORITY**  
**BALANCE SHEETS**  
**JUNE 30, 2011 and 2010**

<u>ASSETS</u>	<u>2011</u>	<u>2010</u>
<b>CURRENT ASSETS:</b>		
Cash and cash equivalents (Notes 2 and 3)	\$ 47,478,023	\$ 20,534,436
Accounts receivable (Note 2):		
State of California:		
Capitation	22,488,687	30,332,877
Reinsurance	2,056,000	3,306,000
Other - net of allowance for doubtful accounts of \$91,904 and \$90,541 in 2011 and 2010, respectively.	464,021	475,370
Total accounts receivable	25,008,708	34,114,247
Advance payments to providers	6,772	11,364
Prepaid expenses and other assets	426,654	337,531
Total current assets	72,920,157	54,997,578
CAPITAL ASSETS - Net (Note 4)	959,449	718,101
RESTRICTED CERTIFICATE OF DEPOSIT (Note 10)	300,000	300,000
DEPOSITS	168,689	206,272
PREPAID PENSION COST (Note 8)	1,480,418	1,745,567
<b>TOTAL</b>	<b>\$ 75,828,713</b>	<b>\$ 57,967,518</b>
<b><u>LIABILITIES AND NET ASSETS</u></b>		
<b>CURRENT LIABILITIES:</b>		
Accounts payable and accrued expenses	\$ 1,140,967	\$ 5,387,807
Accrued salaries and related benefits	1,726,054	1,924,205
Accrued MCO tax (Note 12)	202,206	256,370
Accrued hospital fee (Note 14)	9,347,975	-
Medical claims payable (Note 5)	39,830,000	32,992,000
Distributions payable (Note 6)	2,664,499	2,912,689
Deferred revenue	-	278,108
Total current liabilities	54,911,701	43,751,179
<b>COMMITMENTS AND CONTIGENCIES (Note 7)</b>		
<b>NET ASSETS:</b>		
Invested in capital assets, net of related debt (Note 2)	959,449	718,101
Restricted (Note 2 and 10)	300,000	300,000
Unrestricted (Note 2)	19,657,563	13,198,238
Total net assets	20,917,012	14,216,339
<b>TOTAL</b>	<b>\$ 75,828,713</b>	<b>\$ 57,967,518</b>

*See accompanying notes*

**CENCAL HEALTH**  
**THE REGIONAL HEALTH AUTHORITY**  
**STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS**  
**YEARS ENDED JUNE 30, 2011 AND 2010**

	<u>2011</u>	<u>2010</u>
OPERATING REVENUES:		
Capitation (Note 2)	\$ 368,029,748	\$ 289,426,895
Premiums	3,242,060	3,053,166
Other	52,183	53,749
	<u>371,323,991</u>	<u>292,533,810</u>
OPERATING EXPENSES:		
Medical Related:		
Physician capitation	12,596,277	14,355,007
Physician fee-for-service	50,307,091	47,659,891
Pharmaceuticals	41,959,008	39,229,337
Hospital services	77,018,696	73,724,291
Long-term care services	90,250,482	82,522,884
Other medical care	19,048,413	18,243,605
Intergovernmental transfer (Note 13)	7,494,972	-
Hospital fee (Note 14)	38,793,148	-
Medical and care management	3,292,504	3,468,214
Medical cost recoveries (Note 2)	(1,578,613)	(2,558,068)
	<u>339,181,978</u>	<u>276,645,161</u>
General and administrative:		
Salaries and fringe benefits	10,955,426	10,451,599
Contract services	2,008,590	1,869,148
Travel and transportation	62,665	69,034
Occupancy	1,905,490	1,141,958
Office supplies and equipment	666,659	986,832
Depreciation and amortization	445,538	356,653
MCO tax expense (Note 12)	8,667,441	7,009,413
Other	934,679	645,661
	<u>25,646,488</u>	<u>22,530,298</u>
Total operating expenses	<u>364,828,466</u>	<u>299,175,459</u>
OPERATING INCOME (LOSS)	6,495,525	(6,641,649)
NON-OPERATING REVENUES - Interest income	<u>205,148</u>	<u>306,645</u>
TOTAL REVENUES GREATER (LESS) THAN EXPENSES	6,700,673	(6,335,004)
NET ASSETS, BEGINNING OF YEAR	<u>14,216,339</u>	<u>20,551,343</u>
NET ASSETS, END OF YEAR	<u>\$ 20,917,012</u>	<u>\$ 14,216,339</u>

*See accompanying notes*

**CENCAL HEALTH**  
**THE REGIONAL HEALTH AUTHORITY**  
**STATEMENTS OF CASH FLOWS**  
**YEARS ENDED JUNE 30, 2011 and 2010**

	<b>2011</b>	<b>2010</b>
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Cash received from capitation and premium arrangements	\$ 375,710,161	\$ 286,374,241
Cash received from other revenue arrangements	415,461	1,339,324
Cash paid for medical related expenses	(326,638,185)	(290,783,585)
Cash paid for general and administrative expenses	(22,064,442)	(20,675,933)
Net cash provided by (used in) operating activities	27,422,995	(23,745,953)
<b>CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:</b>		
Acquisition of property and equipment	(686,886)	(404,833)
Net cash used in capital and related financing activities	(686,886)	(404,833)
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Cash received for interest	207,478	320,118
Net increase (decrease) in cash and cash equivalents	26,943,587	(23,830,668)
Cash and cash equivalents, beginning of year	20,534,436	44,365,104
Cash and cash equivalents, end of year	\$ 47,478,023	\$ 20,534,436
<b>RECONCILIATION OF OPERATING INCOME (LOSS) TO NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES:</b>		
Operating income (loss)	\$ 6,495,525	\$ (6,641,649)
Adjustments to reconcile to net cash provided by (used in) operating activities:		
Amortization of prepaid pension cost	265,149	293,810
Depreciation and amortization	445,538	356,653
Gain on disposal of property and equipment	(2,330)	(250)
Changes in assets and liabilities:		
Accounts receivable - net	9,105,539	(10,950,339)
Advance payments to providers	4,592	(812)
Prepaid expenses and other assets	(89,123)	95,469
Deposits	37,583	(118,066)
Accounts payable and accrued expenses	(4,246,840)	4,146,882
Accrued salaries and related benefits	(198,151)	59,175
Accrued MCO tax	(54,164)	(2,734,600)
Accrued hospital fee	9,347,975	
Medical claims payable	6,838,000	(8,991,000)
Distributions payable	(248,190)	870,202
Deferred revenue	(278,108)	(131,428)
Net cash provided by (used in) operating activities	\$ 27,422,995	\$ (23,745,953)

*See accompanying notes*

# CENCAL HEALTH, THE REGIONAL HEALTH AUTHORITY

## NOTES TO THE FINANCIAL STATEMENTS

---

### Note 1 - Organization

Santa Barbara San Luis Obispo Regional Health Authority dba CenCal Health, The Regional Health Authority (CenCal Health), formerly Santa Barbara Regional Health Authority, is an independent public agency organized by the County of Santa Barbara and the County of San Luis Obispo to operate a Medi-Cal program on a capitated, or prepaid, health care system for residents of Santa Barbara County and San Luis Obispo County. CenCal Health receives approximately 98% of its revenue from this program. In addition to the Medi-Cal program, CenCal Health is contracted with the California Major Risk Medical Insurance Board ("MRMIB") to administer health care for pregnant women (known as the "Access to Infants and Mothers") and for children up to age 18 (known as the "Healthy Families Program"). CenCal Health has contracted with two private 501(c)3 organizations to administer its Healthy Kids programs in Santa Barbara and San Luis Obispo counties, which provide insurance coverage for children under the age of 19 who do not qualify for Medi-Cal or the Healthy Families Program. CenCal Health also administers its In-Home Supportive Services health care program (known as "IHSS") to cover qualifying employees of an employer.

The prepaid system was authorized by legislation in March 1982, and CenCal Health subsequently entered into a contract with the Department of Health Services of the State of California (the "State") that was to expire on June 30, 1986. The contract with the State has been extended annually with the current contract expiring on December 31, 2011.

In 1993, CenCal Health entered into a contract with the MRMIB for the administration of health care of pregnant women. CenCal Health is paid a flat fee for each woman enrolled. This fee provides coverage from her enrollment date up to a maximum of 60 days following delivery.

In 1998, CenCal Health entered into a contract with the MRMIB to administer the Healthy Families Program in Santa Barbara County. This program, which began on July 1, 1998, offers low-cost health benefits to children whose working parents do not qualify for welfare and do not have medical insurance. CenCal Health is contracted to manage this program through June 30, 2011. CenCal Health is paid a flat fee per month per subscriber. The program required CenCal Health to obtain a Knox-Keene license, which it obtained on June 22, 2000. Beginning in fiscal year 2006, the Healthy Families Program extended its services to qualifying residents in the San Luis Obispo County.

In 2008, CenCal Health began operating the Multi-Purpose Senior Service Program (known as "MSSP") in Santa Barbara County. This program is designed to allow frail seniors to remain safely in their homes through social and health care management services that prevent or defer the need for long-term facility care.

### Note 2 - Summary of Significant Accounting Policies

#### A) Basis of Accounting

CenCal Health is a governmental health insuring organization and, accordingly, follows principles as prescribed by the Governmental Accounting Standards Board ("GASB") and the provisions of the American Institute of Certified Public Accountants Audit and Accounting Guide, *Health Care Organizations*. CenCal Health uses the accrual basis of accounting in accordance with provisions for proprietary fund types.

CENCAL HEALTH, THE REGIONAL HEALTH AUTHORITY

NOTES TO THE FINANCIAL STATEMENTS

---

Note 2 - Summary of Significant Accounting Policies (continued)

B) Net Assets

Net assets are classified into three components:

*Invested in capital assets, net of related debt* – This component of net assets consists of capital assets including restricted capital assets, net of accumulated depreciation and reduced by the outstanding balances of any bonds, mortgages, notes or other borrowings, if any, that are attributable to the acquisition, construction, or improvement of those assets.

*Restricted* – This component of net assets consists of constraints placed on net asset use through external constraints imposed by creditors (such as through debt covenants), grantors, contributors, or laws or regulations of other governments or constraints imposed by law through constitutional provisions or enabling legislation.

*Unrestricted* – This component of net assets consists of net assets that do not meet the definition of “restricted” or “invested in capital assets, net of related debt.”

C) Accounting Standards

Pursuant to GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, CenCal Health has elected to apply the provisions of all relevant pronouncements of the Financial Accounting Standards (“FASB”), including those issued after November 30, 1989, that do not conflict with or contradict GASB pronouncements.

D) Cash and Cash Equivalents

Cash and cash equivalents consist of demand deposits, highly liquid securities and investments in the State Treasurer’s Local Agency Investment Fund (“LAIF”), and other short-term, highly liquid securities with original maturities of three months or less. The LAIF is a voluntary program created by statute as an investment alternative for California’s local governments and special districts. The carrying value of cash and cash equivalents approximates the fair value due to their short-term nature.

E) Basis of Accounting for Receivables

Accounts receivable are carried at their estimated collectible amount. Management evaluates receivables for collectibility and records an allowance for any amounts estimated to be uncollectible.

**CENCAL HEALTH, THE REGIONAL HEALTH AUTHORITY**

**NOTES TO THE FINANCIAL STATEMENTS**

---

**Note 2 - Summary of Significant Accounting Policies (continued)**

F) Capital Assets

Capital assets are recorded at historical cost less accumulated depreciation. (See Note 4.) Depreciation is computed on the straight-line method over the estimated useful lives of the various classes of assets or the lease term, whichever is less, as follows:

Office furniture and fixtures	5 years
Computer equipment and software	3 years
Leasehold improvements	5 years or lease term, if less

G) Revenue Recognition

Under the contracts with the State, Medi-Cal and Healthy Families Program revenues are recognized based on the estimated number of eligible enrollees per month, times the contracted monthly capitation rate. Capitation revenues are paid monthly in arrears. Membership adjustments are paid by the State in the month that a member was retroactively eligible for any previous months. Adjustments to revenue due to changes in estimated membership by CenCal Health are recognized currently. Revenue is recorded in the month in which eligible enrollees are entitled to health care services. Under the Access to Infants and Mothers program, revenue is recognized at the per member per month rate received and the rate received for the birth of a child. CenCal Health provides insurance coverage for participants in the In-Home Support Services program and for participants in the Healthy Kids programs and receives insurance premium payments on a monthly basis based on the number of eligible members per month. Under the MSSP program, CenCal Health recognizes the per member per month rate received for direct administrative costs in the month earned and recognizes revenue for the waived services as the expense is incurred. CenCal Health premium revenue received in advance is recorded in deferred revenue.

H) Medical Related Claims Payable and Expenses

CenCal Health pays certain contracting health care providers, mostly primary care physicians, pursuant to capitation arrangements under which a provider agrees to supply all covered services for a monthly fixed fee. Capitation arrangements represent full payment for services and are not subject to retroactive adjustment of claims. CenCal Health withholds 20% to 40% of the monthly capitation payments for an incentive pool. (See Note 6.) For certain services not covered by the capitation fees, providers bill CenCal Health as services are provided to enrollees pursuant to fee-for-service arrangements. Fee-for-service arrangements result in claims by providers that are billed subsequent to services being rendered. Medical claims payable include the liability for claims received and unpaid and a provision for claims incurred but not reported. The provision for claims incurred but not reported is established using a historical analysis of the claims volume and the average time lag between the date the claim is incurred and the date that is reported to CenCal Health.

**CENCAL HEALTH, THE REGIONAL HEALTH AUTHORITY**  
**NOTES TO THE FINANCIAL STATEMENTS**

---

**Note 2 - Summary of Significant Accounting Policies (continued)**

H) Medical Related Claims Payable and Expenses (continued)

Medical cost recoveries consist of reinsurance recoveries and recoveries from third parties and Medicare. Effective July 1, 2009, CenCal Health contracted with a private insurance carrier to cover such costs. Reimbursement amounts are based on the lower of the amount paid by CenCal Health in excess of \$150,000 for MediCal and \$100,000 for all other programs. Beginning July 1, 2010 the reimbursement amounts were increased to \$250,000 for MediCal and remained at \$100,000 for all other programs. Reinsurance recoveries are reported as reductions of medical related expenses.

CenCal Health reassesses the profitability of the Medi-Cal contract for providing health insurance coverage to the members when current operating results or forecasts indicate probable future losses. CenCal Health establishes a premium deficiency reserve in current operations to the extent that the sum of expected future medical costs, claim adjustment expenses, and maintenance costs exceeds related future premiums under contract without consideration of investment income. Losses recognized as a premium deficiency result in a beneficial effect in subsequent periods as operating losses under these contracts are charged to the liability previously established. There were no premium deficiency liabilities recorded at June 30, 2011 and 2010.

I) Restricted Certificate of Deposit

A restricted certificate of deposit of \$300,000 at June 30, 2011 and 2010 is maintained under terms and conditions of CenCal Health's Knox-Keene license.

J) Income Taxes

Taxes on income are not required, as CenCal Health is a special purpose organization created by an act of the California State Legislature.

K) Concentrations of Credit Risk

CenCal Health contracts with the State of California to provide health care services to Medi-Cal eligible recipients under the Santa Barbara Health Initiative ("SBHI") and San Luis Obispo Health Initiative ("SLOHI"). Revenues generated from SBHI and SLOHI contracts accounted for approximately 98% and 96% of total revenues in the years ended June 30, 2011 and 2010, respectively.

**CENCAL HEALTH, THE REGIONAL HEALTH AUTHORITY**  
**NOTES TO THE FINANCIAL STATEMENTS**

---

**Note 2 - Summary of Significant Accounting Policies (continued)**

L) Use of Estimates

The preparation of the financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. CenCal Health's principal areas that include estimates are reinsurance, retroactive capitation receivables, retroactive member months, medical claims payable, and premium deficiency reserve. Actual results could differ from those estimates.

M) Statement of Revenue, Expenses and Changes in Net Assets

All revenues and expenses directly related to the delivery of health care services are included in operating revenues and expenses in the statement of revenue, expenses and changes in net assets. Non-operating revenues and expenses consist of those revenues and expenses that are related to financing and investing types of activities and result from exchange transactions, if any, or investment income.

**Note 3 - Cash and Investments**

At June 30, 2011 and 2010, CenCal Health had the following cash and investments on hand:

	<u>2011</u>	<u>2010</u>
Cash in banks and on hand	\$47,272,239	\$ 16,337,975
Restricted certificate of deposit	300,000	300,000
Local Agency Investment Fund	<u>205,784</u>	<u>4,196,461</u>
Total cash and investments	<u>\$47,778,023</u>	<u>\$ 20,834,436</u>

Investments Authorized by CenCal Health's Investment Policy

CenCal Health's investment policy authorizes investments in only the Local Agency Investment Fund (LAIF), and FDIC insured accounts. CenCal Health's policy does not contain any specific provisions intended to limit exposure to interest rate risk, credit risk and concentration of credit risk.

Custodial Credit Risk

Custodial credit risk for deposits is the risk that, in the event of the failure of a depository financial institution, CenCal Health will not be able to recover its deposits or will not be able to recover collateral securities that are in the possession of an outside party. Deposits are exposed to custodial credit risk if they are uninsured and uncollateralized.

**CENCAL HEALTH, THE REGIONAL HEALTH AUTHORITY**  
**NOTES TO THE FINANCIAL STATEMENTS**

---

**Note 3 - Cash and Investments (continued)**

Custodial Credit Risk (continued)

The California Government Code requires California banks and savings and loans associations to secure CenCal Health's deposits by pledging government securities, which equal at least 110% of CenCal Health's deposits. California law also permits financial institutions to secure CenCal Health's deposits by the pledging of first trust deed mortgage notes in excess of 150% of CenCal Health's deposits. CenCal Health may waive collateral requirements for deposits that are fully insured by the Federal Deposit Insurance Corporation (FDIC).

None of CenCal Health's cash deposits with financial institutions in excess of federal depository insurance limited were held in uncollateralized accounts.

The custodial credit risk for investments is the risk that, in the event of the failure of the issuer of an investment, a government will not be able to recover the value of its investment or collateral securities that are in the possession of another party. Credit risk is measured by the assignment of a rating by a nationally recognized statistical rating organization. The California Government Code and CenCal Health's investment policy do not contain legal or policy requirements that would limit the exposure to custodial credit risk for investments. With respect to investments, custodial credit risk generally applies only to direct investments in marketable securities and does not apply to a local government's indirect investment in securities through the use of mutual funds or government investment pools (i.e., LAIF). As such, investments in LAIF are not rated by a national rating agency.

Investment in Local Agency Investment Fund (LAIF)

LAIF is regulated by the California Government Code under the oversight of the Treasurer of the State of California. The fair value of CenCal Health's investment in this pool is reported in the accompanying financial statements at amounts based on CenCal Health's pro-rata share of the fair value provided by LAIF for the entire LAIF portfolio. The balance available for withdrawal is based on the accounting records maintained by LAIF, which are recorded on the amortized cost basis. LAIF invests some of its portfolio in derivatives. Detailed information on derivative investments held by this pool is not readily available.

Disclosures Relating to Interest Rate Risk

Interest rate risk is the risk that changes in market interest rates will adversely affect the fair value of an investment. Generally, the longer the maturity of an investment, the greater the sensitivity of its fair value to changes in market interest rates. CenCal Health did not have any investments that are considered highly sensitive to changes in interest rates at June 30, 2011 and 2010, as all are short-term in nature.

**CENCAL HEALTH, THE REGIONAL HEALTH AUTHORITY**  
**NOTES TO THE FINANCIAL STATEMENTS**

**Note 4 - Capital Assets**

A summary of changes in capital assets during 2011 and 2010 is as follows:

	<u>Beginning Balance 2011</u>	<u>Additions</u>	<u>Deletions</u>	<u>Ending Balance 2011</u>
Office furniture and fixtures	\$ 1,036,198	\$ 270,337	\$ -	\$ 1,306,535
Computer equipment and software	2,716,134	159,149	(67,593)	2,807,690
Leasehold improvements	<u>591,894</u>	<u>257,400</u>	<u>-</u>	<u>849,294</u>
Total capital assets	4,344,226	686,886	(67,593)	4,963,519
Less accumulated depreciation and amortization	<u>3,626,125</u>	<u>445,538</u>	<u>(67,593)</u>	<u>4,004,070</u>
Net capital assets	<u>\$ 718,101</u>	<u>\$ 241,348</u>	<u>\$ -</u>	<u>\$ 959,449</u>

  

	<u>Beginning Balance 2010</u>	<u>Additions</u>	<u>Deletions</u>	<u>Ending Balance 2010</u>
Office furniture and fixtures	\$ 1,033,855	\$ 9,368	\$ (7,025)	\$ 1,036,198
Computer equipment and software	2,427,884	379,465	(91,215)	2,716,134
Leasehold improvements	<u>575,894</u>	<u>16,000</u>	<u>-</u>	<u>591,894</u>
Total capital assets	4,037,633	404,833	(98,240)	4,344,226
Less accumulated depreciation and amortization	<u>3,354,489</u>	<u>356,653</u>	<u>(85,017)</u>	<u>3,626,125</u>
Net capital assets	<u>\$ 683,144</u>	<u>\$ 48,180</u>	<u>\$ (13,223)</u>	<u>\$ 718,101</u>

**Note 5 - Medical Claims Payable**

Medical claims payable at June 30, 2011 and 2010 comprise the following:

	<u>2011</u>	<u>2010</u>
Claims payable or pending approval	\$ 12,519,847	\$ 3,412,041
Provisions for claims incurred but not yet reported	<u>27,310,153</u>	<u>29,579,959</u>
	<u>\$ 39,830,000</u>	<u>\$ 32,992,000</u>

The cost of health care services is recognized in the period in which it is provided and includes an estimate of the cost of services that have been incurred but not yet reported. CenCal Health estimates accrued claims payable based on historical claims payments and other relevant information. Estimates are continually monitored and reviewed, and as settlements are made or estimates adjusted, differences are reflected in current operations.

**CENCAL HEALTH, THE REGIONAL HEALTH AUTHORITY**

**NOTES TO THE FINANCIAL STATEMENTS**

---

**Note 5 - Medical Claims Payable (continued)**

Such estimates are subject to the impact of changes in the regulatory environment and economic conditions. Given the inherent variability of such estimates, the 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 claims payable is adequate.

The following reconciliation for the years ended June 30, 2011 and 2010 are of accrued claims payable liability:

	<u>2011</u>	<u>2010</u>
Beginning balance	\$ 32,992,000	\$ 41,983,000
Incurred:		
Current	273,046,944	257,372,042
Prior	<u>(1,025,572)</u>	<u>(2,889,407)</u>
Total	<u>272,021,372</u>	<u>254,482,635</u>
Paid:		
Current	235,261,686	226,342,090
Prior	<u>29,921,686</u>	<u>37,131,545</u>
Total	<u>265,183,372</u>	<u>263,473,635</u>
Ending balance	<u>\$ 39,830,000</u>	<u>\$ 32,992,000</u>

**Note 6 - Distributions Payable**

CenCal Health contracts with certain primary care physicians who agree to case manage all medical services provided to members assigned to them. For physicians thus contracted, CenCal Health withholds 20% to 40% of the fixed monthly capitation payment otherwise due to the physicians. The withheld portion plus other amounts included by CenCal Health represent the physician's incentive pool, which is paid out to the physicians based on their ability to meet certain predetermined utilization and quality measures. In accordance with those physician agreements, CenCal Health has accrued distributions payable of \$2,664,499 and \$2,912,689 as of June 30, 2011 and 2010, respectively.

**Note 7 - Commitments and Contingencies**

Legal proceedings may arise from the normal conduct of business, but in the opinion of management and legal counsel, the ultimate dispositions of these matters will not have a materially adverse effect on the financial position of results of operations of CenCal Health.

**CENCAL HEALTH, THE REGIONAL HEALTH AUTHORITY**

**NOTES TO THE FINANCIAL STATEMENTS**

---

**Note 7 - Commitments and Contingencies (continued)**

On April 15, 2010, CenCal Health entered into an agreement to lease new office space in Santa Barbara, California. The initial payment was due on July 1, 2010. The monthly base rent is \$87,136 plus additional amounts for utilities, common area maintenance, taxes and insurance. The base rent is to be adjusted annually by the change in the consumer price index, however it will not be less than 2% or exceed 6% of the then current base rent. The term of the lease is fifteen years, with two options to extend the lease a period of five years each.

The following is a schedule at June 30, 2011, of future minimum lease payments required under operating leases that have initial or remaining non-cancelable lease terms in excess of one year:

2012	\$ 1,444,273
2013	1,411,873
2014	1,279,959
2015	1,279,959
2016	1,279,959
Thereafter	<u>11,519,631</u>
Total minimum lease payments	<u>\$ 18,215,654</u>

Rental expense (which includes office space and various equipment) for the years ended June 30, 2011 and 2010 was \$1,500,008 and \$997,491, respectively.

**Note 8 - Defined Benefit Pension Plan**

Plan Description

CenCal Health contributes to the California Public Employees Retirement System Miscellaneous 2% at 60 Risk Pool, a cost-sharing multiple-employer defined benefit pension plan administered by the California Public Employees Retirement System ("CalPERS"). A menu of benefit provisions, as well as other requirements, is established by State statutes within California Public Employee Retirement Law. CenCal Health selects optional benefit provisions from the benefit menu by contract with CalPERS and adopts those benefits through the Board of Directors' (the "Board") authorization.

CalPERS issues a separate comprehensive annual financial report for the Miscellaneous 2% at 60 Risk Pool. Copies of the annual financial report may be obtained from the CalPERS Executive Office at 400 P Street, Sacramento, California 95814.

All regular CenCal Health employees with greater than 1,000 hours scheduled are eligible to participate in CalPERS. Benefits vest after five years of service. Employees who retire at or after age 50, with five years of credited service, are entitled to an annual retirement benefit, payable monthly for life, in an amount based on the average monthly pay rate during the highest consecutive 36 months of employment that varies from 1.09% at age 50 to a maximum of 2.42% at age 63 for each year of credited service. The system also provides for death and survivor's benefits.

**CENCAL HEALTH, THE REGIONAL HEALTH AUTHORITY**  
**NOTES TO THE FINANCIAL STATEMENTS**

**Note 8 - Defined Benefit Pension Plan (continued)**

Funding Policy

Active plan members in the CenCal Health defined benefit plan (the “Plan”) are required to contribute 7% of their annual covered salary. CenCal Health is required to contribute the actuarially determined remaining amounts necessary to fund the benefits for its employees. The actuarial methods and assumptions used are those adopted by the CalPERS Board of Administration. The required employer contribution rate was 6.90% and 6.73% for fiscal years 2011 and 2010, respectively. The contribution requirements of the Plan’s members are established by State statute, and the employer contribution rate is established and may be amended by CalPERS.

Annual Pension Cost

For the years ended June 30, 2011 and 2010, CenCal Health’s annual pension cost was \$716,769 and \$700,122, respectively. The required contribution for the years ended June 30, 2011 and 2010, was determined as part of the actuarial valuation using the entry-age-normal-actuarial-cost method, with the contributions determined as percentage of pay. The actuarial assumptions included (a) 7.75% investment rate of return (net of administrative expenses); (b) projected salary increases of 3.25% to 14.45% a year compounded annually, depending on age, service, and type of employment, attributable to inflation, and (c) merit increases. Both (a) and (b) include an inflation component of 3.0%. The actuarial value of the Plan’s assets was determined using a technique that smoothes the effect of short-term volatility in the market value of investments over a three-year period.

During 2006, CenCal Health deposited \$3,071,315 with CalPERS to fully fund the unfunded actuarial accrued liability (UAAL). The remaining amortization period at June 30, 2011 was 6 years. A total of \$1,480,418 and \$1,745,567 of net pension assets, which represents the deposit, is included as a prepaid expense on the balance sheet at June 30, 2011 and 2010, respectively.

Three-year trend information for CalPERS:

Fiscal Year Ended June 30,	Annual Pension Cost (APC)	Percentage of APC Contributed	Net Pension Obligation
2009	\$ 714,479	75.28%	\$ 451,069
2010	700,122	81.82%	578,350
2011	716,769	97.75%	594,507

**Note 9 - Deferred Compensation Plan**

CenCal Health offers its employees a deferred compensation plan created in accordance with the Internal Revenue Code Section 457. The plan, available to employees at their option, permits participants to defer a portion of their salary until future years. The deferred compensation is not available to participants until termination, retirement, death or unforeseeable emergency. All amounts of compensation deferred under the plan, all property and rights purchased with those amounts, and all income attributable to those amounts, property, or rights are maintained (until paid or made available to the participant or beneficiary) in a trust account administered by State Street Bank and Trust. Participants have sole rights under the plan in an amount equal to the fair market value of the deferred account for each participant.

# CENCAL HEALTH, THE REGIONAL HEALTH AUTHORITY

## NOTES TO THE FINANCIAL STATEMENTS

---

### Note 10 - Regulatory Requirements

Under the California Knox-Keene Health Care Service Plan Act of 1975, as amended, CenCal Health must comply with certain minimum capital or tangible net equity requirements. CenCal Health's net worth exceeded the minimum requirement at June 30, 2011 and 2010. Additionally, CenCal Health must maintain minimum investment amounts for the restricted use of the regulators, which totaled \$300,000 at June 30, 2011 and 2010.

### Note 11 - Related Party Transactions

The Foundation of Santa Barbara Regional Health Authority (the Foundation) is a non-profit corporation established to solicit contributions from the general public and to administer the Healthy Kids of Santa Barbara program (HKSB) on behalf of the CenCal Health. Unrestricted funds are distributed to CenCal Health as determined by the Foundation's Board of Directors. Funds restricted for the purpose of premium revenue for HKSB are distributed to CenCal Health based on the number of members per month.

The Foundation distributed \$918,636 and \$876,822 in premium revenue for HKSB to CenCal Health during the years ended June 30, 2011 and 2010, respectively. CenCal Health provides certain management services to the Foundation. These services include administration, finance and accounting services. The total amounts charged to the Foundation for these services was \$49,648 and \$46,572 in 2011 and 2010, respectively.

CenCal Health's Board of Directors consists primarily of medical care providers for whom CenCal Health has executed reimbursement contracts for providing medical services to CenCal Health members. The following represent the three largest financial provider contracts whom directly or indirectly through assigned representative are members of CenCal Health's Board of Directors:

- The President of Marian Medical Center became a member of the Board of Directors during the fiscal year ending June 30, 2010. Payments to Marian Medical Center for medical services were \$16,440,089 and \$16,392,216 during the years ended June 30, 2011 and 2010, respectively.
- The Chief Executive Officer of Lompoc Healthcare District was a member of the Board of Directors during a portion of the year ended June 30, 2010. CenCal Health made payments to Lompoc Healthcare District for medical services in the amount of \$9,584,066 during the year ended June 30, 2010.
- A member of the Board of Directors is the Public Health Officer for the Public Health Department of Santa Barbara County. CenCal Health made payments to the Public Health Department of Santa Barbara County for medical services in the amount of \$3,083,132 and \$2,540,469 during the years ended June 30, 2011 and 2010, respectively.
- The Chief Executive Officer of Twin Cities Community Hospital became a member of the Board of Directors during the fiscal year ending June 30, 2010. Payments to Twin Cities Community Hospital were \$4,787,878 and \$4,701,415 during the years ended June 30, 2011 and 2010, respectively.

**CENCAL HEALTH, THE REGIONAL HEALTH AUTHORITY**

**NOTES TO THE FINANCIAL STATEMENTS**

---

**Note 12 - Managed Care Organization Taxes**

In September 2009, the state of California approved a provider tax, or intergovernmental transfer, on Managed Care Organizations (MCO). The provider tax will be assessed at 2.35% on all Medi-Cal managed care plans and is effective retroactively to January 1, 2009. The state of California will use the proceeds from the tax to draw down the corresponding federal match on Medicaid related dollars. The Department of Health Care Services/Medical Managed Care Division adjusted capitation rates retroactively to January 1, 2009 in order to offset the provider tax. The MCO tax for the years ended June 30, 2011 and 2010 was \$8,667,441 and \$7,009,413, respectively.

**Note 13 - Intergovernmental Transfer**

During the year ending June 30, 2011 CenCal Health acted as an intermediary for two intergovernmental transfers (IGT) with Lompoc Valley Medical Center and the Santa Barbara County Department of Health Services. An IGT is where a local entity puts forth the state's share of matching funds for the Medicaid program in order to draw down federal Medicaid matching funds. During fiscal year ended June 30, 2011, CenCal Health received and distributed a total of \$7,494,972.

**Note 14 - Hospital Fee**

During the year ending June 30, 2011, the state of California established a hospital fee through Assembly Bill 1653 and Senate Bill 90, authorizing the State to assess a fee on California hospitals to generate new matching federal funds for the Medi-Cal program which are then reinvested into hospital payments via the managed care plans. The hospital fee for the year ended June 30, 2011 was \$38,793,148.

**Note 15 - Subsequent Events**

Subsequent events have been evaluated through October 4, 2011, the date that the financial statements were available to be issued.

ADDITIONAL INFORMATION

**CENCAL HEALTH**  
**THE REGIONAL HEALTH AUTHORITY**  
**SCHEDULE OF REVENUES AND EXPENSES PER MEMBER PER MONTH**  
**YEARS ENDED JUNE 30, 2011 AND 2010**

	2011		2010	
	Per Member Per Month *	As a Percentage of Capitation / Premium Revenue	Per Member Per Month **	As a Percentage of Capitation / Premium Revenue
<b>REVENUES:</b>				
Capitation/Premiums	\$ 297.75	100.00%	\$ 246.92	100.00%
Interest income	0.16	0.05%	0.26	0.11%
Other	0.04	0.01%	0.05	0.02%
Total revenues	297.95	100.06%	247.23	100.13%
<b>EXPENSES:</b>				
Medical related:				
Primary care provider - capitation	10.10	3.39%	12.12	4.91%
Physician fee-for-service	40.34	13.55%	40.24	16.30%
Pharmaceuticals	33.65	11.30%	33.12	13.41%
Hospital inpatient services	47.95	16.10%	49.34	19.98%
Hospital outpatient services	13.82	4.64%	12.90	5.22%
Long-term care services	72.38	24.31%	69.67	28.22%
Home health care	2.40	0.81%	2.29	0.93%
Laboratory services	2.13	0.72%	2.20	0.89%
Medical supplies and equipment	4.08	1.37%	3.65	1.48%
Other health care	6.67	2.24%	7.26	2.94%
Intergovernmental transfer	6.01	2.02%	-	0.00%
Hospital fee	31.11	10.45%	-	0.00%
Medical and care management	2.64	0.89%	2.93	1.19%
Medical cost recovery	(1.27)	-0.43%	(2.16)	-0.87%
Total medical related	272.01	91.36%	233.56	94.60%
General and administrative:				
Salaries and fringe benefits	8.79	2.95%	8.82	3.57%
Contract services	1.61	0.54%	1.58	0.64%
Travel and transportation	0.05	0.02%	0.06	0.02%
Occupancy	1.53	0.51%	0.96	0.39%
Office supplies and minor equipment	0.53	0.18%	0.83	0.34%
Depreciation and amortization	0.36	0.12%	0.30	0.12%
MCO tax expense	6.95	2.33%	5.92	2.40%
Other	0.75	0.25%	0.55	0.22%
Total general and administrative	20.57	6.90%	19.02	7.70%
Total expenses	292.58	98.26%	252.58	102.30%
REVENUES GREATER THAN (LESS THAN) EXPENSES	\$ 5.37	1.80%	\$ (5.35)	-2.17%

\* 1,246,927 estimated member months

\*\* 1,184,537 member months

**CENCAL HEALTH**  
**THE REGIONAL HEALTH AUTHORITY**  
**SCHEDULE OF MEDICAL RELATED EXPENSES - ACTUAL AND BUDGET**  
**YEAR ENDED JUNE 30, 2011**

	<b>2011</b>		
	<b>Actual</b>	<b>Budgeted</b>	<b>Variance Over (Under) Budget</b>
<b>MEDICAL RELATED EXPENSES:</b>			
Primary care provider - capitation	\$ 12,596,277	\$ 12,469,509	\$ 126,768
Physician fee-for-service	50,307,091	49,683,457	623,634
Pharmaceuticals	41,959,008	41,962,296	(3,288)
Hospital inpatient services	59,791,358	61,598,341	(1,806,983)
Hospital outpatient services	17,227,338	17,081,959	145,379
Skilled nursing facility	82,294,178	79,172,431	3,121,747
Intermediate care facility	7,956,304	8,746,392	(790,088)
Home health care	2,988,589	2,947,382	41,207
Laboratory services	2,662,022	2,796,687	(134,665)
Optometric services	800,175	870,922	(70,747)
Audiology services	543,249	583,706	(40,457)
Physical and speech therapies	369,766	354,168	15,598
Medical transportation	2,300,415	2,254,389	46,026
Medical supplies and equipment	5,085,759	4,762,847	322,912
Other health care	4,298,438	5,530,244	(1,231,806)
Intergovernmental transfer	7,494,972	7,494,972	-
Hospital fee	38,793,148	38,793,148	-
Medical and care management	3,292,504	3,744,081	(451,577)
Medical cost recovery	(1,578,613)	1,387,158	2,965,771
<b>TOTAL MEDICAL RELATED EXPENSES</b>	<b>\$ 339,181,978</b>	<b>\$ 342,234,089</b>	<b>\$ (3,052,111)</b>

**CENCAL HEALTH**  
**THE REGIONAL HEALTH AUTHORITY**  
**SCHEDULE OF GENERAL AND ADMINISTRATIVE EXPENSES - ACTUAL AND BUDGET**  
**YEAR ENDED JUNE 30, 2011**

	2011		
	Actual	Budgeted	Variance Over (Under) Budget
GENERAL AND ADMINISTRATIVE EXPENSES:			
Salaries and wages	\$ 7,965,214	\$ 8,010,040	\$ (44,826)
Fringe benefits	2,990,212	2,898,243	91,969
Outside services	1,936,005	2,220,500	(284,495)
Legal services	(10,044)	25,000	(35,044)
Auditing services	82,629	65,000	17,629
Travel and transportation	62,665	75,482	(12,817)
Rent	1,410,821	1,444,000	(33,179)
Utilities	227,157	216,000	11,157
Repairs and maintenance	58,236	46,600	11,636
Other occupancy costs	209,276	188,000	21,276
Equipment leases	89,186	85,350	3,836
Office supplies and minor equipment	101,629	96,960	4,669
Postage	259,675	294,050	(34,375)
Printing	216,169	326,030	(109,861)
Depreciation and amortization	445,538	550,000	(104,462)
Insurance	131,780	136,000	(4,220)
Equipment and software maintenance	289,848	256,500	33,348
Dues and subscriptions	127,585	115,360	12,225
Other expenses	385,466	402,645	(17,179)
<b>TOTAL GENERAL AND ADMINISTRATIVE EXPENSES*</b>	<b>\$ 16,979,047</b>	<b>\$ 17,451,760</b>	<b>\$ (472,713)</b>

\* Not including the MCO tax expense.



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

**To the Board of Directors of  
CenCal Health  
Goleta, California**

We have audited the financial statements of CenCal Health - The Regional Health Authority (CenCal Health) as of and for the year ended June 30, 2011 and have issued our report thereon dated October 4, 2011. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

**Internal Control over Financial Reporting**

In planning and performing our audit, we considered CenCal Health'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 CenCal Health's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of CenCal Health's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as described in the accompanying Schedule of Findings and Responses, we identified a certain deficiency in internal control over financial reporting that we consider to be a significant deficiency.

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 a 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.

A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiency described in the accompanying Schedule of Findings and Responses to be a significant deficiency (see 2011-1).

## Compliance and Other Matters

As part of obtaining reasonable assurance about whether CenCal Health'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 CenCal Health in a separate letter dated October 4, 2011.

CenCal Health's responses to the findings identified in our audit are described in the accompanying Schedule of Findings and Responses. We did not audit CenCal Health's responses and, accordingly, we express no opinion on them.

This report is intended solely for the information and use of management, the board of directors, others within the entity and the California Department of Aging and is not intended to be and should not be used by anyone other than those specified parties.

*Bartlett, Prungh + Wolf, LLP*  
October 4, 2011

**CENCAL HEALTH, THE REGIONAL HEALTH AUTHORITY**

**SCHEDULE OF FINDINGS AND RESPONSES**

**For the year ended June 30, 2011**

---

**2011-1 Controls over Cash Disbursements**

*Finding:*

All accounting staff have access to the Vendor Master file, including those that process invoices and generate checks. As a result, a legitimate vendor's information could be changed and a check could be diverted to another address where cash could be easily misappropriated. Access to the Vendor Master file should be limited to one or two people, ideally those who do not have responsibilities for accounts payable or cash disbursements. We also suggest that all changes be approved and monitored.

In addition, one employee is responsible for entering invoices into the accounting system, printing checks, obtaining signatures from check signers, transporting both blank and signed checks to and from the mailroom, completing the proper release forms and transmitting disbursement information to the Junior Accountant. Although CenCal has numerous other controls in place to ensure that cash disbursements are properly authorized, this combination of responsibilities, in conjunction with the access to change vendor information noted above, leaves the opportunity for signed checks to be misappropriated. We suggest that some of the above responsibilities be given to other employees to strengthen controls over cash disbursements.

*Management's Response:*

Access to the Vendor Master file will be limited and all changes will be approved and monitored. In addition, responsibilities related to the cash disbursements process will be further segregated.