INLAND COUNTIES REGIONAL CENTER, INC.

FINANCIAL STATEMENTS

June 30, 2017

INLAND COUNTIES REGIONAL CENTER, INC.

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INDEPENDENT AUDITOR'S REPORT

To the Board of Trustees of
Inland Counties Regional Center, Inc.
San Bernardino, California

Report on the Financial Statements

We have audited the accompanying financial statements of Inland Counties Regional Center, Inc. (the Center), a California nonprofit corporation, which comprise the statement of financial position as of June 30, 2017 and the related statements of activities, functional expenses, and cash flows for the year then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. 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. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our qualified audit opinion.

(Continued)

Basis for Qualified Opinion

As discussed in Note 9, the Center is using an actuarial valuation provided by the California Public Employees' Retirement System (CalPERS) to estimate the Center's unfunded projected pension obligation and related pension expense in the accompanying statement of financial position and statement of activities, respectively, that, in our opinion, does not conform to accounting principles generally accepted in the United States of America (GAAP) under the Financial Accounting Standards Board (FASB) standards. The amounts by which this departure affects the liabilities, net deficit, beginning net deficit, expenses, change in net deficit, and footnote disclosures of the pension obligation of the Center have not been determined as it was not practicable to quantify. Also as discussed in Note 9, the Center has recorded a receivable totaling $13,567,651 from the state that, in our opinion, does not conform to GAAP. If the receivable had not been recorded, total assets would decrease by $13,567,651, beginning net deficit would increase by $12,214,319, post-retirement benefit plan expenses would increase by $1,353,332, and ending net deficit would increase by $13,567,651.

Opinion

In our opinion, except for the effects of the matters described in the Basis for Qualified Opinion paragraph, the financial statements referred to above present fairly, in all material respects, the financial position of the Center as of June 30, 2017, and the changes in its net assets and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards,* we have also issued our report dated April 27, 2018 on our consideration of the Center's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Center's internal control over financial reporting and compliance.

Crowe Horwath LLP

Costa Mesa, California
April 27, 2018

INLAND COUNTIES REGIONAL CENTER, INC.
STATEMENT OF FINANCIAL POSITION
For the year ended June 30, 2017

ASSETS	
Cash and cash equivalents	$ 29,590,457
Cash held for clients	1,538,587
Contracts receivable - state of California	6,292,156
Receivable from Intermediate Care Facility vendors	8,483,896
Other receivables	374,223
Investments	529,279
Investments - Master Trust	22,406,954
Prepaid expenses and other assets	1,370,282
Receivable from State of California - accrued vacation and sick leave benefits	4,855,900
Receivable from State of California - other post-retirement benefits	13,567,651
Total assets	$ 89,009,385
LIABILITIES AND NET ASSETS	
Liabilities	
Accounts payable	$ 39,178,170
Accrued payroll	1,351,189
Due to state	3,885,432
Accrued vacation and sick leave benefits	4,855,901
Obligation for post-retirement benefits, pension	33,829,857
Obligation for other post-retirement benefits	13,567,651
Amounts held for clients	1,487,545
Master Trust obligations	22,406,954
Deferred rent	12,654,453
Other liabilities	7,824,064
Total Liabilities	141,041,216
Net assets (deficit)	
Unrestricted	(52,059,319)
Temporarily restricted	27,488
Total Net Deficit	(52,031,831)
Total liabilities and net assets	$ 89,009,385

The accompanying notes are an integral part of these financial statements.

INLAND COUNTIES REGIONAL CENTER, INC.
STATEMENT OF ACTIVITIES
For the year ended June 30, 2017

Support and revenue	
Contracts - state of California	$ 444,108,656
Intermediate Care Facility supplemental services income	17,675,531
Interest and dividend income	213,461
Contributions and grants	466,599
Realized and unrealized gain on investments	24,997
Other income	575,914
Total unrestricted support and revenue	463,065,158
Net assets released from restriction	247,289
Total support and revenue	463,312,447
Expenses	
Program services	
Direct client services	434,644,688
Supporting services	
General and administrative	29,576,882
Fundraising	122,312
Total expenses	464,343,882
Change in unrestricted net deficit before change in post-retirement benefit plan liabilities	(1,031,435)
Post-retirement benefit plan-related changes	(38,509,488)
Change in unrestricted net deficit after post-retirement benefit plan related changes	(39,540,923)
Change in temporarily restricted net assets	
Contributions	30,699
Net assets released from restriction	(247,289)
Decrease in temporarily restricted net assets	(216,590)
Change in net deficit	(39,757,513)
Net deficit at beginning of year	(12,274,318)
Net deficit at end of year	$ (52,031,831)

The accompanying notes are an integral part of these financial statements.

INLAND COUNTIES REGIONAL CENTER, INC.
STATEMENT OF FUNCTIONAL EXPENSES
For the year ended June 30, 2017

	Program Services	Supporting Services			
	Direct Client Services	General and Administrative	Fundraising	Total Supporting Services	Total Expenses
Salaries	$ 28,464,190	$ 13,327,191	$ -	$ 13,327,191	$ 41,791,381
Employee health and retirement benefits	8,336,058	4,126,225	-	4,126,225	12,462,283
Payroll taxes	459,372	208,328	-	208,328	667,700
Total salaries and related expenses	37,259,620	17,661,744	-	17,661,744	54,921,364
Purchase of services					
Residential care facilities	124,727,114	-	-	-	124,727,114
Day program	139,419,099	-	-	-	139,419,099
Other purchased services	132,345,578	-	-	-	132,345,578
Communication	-	242,453	-	242,453	242,453
Printing	-	3,863	-	3,863	3,863
Data processing	-	781,684	-	781,684	781,684
Insurance	-	220,969	-	220,969	220,969
General expenses	-	1,368,536	122,312	1,490,848	1,490,848
Rent expense	-	8,093,863	-	8,093,863	8,093,863
Equipment and facility maintenance	-	170,578	-	170,578	170,578
Equipment purchases	-	334,451	-	334,451	334,451
Board expenses	-	11,363	-	11,363	11,363
Staff travel	893,277	125,667	-	125,667	1,018,944
Legal fees	-	261,202	-	261,202	261,202
Accounting fees	-	95,620	-	95,620	95,620
Consultant fees	-	98,483	-	98,483	98,483
ARCA dues	-	106,406	-	106,406	106,406
Total expenses	$ 434,644,688	$ 29,576,882	$ 122,312	$ 29,699,194	$ 464,343,882

The accompanying notes are an integral part of these financial statements.

INLAND COUNTIES REGIONAL CENTER, INC.
STATEMENT OF CASH FLOWS
For the year ended June 30, 2017

Cash flows from operating activities	
Change in net deficit	$ (39,757,513)
Adjustments to reconcile change in net deficit to net cash from operating activities	
Post retirement benefit obligation adjustments	38,509,488
Deferred rent	1,101,662
Net realized and unrealized investment loss	(24,997)
Dividends reinvested	12,363
(Increase) decrease in operating assets	
Cash - client trust funds	(11,688)
Contracts receivable - state of California	(3,434,539)
Receivable from Intermediate Care Facility vendors	1,774,872
Other receivables	(152,010)
Investments	233,742
Investments - Master Trust	(412,764)
Prepaid expenses and other assets	3,789,999
Receivable from State of California - accrued vacation and sick leave benefits	(596,317)
Receivable from State of California - other post-retirement benefits	(1,353,332)
Increase (decrease) in operating liabilities	
Accounts payable	4,428,628
Accrued payroll	420,899
Due to state	(982)
Accrued vacation and sick leave benefits	596,318
Obligation for other post-retirement benefits	1,353,332
Accounts held for clients	(31,206)
Master Trust obligations	412,764
Other liabilities	(454,387)
Net cash provided by operating activities	6,404,332
Net change in cash and cash equivalents	6,404,332
Cash and cash equivalents at beginning of year	23,186,125
Cash and cash equivalents at end of year	$ 29,590,457

The accompanying notes are an integral part of these financial statements.

NOTE 1- SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Background Information: Inland Counties Regional Center, Inc. (the Center), was incorporated on August 5, 1971 as a California not-for-profit corporation for the purpose of operating Inland Regional Center and related activities. The Center was organized in accordance with the provisions of the Lanterman Developmental Disabilities Services Act (Act) of the Welfare and Institutions Code of the State of California (the State). In accordance with the Act, the Center provides diagnostic evaluations, client program management, and lifelong planning services for persons with developmental disabilities and their families. The areas served include the Counties of San Bernardino and Riverside.

The Act includes governance provisions regarding the composition of the Center's board of directors. The Act states that the board shall be comprised of individuals with demonstrated interest in, or knowledge of, developmental disabilities, and other relevant characteristics, and requires that a minimum of 50 percent of the governing board be persons with developmental disabilities or their parents or legal guardians; and that no less than 25 percent of the members of the governing board shall be persons with developmental disabilities. In addition, a member of a required advisory committee, composed of persons representing the various categories of providers from which the Center purchases client services, shall serve as a member of the regional center board. To comply with the Act, the Center's board of directors includes persons with developmental disabilities, or their parents or legal guardians, who receive services from the Center and a client service provider of the Center.

The Center contracts with the State Department of Developmental Services (DDS) to operate a regional center for the developmentally disabled and their families. Under the terms of these contracts, the Center’s expenses incurred in the performance of the contracts are compensable. Such expenses are billable and reimbursable under the DDS contract when they are paid. For the 2016-2017 contract year, funded expenditures are not to exceed $456,212,176. Actual net expenditures under the regional center contract for the 2016-2017 contract were $438,892,987 as of June 30, 2017.

As discussed above, the Center operates under contracts with the DDS and is only funded on a cost reimbursement basis as expenses are paid. However, the accounting standards require the Center to recognize and accrue expenses when incurred. The net deficit reported as of June 30, 2017 on the statement of financial position is primarily the result of the accruals of deferred rent, the legal settlement with the DDS, and the obligation for retirement pension benefits. For long-term leases with escalating rental expense, accounting standards require the Center to recognize the total rental expense evenly over the life of the lease. The deferred rent of the Center represents the difference between the cash paid and the rental expense recognized since inception of the lease. Rental expenditures are reimbursable under the DDS contract as they are paid. For retirement pension benefits under a defined benefit plan, accounting standards require the Center to recognize a liability that equals the unfunded projected benefit obligation related to its participation in the CalPERS retirement plan. The obligation for post-retirement pension benefits of the Center represents an unfunded projected benefit obligation based on the actuarial valuation provided by CalPERS. Retirement pension plan expenses are reimbursed under the DDS contract as they are paid.

Basis of Presentation: The Center reports information regarding its financial position and activities according to three classes of net assets: unrestricted, temporarily restricted, and permanently restricted. Accordingly, the net assets of the Center are classified and reported as described below:

Unrestricted Net Assets - Net assets that are neither permanently restricted nor temporarily restricted.

(Continued)

NOTE 1- SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Temporarily Restricted Net Assets - Net assets subject to donor-imposed stipulations that may or will be met either by actions of the Center and/or the passage of time. As the restrictions are satisfied, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the accompanying statements of activities as net assets released from restrictions.

Permanently Restricted Net Assets - Net assets subject to donor-imposed restrictions that the corpus be invested in perpetuity and only the income be made available for program operations in accordance with donor restrictions. Such income generally includes interest, dividends, and realized and unrealized earnings from the corpus. As of June 30, 2017, the Center had no permanently restricted net assets.

Contributions: All contributions are considered to be available for unrestricted use unless specifically restricted by the donor. Contributions received that are designated for future periods or restricted by the donor for specific purposes are reported as temporarily restricted or permanently restricted support that increases those net asset classes. When a donor's stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the statement of activities as net assets released from restrictions. Permanently restricted contributions and net assets have restrictions stipulated by the donor that the corpus be invested in perpetuity and only income be made available for operations.

Unconditional promises to give that are expected to be collected within one year are recorded at their net realizable value. Promises to give that are silent about payment terms but otherwise are clearly unconditional are accounted for as unconditional promises to give. Unconditional promises to give that are expected to be collected in future years are recorded at the present value of their estimated future cash flows. Amortization of the discount to present value is included in contribution revenue. Conditional promises to give are not included as support until the conditions are substantially met.

Use of Estimates and Assumptions: The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America (GAAP) 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. Actual results could differ from those estimates. Principal areas requiring the use of estimates are assumptions utilized for the obligation for post-retirement benefits and the functional allocation of expenses.

Cash and Cash Equivalents and Concentration of Credit Risk: For purposes of the statement of cash flows, the Center considers all highly liquid debt instruments purchased with an original maturity of three months or less to be cash equivalents.

At June 30, 2017 and at various times during the year, the Center maintained cash balances in its financial institutions in excess of federally insured limits.

Investments: Investments in marketable securities with readily determinable fair values and all investments in debt securities are stated at their fair values in the statements of financial position. Unrealized gains and losses are included in the change in net assets in the accompanying statement of activities, except for the Master Trust investments as described in Note 8.

Revenue Recognition: Receivables from the State are recorded on the accrual method as related expenses are incurred. Receivable from Intermediate Care Facility vendors and supplemental services income are recorded on the accrual method as related expenses are incurred.

(Continued)

NOTE 1- SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Other Receivables: Other receivables primarily consist of client support receivables and loans and vendor receivables. Other receivables and loans are recorded when support or loans are granted to clients and when vendor audits have been completed and overpayments have been determined. Other receivables and loans are presented on the statements of financial position net of the allowance for doubtful accounts and are written off when they are determined to be uncollectible. Management determined there was no allowance necessary as of June 30, 2017.

Property and Equipment: Pursuant to the terms of the DDS contract, equipment purchases become the property of the State and, accordingly, are charged as expenses when incurred. There were no assets acquired or held during the fiscal year. For the year ended June 30, 2017, sensitive and nonexpendable equipment purchases totaled $12,862. Equipment owned by the Center is stated at cost and is depreciated on the straight-line method over the estimated useful life of ten years.

The State requires all sensitive and nonexpendable equipment to be tagged and reported annually. Sensitive equipment is defined as having a normal useful life of greater than one year, costing less than $5,000, and being highly desirable or susceptible to theft. Nonexpendable equipment is defined as having a useful life of greater than one year and costing more than $5,000.

Accrued Vacation and Sick Leave Benefits: The Center has accrued a liability and a receivable from the State for leave benefits earned. Such liability and related benefit expenses required to be recognized by the accounting standards are accrued expenses incurred in the performance of the DDS contracts. Such expenses are compensable costs incurred under the terms of the DDS contracts. Such expenses will become billable and reimbursable under the terms of the DDS contracts when they are actually paid to employees.

Post-Retirement Medical Reimbursement Plan: The Center is required to recognize the funded status of the Retirement Medical Reimbursement Plan (RMR Plan), measured as the difference between plan assets at fair value and the benefit obligation, in the statement of financial position, with an offsetting charge or credit to net assets. The Center has accrued a liability for the RMR Plan. Gains or losses and prior service costs or credits that arise during the period but are not recognized as components of net periodic benefit cost will be recognized each year as a separate charge or credit to net assets. Such liability and related benefit expenses required to be recognized by the accounting standards are accrued expenses incurred in the performance of the DDS contracts. Such expenses are compensable costs incurred under the terms of the DDS contracts. Such expenses will become billable and reimbursable under the terms of the DDS contracts only if they are paid. The Center did not contribute to the RMR Plan for the year ending June 30, 2017.

Obligation for Retirement Pension Benefits: The Center is required to recognize the funded status of the California Public Employees' Retirement System (CalPERS) pension plans, measured as the difference between plan assets at fair value and the pension obligation, in the statement of financial position, with an offsetting charge or credit to net assets. The Center has accrued a liability for the CalPERS pension. Such liability and pension expenses required to be recognized by the accounting standards are accrued expenses incurred in the performance of the DDS contracts. Such expenses are compensable costs incurred under the terms of the DDS contracts. Such expenses will become billable and reimbursable under the terms of the DDS contracts when the Center makes an annual contribution to the CalPERS pension plan.

(Continued)

NOTE 1- SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

As discussed further in Note 9, the Center used an actuarial valuation provided by the CalPERS that does not conform to GAAP under the Financial Accounting Standards Board (FASB) standards.

Deferred Rent: The Center leases office facilities under a lease agreement that are subject to scheduled increases of rental payments. The scheduled rent increases are amortized evenly over the life of the lease. The deferred rent liability represents the difference between the cash payments made and the amount expensed since inception of the lease.

Allocation of Functional Expenses: Salaries and related expenses, purchase of services, and travel expenses are allocated to the program and supporting services categories on a direct-cost basis. All other operating expenses are allocated to the supporting services category.

Tax Status: The Center has received tax-exempt status from the Internal Revenue Service and California Franchise Tax Board under Section 50l(c)(3) of the Internal Revenue Code and Section 2370l (d) of the Revenue and Taxation Code, respectively.

The Center recognizes the financial statement benefit of tax positions, such as a filing status of tax-exempt, only after determining that the relevant tax authority would more likely than not sustain the position following an audit. The Center is subject to potential income tax audits on open tax years by any taxing authority in the jurisdiction in which it operates. The statute of limitations for federal and California purposes is generally three and four years, respectively.

Subsequent Events: The Center's management has evaluated subsequent events from the statement of financial position date through April 27, 2018, the date the financial statements were available to be issued for the year ended June 30, 2017, and, except as disclosed in Note 10, determined there are no other items to disclose.

NOTE 2 - STATE CONTRACTS

The Center's major source of revenue is from the State. Each fiscal year, the Center enters into a new contract with the State for a specified funding amount subject to budget amendments. Revenue from the State is recognized monthly when a claim for reimbursement of actual expenses is filed with the State. These reimbursement claims are paid at the State's discretion either through direct payments to the Center or by applying the claims reimbursements against advances already made to the Center.

As of June 30, 2017, the DDS had advanced the Center $113,691,655, under the regional center contracts. For financial statement presentation, to the extent there are claims receivable, these claims have been offset against the advances from the State as follows:

Contracts receivable	$ 119,983,811
Contract advances	(113,691,655)
Net contracts receivable	$ 6,292,156

NOTE 2 - STATE CONTRACTS (Continued)

The Center has renewed its contract with the State for the fiscal year ending June 30, 2018. The contract provides for initial funding of $481,682,365.

In addition, the Center has recorded receivables from the State for compensable costs incurred for accrued vacation and sick leave of $4,855,900, and other post-retirement benefits of $13,567,651 as of June 30, 2017

As discussed further in Note 9, the recognition of the $13,675,651 receivable is not in accordance with GAAP.

The Center's contract with the DDS includes various fiscal provisions, which provide that the State retains all rights, title, and interest to the funds provided by the DDS and that funds received from the DDS may only be used for the purpose of satisfying claims against or expenses of the Center incurred pursuant to and in the performance of its contract with the DDS.

NOTE 3 - RECEIVABLE FROM INTERMEDIATE CARE FACILITY VENDORS

The Centers for Medicare and Medicaid Services (CMS) approved federal financial participation in the funding of day and related transportation services purchased by the Center for consumers who reside in Intermediate Care Facilities (ICFs). CMS agreed that the day and related transportation services are part of the ICF service; however, the federal rules allow for only one provider of the ICF service. Accordingly, all the Medicaid funding for the ICF residents must go through the applicable ICF provider. The Center receives a 1.5% administrative fee based on the funds received to cover the additional workload.

The DDS has directed the Center to prepare billings for these services on behalf of the ICFs and submit a separate state claim report for these services. The Center was directed to reduce the amount of their regular state claim to the DDS by the dollar amount of these services.

Reimbursement for these services will be received from the ICFs. The DDS advances the amount according to the state claim to the ICFs. The ICFs are then required to pass on the payments received, as well as the Center's administrative fee to the Center, within 30 days of receipt of funds from the State Controller's Office.

NOTE 4 - NET ASSETS

The Center uses fund accounting to maintain accountability for various activities. Grants or contributions received in response to specific grant applications or with donor-imposed stipulations that limit the use of the donated assets are considered temporarily restricted.

Temporarily Restricted Net Assets are available for the following purposes:

Another Way Program	$ 19,497
Staff Training	7,991
	$ 27,488

(Continued)

NOTE 4 – NET ASSETS (Continued)

The Unrestricted Net Assets of each fund are generally available for use within that activity. The Regional Center Fund accounts for the funds received from the state contracts. Another Way Program Fund accounts for grants and donations that are received with the understanding and intent that the funds are to be used for the purpose of providing additional funds to support the consumers of the Center, besides the funds received from the state contracts. The General Fund and Master Trust Fund mainly account for trustee fees and administrative support services income collected for the operation of Master Trust of California (Master Trust).

Unrestricted Net Assets (Deficit) consisted of balances in the following funds:

Regional Center Fund	$ (53,048,013)
Another Way Program	411,064
General Fund	484,504
Master Trust Fund	93,126
	$ (52,059,319)

NOTE 5 – LINE OF CREDIT

The Center had a $24,600,000 operating line of credit with a bank which expired on September 30, 2016. The interest rate was fixed at 3.5%. Amounts borrowed on the line of credit were secured by all personal property and assets of the Center. There was no balance outstanding as of June 30, 2017. In March of 2017, the Center executed a revolving loan agreement in the maximum principal amount of $35,000,000, to meet immediate cash needs for the remaining portion of the fiscal year ended June 30, 2017. The current loan agreement is available to the center through September 9, 2017. At June 30, there was no balance outstanding.

NOTE 6 – CASH HELD FOR CLIENTS

The Center functions as custodian for receipt of certain governmental payments and resulting disbursements made to providers, on behalf of regional center clients, for authorized services. The cash balances are segregated from the operating cash accounts of the Center and are restricted for client support. Since the Center is acting as an agent in processing these transactions, no revenue or expense is reflected on the accompanying statement of activities. The following is a summary of the operating cash activity related to cash held for clients during the year ended June 30, 2017:

Social Security and other client support received	$ 18,449,705
Residential care and other disbursements	18,480,910
Disbursements over support	(31,205)
Changes to reconcile support over disbursement (disbursements over support) to net cash for support and care activities:	
Add increase (decrease) in amounts due to the Center	32,909
Add decrease in receivable from state and federal agencies	9,984
Increase (decrease) in cash	11,688
Add cash at beginning of year	1,526,899
Cash at end of year	$ 1,538,587

(Continued)

NOTE 7 – INVESTMENTS

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. GAAP establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements).

The three levels of the fair value hierarchy are described as follows:

Level 1 - Inputs are unadjusted quoted prices for identical assets or liabilities in active markets that the Center has the ability to access.

Level 2 - Inputs other than quoted prices included in Level 1 that are observable for the asset or liability either directly or indirectly.

Level 3 - Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

The fair value measurement level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement in its entirety. Valuation techniques used need to maximize the use of observable inputs and minimize the use of unobservable inputs.

Fair value is determined for each investment security as follows:

International and corporate bonds: Fair values of assets in this security type in markets that are not active are determined using model inputs that are observable either directly or indirectly using historical data from comparable bonds, relative level yield curve, or pricing matrix (Level 2 inputs - income approach).

Municipal bonds and government securities: Fair values of assets in this security type are valued by discounting their underlying assets, combining option pricing and expected cash flows (Level 2 inputs - income approach).

Certificates of deposit: Fair values are estimated to approximate deposit account balances, payable on demand, as no discounts for credit quality or liquidity were determined to be applicable (Level 2 inputs - income approach).

Equities: Fair values reflect the closing price reported in the active market in which the security is traded (Level 1 inputs).

(Continued)

NOTE 7 – INVESTMENTS (Continued)

The following table sets forth by level, with the fair value hierarchy, the Center's investments at fair value as of June 30:

	Total	Quoted Prices in Active Markets for Identical Assets Level 1	Significant Other Observable Inputs Level 2
Mutual FundsQuo	$ 212,500	$ 212,500	$ -
Money Market Funds	187,094	-	187,094
Government Securities	129,685	-	129,685
	$ 529,279	$ 212,500	$ 316,779

There were no investments classified as level three.

Investments at fair value were held as follows:	
Unrestricted	
Another Way Fund	$ 259,037
General Fund	177,116
Master Trust Fund	93,126
Total	$ 529,279

The following schedule summarizes investment income:	
Interest and dividend Income	$213,461
Realized and unrealized gain on investments	24,997
Net investment income	$ 238,458

NOTE 8 – MASTER TRUST PROGRAM

Background: Master Trust of California (Master Trust) was established in 1978 to receive property from individuals or other entities (trustors) to be administered for the benefit of specified developmentally disabled persons (beneficiaries). Property is admitted as a separate trust into Master Trust upon approval of Inland Counties Regional Center, Inc. Trustee through the Master Trust of California Trust Committee; then by direction of a court order, or the execution of a Joinder and Trust Agreement by a Trustor.

Distributions from a trust are made in accordance with the direction of the Master Trust of California Trust Committee. Termination of a Trust Agreement will occur upon the death of the beneficiary, depletion of the trust assets, according to court order, or according to the trust document.

Assets and obligations of the program are shown on the statement of financial position. Operating activities such as capital additions and distributions are not shown in the statement of activities, as the Center is only acting as an agency for the beneficiaries. Operating activities, such as trustee fees and administrative support services, were included in other income and general administrative expense, respectively, in the statement of activities.

(Continued)

NOTE 8 – MASTER TRUST PROGRAM (Continued)

Investments: The following table sets forth by level, within the fair value hierarchy, Master Trust's assets at fair value as of June 30, 2017:

	Cost	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)
International bonds	$ 560,033	$ 553,612	$ -	$ 553,612
Corporate bonds	3,900,300	3,763,714	-	3,763,714
Municipal bonds	3,634,169	3,614,337	-	3,614,337
Government securities	850,182	875,207	-	875,207
Certificates of Deposit	149,475	150,360	-	150,360
Equities	2,804,990	3,674,720	3,674,720	-
Mutual funds	5,822,529	6,037,975	6,037,975	-
Total assets	$ 17,721,678	$ 18,669,925	$ 9,712,695	$ 8,957,230

There were no investments classified as level three.

The following summarizes the maturity of investments with stated maturity dates:

	Fair Value	Cost
Due in one year or less	$ 2,106,159	$ 2,185,944
Due in one to five years	4,983,351	5,001,155
Due in more than five years	1,867,720	1,907,059
Total	$ 8,957,230	$ 9,094,158

Other assets: The Master Trust of California also holds other assets which are classified as investments for the Center: these include:

Pooled cash	$ 985,849
Accrued interest receivable	100,126
Other assets	2,651,054
Total other assets	3,737,029
Investments	18,669,925
Total Investments-Master Trust	$ 22,406,954

Income sources: Trustee fees and administrative support services income of $491,911 are included in other income for the year ended June 30, 2017.

(Continued)

NOTE 9 – EMPLOYEE RETIREMENT BENEFITS

Post-Retirement Benefits Other Than Pensions

The Center instituted an unfunded Retiree Medical Reimbursement Plan (RMR Plan), effective July 1, 1988. The RMR Plan was established to provide reimbursement of medical expenses for the medical care of each participant and eligible dependents up to their maximum yearly allowance. An employee of the Center who meets certain age and length of service requirements becomes a participant of the RMR Plan upon separation from service. Investments are maintained in an irrevocable trust for the RMR Plan from funds set aside in previous years. The Center did not contribute to the RMR Plan assets for the year ending June 30, 2017.

The Center has the right to amend the RMR Plan at any time. The RMR Plan and its obligations will terminate when the assets in the plan are completely spent. The Center uses a June 30 measurement date.

Reconciliation of Benefit Obligations: The following tables provide a reconciliation of the changes in the plan's benefit obligations and a statement of the funded status as of June 30, 2017:

Change in benefit obligation	
Benefit obligation at beginning of year	$ 14,431,000
Service cost	363,745
Interest cost	780,400
Actuarial gain	387,680
Benefits paid	(354,825)
Obligation at end of year	15,608,000
Change in plan assets	
Fair value of plan assets at beginning of year	2,216,681
Actual return on plan assets	201,913
Expenses other than benefits	(23,420)
Benefit payments	(354,825)
Fair value of plan assets at end of year	2,040,349
Net post-retirement benefit obligation	$ 13,567,651

The Center has recorded a receivable from the state totaling $ 13,567,651 as of June 30, 2017, corresponding with the net post-retirement benefit obligation. The recognition of the $13,675,651 receivable is not in accordance with GAAP.

The following table provides the components of the net periodic benefit cost for the plan for the year ended June 30, 2017:

Service cost	$ 363,745
Interest cost	780,400
Return on assets	(201,913)
Net asset and other deferred gain	(351,657)
Amortization of unrecognized prior service cost	321,383
Net periodic post-retirement benefit cost	$ 911,958

(Continued)

NOTE 9 – EMPLOYEE RETIREMENT BENEFITS (Continued)

Amounts recognized in net assets and not yet recognized in periodic post-retirement benefit cost are as follows as of June 30, 2017:

Prior-service cost	$ 1,928,170
Net actuarial gain	(6,166,427)
	$ (4,238,257)

Amortization of unrecognized prior service cost is expected to be recognized as a component of the net periodic post-retirement benefit cost in the amount of $321,338 for the year ending June 30, 2018.

Asset Category: Assets held in trust are invested in a balanced account with income and growth investment objectives. The objective is to produce reasonable current income and long-term capital growth. Percentages for each asset category will vary based on the trust needs, contributions, and on market conditions. Uninvested cash balances are held in a money market account.

The percentages of the fair value of total plan assets held in trust were as follows:

Cash and cash equivalents	4.1%
Mutual funds	6.9
Bonds	33.5
Common stock	55.5
	100.0%

The fair values of the Center's plan assets for the RMR plan as of June 30 were as follows:

	Total	Quoted Prices in Active Markets For Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)
Cash and cash equivalents	$ 83,273	$ 83,273	$ -
Mutual funds	139,775	139,775	-
Equity securities - U.S. companies	1,134,148	1,134,148	-
Corporate bonds	390,296	-	390,296
U.S. Government bonds	292,857	-	292,857
Total assets at fair value	$ 2,040,349	$ 1,357,196	$ 683,153

(Continued)

NOTE 9 – EMPLOYEE RETIREMENT BENEFITS (Continued)

The expected benefits to be paid are as follows for the year ending June 30:

2018	$ 326,000
2019	384,000
2020	404,000
2021	489,000
2022	571,000
Thereafter	4,227,000
	$ 6,401,000

Assumptions: Weighted-average assumptions used to determine benefit obligations at June 30, 2017:

Discount rate	3.75%
General Inflation	2.50%
Long term rate of return on plan assets	3.75%

Weighted-average assumptions used to determine net periodic benefit cost for years ended June 30:

Discount rate	3.75%
General Inflation	2.50%
Long term rate of return on plan assets	3.75%

Assumed health care cost trend at June 30, 2017:

Net Periodic Benefit Cost:

Health care cost trend rate assumed for next year	8.0%
Rate to which the cost trend is assumed to decline (the ultimate trend rate)	4.5%
Year that the rate reaches the ultimate trend rate	2022

Accumulated Post Retirement Benefit Obligation

Health care cost trend rate assumed for next year	8.0%
Rate to which the cost trend is assumed to decline (the ultimate trend rate)	4.5%
Year that the rate reaches the ultimate trend rate	2022

Sensitivity of Assumed Health Care Cost Trend Rate and the Effect on the Accumulated Post-Retirement Benefit Obligation:

	1% Increase	1% Decrease
Effect on the accumulated post-retirement benefit obligation	$ 2,871,000	$ (1,532,000)

NOTE 9 – EMPLOYEE RETIREMENT BENEFITS (Continued)

PERS Retirement Plan

Since 1998, the Center has participated in CalPERS, an agent multiple-employer public employee retirement system that acts as a common investment and administrative agent for participating public entities within the State. All eligible employees of the Center are enrolled in CalPERS.

The Public Employee's Retirement Law (Part 3 of the California *Government Code* § 20000, et seq.) establishes benefit provisions for CalPERS. CalPERS issues a separate comprehensive annual financial report that includes financial statements and required supplementary information. Copies of the CalPERS annual financial report may be obtained from the CalPERS Executive Office, 400 Q Street, Sacramento, California 95811 and at www.calpers.ca.gov.

The provisions of FASB ASC 715-30, *Retirement Benefits, Defined Benefit Plans* - Pension require the Center to recognize in its statement of financial position a liability that equals the unfunded projected pension obligation related to its participation in the CalPERS pension plan. The Center estimated and recorded an unfunded projected pension obligation of $33,829,957 as of June 30, 2017 using an actuarial valuation provided by CalPERS that was prepared in accordance with Governmental Accounting Standards Board (GASB) 68, *Accounting and Financial Reporting for Pensions*, and does not conform to GAAP under the FASB standards. The impact on liabilities, net assets, beginning net assets, expenses, change in net assets, and footnote disclosures of the pension obligation for the year ended June 30, 2017 has not been determined. The following footnote disclosures present amounts from the GASB 68 report and do not conform to requirements of FASB ASC 715.

Reconciliation of Pension Obligations: The Schedule of Funding Progress below, provided by the CalPERS Actuarial Office, shows the recent history of the actuarial accrued liability, market value of assets, the funded ratio, and the annual covered payroll.

Measurement Date	Accrued Liability	Market Value of Assets	Unfunded Liability	Funded Ratios Market Value	Annual Covered Payroll
06/30/17	$ 189,816,520	$ 155,986,663	$ 33,829,857	82.2%	$ 37,829,859

NOTE 9 – EMPLOYEE RETIREMENT BENEFITS (Continued)

The unfunded actuarial accrued liability as of June 30, 2017 was as follows:

Unfunded Actuarial Accrued Liability	
Total pension liability – beginning	$ 164,146,967
Service cost	6,094,769
Interest	12,622,599
Change of assumptions	12,566,165
Difference between expected and actual experience	(827,360)
Benefit payments, including refunds of employee contributions	(4,786,620)
Total pension liability – ending	189,816,520
Change in plan assets	
Plan fiduciary net position – beginning	138,583,290
Contributions – employer	3,688,934
Contributions – employee	2,805,455
Net investment income	15,900,213
Benefit payments, including refunds of employee contributions	(4,786,620)
Administrative expense	(204,609)
Plan fiduciary net Position – ending	155,986,663
Plan net pension liability	$ 33,829,857

The following table provides the components of the net periodic pension benefit cost for the plan for the years ended June 30, 2017:

Service Cost	$ 6,094,769
Interest Cost	12,622,599
Expected Return on Plan Assets	(9,953,729)
Net Periodic Pension Benefit Cost	$ 8,763,639

(Continued)

NOTE 9 – EMPLOYEE RETIREMENT BENEFITS (Continued)

Asset Category: The asset allocation shown below, provided in the CalPERS's Comprehensive Annual Financial Report (CAFR), reflects the CalPERS fund in total as of June 30, 2017. CalPERS adheres to an Asset Allocation Strategy which establishes asset class allocation policy targets and ranges, and manages those asset class allocations within their policy ranges. CalPERS recognizes that strategic asset allocation is the dominant determinant of portfolio risk and return. The asset allocation shown below reflects the values of the Public Employees' Retirement Fund (PERF) in its entirety as of June 30, 2017. The assets of the Center's plan are part of the PERF and are invested accordingly.

Asset Class	Current Allocation	Target Allocation
Global Equity	48.3%	46.0%
Global Fixed Income	19.4	20.0
Inflation Assets	7.8	9.0
Private Equity	8.0	8.0
Real Assets	11.2	13.0
Liquidity	4.8	4.0
Other	0.5	0.0
	100.0%	100.0%

Contributions: The Center has two retirement plans with CalPERS. One plan is a 2%-at-age-55 formula which closed as of December 31, 2012. All employees hired prior to January 1, 2013 participate in this plan. The second plan is a 2%-at-age-62 formula which was established by the Public Employees' Pension Reform Act of 2013 (PEPRA) and all employees hired on or after January 1, 2013 participate in this plan. The total required employee contributions are 2% of earnings for the 2%-at-age-55 plan and 6.25% of earnings for the 2%-at-age-62 plan.

The Center contributes annually at an actuarially determined rate required by CalPERS as below:

Year Ended	Actuarially Determined Contribution	Center's Contribution	Covered Payroll	Percentage of Covered Payroll
June 30, 2017	$ 3,688,934	$ (3,688,934)	$ 37,829,859	9.75%

Assumptions: CalPERS uses the Entry Age Normal Cost Method to fund benefits. Under this method, projected benefits are determined for all members and the associated liabilities are spread in a manner that produces level annual cost as a percent of pay in each year from the age of hire to the assumed retirement age. The cost allocated to the current fiscal year is called the normal cost.

The actuarial accrued liability for active members is then calculated as the portion of the total cost of the plan allocated to prior years. The actuarial accrued liability for members currently receiving benefits, for active members beyond the assumed retirement age, and for members entitled to deferred benefits, is equal to the present value of the benefits expected to be paid. No normal costs are applicable for these participants.

(Continued)

NOTE 9 – EMPLOYEE RETIREMENT BENEFITS (Continued)

The excess of the total actuarial accrued liability over the market value of plan assets is called the unfunded actuarial accrued liability. Funding requirements are determined by adding the normal cost and an amortization of the unfunded liability as a level percentage of assumed future payrolls.

The CalPERS Board of Administration adopted and lowered the discount rate from 7.50 percent to 7.00 percent using a three-year phase-in beginning with the June 30, 2016 actuarial valuations. The projected employer contributions are calculated assuming that the discount rate will be lowered to 7.25 percent with the June 30, 2017 actuarial valuations and to 7.00 percent with the June 30, 2018 actuarial valuations.

The actuarial discount rates, assumptions and methods used in CalPERS public agency valuations are approved by CalPERS Board of Administration upon the recommendation of its Chief Actuary. An annual actuarial valuation report plus a separate accounting valuation report were provided by CalPERS Actuarial Office for the use of estimates and assumptions in the determination of the Center's obligation for retirement pension benefits. The Center's total actuarial accrued liability, unfunded actuarial accrued liability, funded status, and annual required contribution are all disclosed in these reports.

A summary of principal actuarial assumptions and methods, used by CalPERS Actuarial Office, are as follows:

Measurement Date	June 30, 2017
Actuarial Cost Method	Entry Age Normal Cost Method
Amortization Method	Level percent of payroll
Asset Valuation Method	Market value
Actuarial Assumptions	
Discount Rate	7.15% (net of expenses)
Projected Salary Increases	Varies by age and service
Inflation	2.75%
Payroll Growth	3.00%
Investment Rate of Return	7.50%

Sensitivity of Assumed Discount Rate and the Effect on Unfunded Actuarial Accrued Liability:

	Assumed Discount Rate	
	At 8.15%	At 6.15%
Effect on Unfunded Actuarial Accrued Liability	$ (25,764,586)	$ 32,026,103

An analysis of discount rate sensitivity above was provided by CalPERS Actuarial Office to give a sense of the long-term risk to the unfunded actuarial accrued liability.

The CalPERS actuarial valuation used by the Center was prepared in accordance with GASB 68, *Accounting and Financial Reporting for Pensions.* The majority of the CalPERS pension plan members are substantially state and local agencies within the State whose pension reporting is in accordance with GASB 68. The Center is a 501c(3) Corporation whose operation is fully funded by the State under the DDS. The Center as a 501c(3) corporation falls within the FASB guidelines; however, the Center's pension plan is under CalPERS which is under the GASB guidelines. CalPERS did not provide the Center with an actuarial valuation in accordance with the FASB ASC 715-30, *Retirement Benefits, Defined Benefit Plans - Pension.* The Center recognizes the differences between the actuarial valuation provided by CalPERS and the methodology and assumptions required by the FASB ASC 715-30. The FASB ASC 715-30 requires a different actuarial method and assumed discount rate to reflect a rate at which the pension benefits could be effectively settled.

(Continued)

NOTE 9 – EMPLOYEE RETIREMENT BENEFITS (Continued)

The CalPERS Actuarial Office in fact provided an estimate of the hypothetical termination liability of the plan had the pension benefits of the plan been settled and the contract between the Center and CalPERS had been terminated as of June 30, 2016. Under this circumstance, the Center's pension plan will be categorized as a Terminated Agency Pool by CalPERS. The hypothetical termination liability is calculated differently compared to the plan's ongoing funding liability. Both compensation and service are frozen as of the measurement date and no future pay increases or service accruals are assumed. A more conservative investment policy and asset allocation strategy is adopted by the CalPERS Board since no future employer contributions will be made. Expected benefit payments are secured by risk-free assets and benefit security for members in the plan is increased while limiting the funding risk. As a result, the asset allocation for a terminated plan has a lower expected rate of return than the PERF and, consequently, a lower discount rate assumption. The lower discount rate for the Terminated Agency Pool results in a higher unfunded actuarial accrued liability. Below is a table provided by the CalPERS Actuarial Office with assumed discount rates for a hypothetical termination liability as of June 30, 2016:

	Assumed Discount Rate	
	At 1.75%	At 3.00%
Hypothetical Termination Liability	$ 307,443,310	$ 251,843,220
Actuarial Accrued Liability Already Recorded	(164,146,967)	(164,146,967)
Effect on Unfunded Actuarial Accrued Liability	$ 143,296,343	$ 87,696,253

In the absence of evidence that the Center's CalPERS pension plan will not continue, Center's management is of the opinion that the event of a termination or settlement of the Center's CalPERS pension plan is remote and unlikely. Applying a different assumed discount rate other than the rate used by PERF in a calculation of the Center's projected CalPERS unfunded actuarial accrued liability is not indicative of the future events that will determine the amount and timing of the benefit payments of the Center's CalPERS pension plan. It also does not represent the best estimate of the Center's future event. Therefore, the Center does not record the effect on unfunded actuarial accrued liability assuming a termination of the Center's CalPERS pension plan in the statement of financial position, but rather disclose the effect in this note.

NOTE 10 – COMMITMENTS AND CONTINGENCIES

Commitments

The Center is obligated under various operating leases for its office facilities, which expire at various dates through June 2045. The terms of the leases provide for payment of minimum annual rentals, with fixed increases in annual rents. In addition, the leases provide for adjustments relating to changes in property taxes and other operating expenses.

(Continued)

NOTE 10 – COMMITMENTS AND CONTINGENCIES (Continued)

In November 2007, the Center entered into an operating lease agreement with California Housing Foundation to lease office facilities. The original lease term is 32 years and began on September 1, 2009. During the year ended June 30, 2016, the agreement was amended to extend the lease term to end June 30, 2045, and reduce the monthly base rent. Future minimum facilities lease commitments for the years ending June 30 are as follows:

2018	$ 5,218,383
2019	5,372,333
2020	5,530,386
2021	5,653,676
2022	5,330,319
Thereafter	149,383,128
	$ 176,488,225

Contingencies

DDS Audit / Settlement: In accordance with the terms of the DDS contract, an audit may be performed by an authorized state representative. DDS conducted fiscal compliance audits of the Center for the period of July 1, 2008 through June 30, 2012 and issued its final audit reports with various findings and recommendations that the Center should repay certain amounts of money to DDS. The Center pursued its administrative appeal of the findings and recommendations and entered into an agreement with DDS to settle the disputed audit findings. Terms of the settlement agreement call for the Center to pay DDS a total of $6,588,703 through 13 annual installments of $500,000 and one final payment of $88,703 with the first payment due on August 15, 2019. The provision for the total amount due to DDS is included in other liabilities on the statement of financial position.

DDS conducted fiscal compliance audits of the Center for the periods of July 1, 2012 through June 30, 2014, July 1, 2014 through June 30, 2015, and July 1, 2015 through June 30, 2016. DDS issued its draft audit reports for July 1, 2012 through June 30, 2014 on June 15, 2017 and July 1, 2014 through June 30, 2015 on February 16, 2018. Final audit reports have not yet been issued. In the opinion of the Center's management, the effect of any findings or recommendations would be immaterial to the financial statements at June 30, 2017.

DDS Funding: The Center is dependent on continued funding provided by the DDS to operate and provide services for its clients. The Center's contract with DDS provides funding for services under the Lanterman Act. In the event that the operations of the Center result in a deficit position at the end of any contract year for client services, DDS may reallocate surplus funds within the Regional Center system to supplement the Center's funding. In the event that the State determines that the Center has insufficient funds to meet its contracted obligations, the State shall make its best efforts to secure additional funding and/or provide the Center with regulatory relief.

The Center is required to reimburse the State for state unemployment insurance benefits paid to its former employees. A trust fund is maintained to fund any reimbursements. As of June 30, 2017, the trust fund balance was approximately $735,000, which is included in other assets on the statement of financial position.

(Continued)

NOTE 10 – COMMITMENTS AND CONTINGENCIES (Continued)

Landlord (Brier II) Settlement Agreements: Upon completion of its current headquarter building, the Center ceased paying rent on vacated office facilities (Brier II) and, in September 2010, the landlord of Brier II filed a complaint for breach of contract. The Center entered into a confidential settlement agreement with the landlord of Brier II during the fiscal year ended June 30, 2011. Unrestricted Net Assets were expended in the settlement, and the Center has certain obligations in the future pursuant to the settlement agreement ("Brier II Settlement Agreement"). Payments made pursuant to the Brier II Settlement Agreement cannot be claimed for reimbursement from the State under the DDS contract unless the State provides specific funding for this purpose. If specific funding is not provided by the State, the amount of any payments to be made, if any, is determined by the specific provisions of the Brier II Settlement Agreement. Management is of the opinion that since the State has not provided specific funding, and the requirements of the Brier II Settlement Agreement that would trigger a payment by the Center have not been met, that no amounts are due to the landlords at this time.

On December 8, 2014, the landlord for Brier II filed an action against the Center seeking payment of the amounts it claims are owed under the Brier II Settlement Agreement totaling approximately $421,000 plus interest, special damages and punitive damages. The Center denies that it owes any money and intends to vigorously defend against these allegations. Trial is currently scheduled for April 23, 2018. The Center believes, based upon its current knowledge and after consultation with counsel, that the current pending litigation involving the Brier II Settlement Agreement will not have a material adverse effect on the Center's financial condition. However, litigation can be unpredictable and, in light of the uncertainties involved in such proceedings, there is no assurance of the ultimate outcome of this matter.

Other Litigation: The Center is involved as a defendant in other various matters of litigation arising in the normal course of its business. The Center accrues for potential liability arising from proceedings when it is probable that such liability has been incurred and the amount of the loss can be reasonably estimated. In view of the inherent difficulty of predicting the outcome of legal proceedings, the Center cannot state what will be the eventual outcomes of the currently pending matters, the timing of their ultimate resolution or the eventual losses, fines, penalties or impact related to those matters. The Center believes, based upon its current knowledge, after consultation with counsel, that the legal proceedings currently pending against it should not have a material adverse effect on the Center's financial condition. The Center notes, however, that considering the uncertainties involved in such proceedings, there is no assurance of the ultimate resolution of these matters.

During the year ended June 30, 2015, the Center entered into a legal settlement related to litigation with a former employee for $2,000,000. Terms of the settlement call for four annual payments of $500,000. As of June 2017, the Center has an outstanding balance of the final payment of $500,000, which is included in other liabilities on the statement of financial position. The final payment is due on August 18, 2018.

(Continued)

NOTE 11 – TRANSACTIONS WITH AFFILIATED ORGANIZATION

California Housing Foundation (Foundation or CHF) was formed by members of the Center's board of trustees for the purpose of providing support services to consumers of the Center. The Foundation and the Center have no common board members. The Foundation provides residential facilities for occupancy by persons with developmental disabilities.

The Center entered into an operating lease agreement with the Foundation in November 2007, as discussed in Note 10. Lease and common area maintenance payments made to the Foundation amounted to approximately $6,600,000 for the year ended June 30, 2017. This amount is included within the Supporting Services: general and administrative expenses.

Community Placement Plan Loans: The Center entered into multiple contracts with the Foundation to provide advance funding for the purchases of homes to be used as residential facilities for its consumers. The advances are secured by promissory notes, which will be forgiven, without interest, upon the completion of the residential facilities. In the event that the contract is breached, the Foundation would be responsible to repay the Center the total amount of the advance with interest at a rate equal to ten percent. During the year ended June 30, 2017, the Center made no advances to the Foundation. As of June 30, 2017, total advances which have not been forgiven was $400,000.

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 Trustees of
Inland Counties Regional Center, Inc.

We have audited, in accordance with the 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, the financial statements of Inland Counties Regional Center, Inc. (the Center), a California nonprofit organization, which comprise the statement of financial position as of June 30, 2017, and the related statement of activities, functional expenses, and cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated April 27, 2018, in which we expressed a qualified opinion.

Basis for Qualified Opinion

The Center is using an actuarial valuation provided by the California Public Employees' Retirement System (CalPERS) to estimate the Center's unfunded projected pension obligation and related pension expense in the accompanying statement of financial position and statement of activities, respectively, that, in our opinion, do not conform to accounting principles generally accepted in the United States of America under the Financial Accounting Standards Board (FASB) standards. The amounts by which this departure affects the liabilities, net assets, beginning net assets expenses, change in net assets, and footnote disclosures of the pension obligation of the Center have not been determined as it was not practicable to quantify. Also, the Center has recorded a receivable totaling $13,567,651 from the state that, in our opinion, does not conform to GAAP. If the receivable had not been recorded, total assets would decrease by $13,567,651, beginning net deficit would increase by $12,214,319, post-retirement benefit plan expenses would increase by $1,353,332, and ending net deficit would increase by $13,567,651.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Center's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances 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 Center's internal control. Accordingly, we do not express an opinion on the effectiveness of the Center's internal control.

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.

(Continued)

Our consideration of internal control 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 material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. We did identify a deficiency, described in the accompanying Schedule of Findings and Responses at item 2017-001 that we consider to be a material weakness.

Compliance and Other Matters

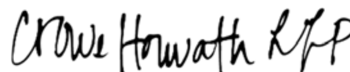
As part of obtaining reasonable assurance about whether the Center's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

The Center's Response to Findings

The Center's response to the finding identified in our audit is described in the accompanying Schedule of Findings and Responses. The Center's response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

Purpose of this Report

The purpose of this report is solely 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 effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.



Crowe Horwath LLP

Costa Mesa, California
April 27, 2018

2017-001 FINANCIAL REPORTING – (Material Weakness)

<u>Criteria</u>:

Post-retirement plans:

FASB Accounting Standards Codification (ASC) 715-30, "Defined Benefit Plans - Pension," requires entities to recognize the funded status of a defined benefit retirement plan as an asset or liability in its statements of financial position and to recognize changes in that funded status in unrestricted net assets in the year in which the change occurs.

Receivables from State of California

ASC 958-605 discusses transactions in which entities provide resources to not-for-profit (NFP) entities under programs referred to as grants, and specifies that such asset transfers are contributions if the resource providers receive no value in exchange for the assets transferred or if the value received by the resource providers is incidental to the potential public benefit from using the assets transferred. The recognition principles for contributions received are discussed in ASC 958-605 specifies that accounting for contributions depends on whether the transfer of assets, including promises to give, is received by the NFP with donor-imposed conditions, donor- imposed restrictions, or both. Donor-imposed conditions create a barrier that must be overcome before a contribution can be recognized; by definition, a contribution is unconditional.

The FASB ASC glossary defines a donor-imposed condition as a donor-imposed stipulation that specifies a future and uncertain event whose occurrence or failure to occur gives the donor the right of return of the assets or releases the donor from the obligation to transfer assets in the future.

Conditional transfers are not contributions yet; they may become contributions upon the occurrence of one or more future and uncertain events. Because of the uncertainty about whether they will be met, conditions imposed by resource providers may cast doubt on whether the resource provider's intent was to make a contribution, to make a conditional contribution, or to make no contribution. As a result of this uncertainty, donor- imposed conditions should be substantially met by the entity before the receipt of assets is recognized as a contribution or a contribution receivable.

Transfers of assets, including promises to give, on which resource providers have imposed conditions should be recognized as contributions if the likelihood of not meeting the conditions is remote. For example, a stipulation that an annual report must be provided by the donee to receive subsequent annual payments on a multiyear promise is not a condition if the possibility of not meeting that administrative requirement is remote (ASC 958-605-55-16).

FASB ASC 958-605-55-21 discusses promises that become unconditional in stages because they are dependent on several or a series of conditions—milestones—rather than on a single future and uncertain event. Those promises are recognized in increments as each of the conditions is met. Similarly, other promises are conditioned on promises incurring certain qualifying expenses (or costs). Those promises become unconditional and are recognized to the extent that the expenses are incurred. A portion of those contributions should be recognized as revenue as each of those stages is met.

The Center contracts with DDS to operate a regional center for individuals with developmental disabilities and their families. Under the terms of this contract, in Article III: Fiscal Provisions, 4. Payment Provisions, it states, ""In consideration of the services rendered by the Contractor pursuant to this contract, the State shall reimburse the Contractor, for cash expenditures, monthly in arrears". The contract term is for the period from July 1, 2014, through June 30, 2021.

(Continued)

Condition:
During the course of our audit, we noted that the Center contributes to the California Public Employees' Retirement Systems (CalPERS) for retirement benefits. CalPERS is an agent multiple-employer public employee retirement system that acts as a common investment and administrative agent for participating public entities within California. During prior years, management did not record the unfunded status of the defined benefit retirement plan in its financial statements due to the Plan being incorrectly identified as a multi-employer plan, instead of a multiple employer plan in accordance with ASC 715-30. Under such circumstances, management elected to obtain the most readily available actuarial valuation provided by CalPERS which was prepared in accordance with standards promulgated by the Governmental Accounting Standards Board (GASB). As a result, the Center recorded a net pension liability and related pension expense in the amount of $33,829,857 as of June 30, 2017. However, the Center is a California nonprofit corporation where generally accepted accounting principles (GAAP) is based on the standards promulgated by the Financial Accounting Standards Board (FASB).

In addition, we noted that the Center has an unfunded Retiree Medical Reimbursement Plan (RMR Plan) to provide reimbursement of medical expenses for the medical care of each participant and eligible dependents up to their maximum yearly allowance. The Center recorded a post-retirement medical benefits receivable from the State in the amount of $13,567,651. While the Center has incurred certain qualifying expenses under their contract with the State, required payment provisions represent a donor-imposed condition that must be overcome before a contribution can be recognized as revenue. The receivable does not represent cash expenditures for contributions to the RMR Plan or premium payments. Rather, this amount represents an estimate for the unfunded post-retirement benefit obligation. The payment condition necessary to recognize grant revenue from the State has not been satisfied.

Context:
These findings were identified as part of our review of the types of benefit plans in place during our first year auditing the Center.

Cause:
Management did not record the unfunded projected benefit obligation in prior years due to the Plan being incorrectly identified as a multi-employer plan, instead of a multiple employer plan in accordance with ASC 715-30.

The Center recorded a receivable from the State to reflect the future reimbursement of the unfunded post-retirement medical benefit liability. However, such expenses are reimbursed under the state contract only when actually paid by the Center.

Effect:
The amounts by which beginning net assets, net assets, liabilities, expenses, change in net assets, and footnote disclosures of the pension obligation are misstated in relation to the CalPERS pension plan have not been determined.

Regarding the RMR plan, if the $13,567,651 receivable had not been recorded, total assets would decrease by $13,567,651, beginning net assets would decrease by $12,214,319, post-retirement medical plan expense would increase by $1,353,332, and ending net assets would decrease by $13,567,651.

Recommendation:
We recommend that management consider implementing procedures to obtain actuarial valuations of the CalPERS plan in accordance with ASC 715-30 and record the funded status of the defined benefit retirement plan annually. In addition, we recommend that management ensure that receivables recorded represent reimbursements for cash expenditures in accordance with their contract with DDS.

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Views of responsible officials and planned corrective actions:

Responses to CalPERS Pension Plan's Recommendation

The Center already has a procedure to obtain actuarial valuations from CalPERS annually. The Center's management disagrees that an implementation of another procedure to obtain an actuarial valuation outside CalPERS Actuary Office is needed for its pension plan. CalPERS Actuary Office has provided the Center an actuarial valuation for financial reporting purpose including an assumed discount rate sensitivity analysis. The analysis includes a hypothetical termination liability for the Center's pension plan in case the Center would terminate its pension plan with CalPERS and need to settle the pension benefits. The FASB ASC 715-30-35-1 requires the use of reasonable approximations to measure the pension obligation, and states that the guideline is intended to specify accounting objectives and results rather than specific computational means of obtaining those results. The guideline states that if estimates, averages, or computational shortcuts can reduce the cost of applying the measurement, their use is appropriate, provided the results are reasonably expected not to be materially different from the results of a detailed application. Should it become necessary; the Center may consider implementing a procedure to verify that the effect of the hypothetical termination liability provided by CalPERS for the Center's CalPERS plan is not materially different from the actuarial valuations in accordance with the FASB ASC 715-30.

The Center's management agrees to record the funded status of the CalPERS pension plan annually. However, the Center's CalPERS pension plan is a unique defined benefit plan. It is one of very few participating agencies subjected to the FASB guidelines; but is required to follow CalPERS funding and contribution methodology every year, based on CalPERS actuarial valuations in accordance with the GASB guidelines. The Center's operation is fully funded by the State of California (the State) through Department of Developmental Services (DDS). Even though it is a 501c(3) Corporation which falls within the FASB guidelines, the Center is allowed to participate in CalPERS due to the fact that CalPERS considers the Center an instrumentality of the State and is a public agency as defined in California Government Code Section 22009, "Public agency means the state, any city, county, city and county, district, municipal or public corporation or any instrumentality…the employees of which constitute one or more coverage groups or retirement system coverage groups." Also, the main audience of the Center's audited financial statements is DDS.

The Center's management is of the opinion that the projected CalPERS unfunded actuarial liability to be recorded should reflect the actual ongoing funding status of the Center with its CalPERS pension plan which is $33,829,857 as of June 30, 2017, calculated from the actuarial valuations provided by CalPERS for financial reporting of the on-going funding pension plan under Public Employees' Retirement Fund (PERF). In the absence of evidence that the Center's CalPERS pension plan will not continue, the Center's management is of the opinion that applying a different assumed discount rate other than the rate used by PERF in a calculation of the Center's projected CalPERS unfunded actuarial liability is not indicative of the future events that will determine the amount and timing of the benefit payments of the Center's CalPERS pension plan. It also does not represent the best estimate of the Center's future event. The FASB ASC 715-30-35-29 and 715-30-35-30 state that explicit estimates or assumptions must be made concerning the future events that will determine the amount and timing of the benefit payments, and each of explicit assumptions individually represents the best estimate of a particular future event. Moreover, the FASB ASC 715-30-35-42 requires an explicit approach to assumptions, and states that all assumptions shall presume that the plan will continue in effect in the absence of evidence that it will not continue.

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Responses to the Recommendation of Recording Receivables in The Financial Statements in Accordance with Article III: Fiscal Provisions, 4. Payment Provisions in the DDS Contract

The following provision is in the DDS contracts:

> Article I Standard Terms and Conditions 7. General Provisions of the DDS contract states, "the consideration to be paid Contractor, as provided herein, shall be in compensation for all of Contractor's expenses incurred in the performance hereof,…unless otherwise expressly so provided."

The following provisions are in the accounting standards:

> The FASB ASC 958-605-55-21 "*Not-For-Profit Entities Revenue Recognition*" states, "…other promises are conditioned on promises' incurring certain qualifying expenses (or costs). Those promises become unconditional and are recognized to the extent that the expenses are incurred..."
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> The FASB ASC 958-605-25-15 "*Not-For-Profit Entities Revenue Recognition*" states, "Absence of a specified time for transfer of cash or other assets, by itself, does not necessarily lead to a determination that a promise to give is ambiguous…Promises to give that are silent about payment terms but otherwise are clearly unconditional shall be accounted for as unconditional promises to give."
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> The FASB Proposed ASU No. 2017-270, 958-605-25-5C, "*Not-for-Profit Entities (Topic 958)*" states, "If a recipient has broad discretion (for example, the only stipulation is that the transferred assets should be spent for general operating purposes…If a recipient has broad discretion on how to use the assets and the agreement contains no other stipulations that would indicate that a barrier exists, the agreement shall be deemed unconditional," and "The stipulations are related to the purpose of the agreement. This indicator would generally exclude administrative tasks..."
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> The FASB Proposed ASU No. 2017-270, 958-605-15-6e, "*Not-for-Profit Entities (Topic 958)*" states, "Transfers of assets (typically from a government entity) that are part of an existing exchange transaction between a recipient and an identified customer…In those instances, an entity shall apply the applicable guidance (for example, Topic 606 (ASU No. 2014-09) on revenue from contracts with customers)."
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> The FASB Accounting Standards Update (ASU) No. 2014-09, "*Revenue from Contracts with Customers*" -BC20, "*Basis For Recognizing Revenue*" states, "…revenue should be recognized only when an entity transfers a promised good or service to a customer, thereby satisfying a performance obligation in the contract. That transfer results in revenue recognition because upon satisfying a performance obligation an entity no longer has that obligation to provide the good or service."
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> The FASB ASU No. 2014-09, "*Revenue from Contracts with Customers*" -BC36, "*The Parties Have Approved the Contract and Are Committed to Perform Their Respective Obligations*" states, "the Boards decided that the parties should be committed to performing their respective obligations under the contract. However, the Boards decided that an entity and a customer would not always need to be committed to fulfilling all of their respective rights and obligations for a contract to meet the guidance…The Boards noted that requiring all of the rights and obligations to be fulfilled would have inappropriately resulted in no recognition of revenue for some contracts in which the parties are substantially committed to the contract."

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The FASB ASU No. 2014-09, "*Revenue from Contracts with Customers*" -BC168, "*Input Methods*" states, "Input methods recognize revenue on the basis of an entity's efforts or inputs toward satisfying a performance obligation (for example, resources consumed, labor hours expended, costs incurred, time elapsed, or machine hours used) relative to the total expected inputs to satisfy the performance obligation.

The FASB ASU No. 2014-09, *"Revenue from Contracts with Customers*" -BC180, "*Reasonable Measures of Progress*" states, "The Boards also concluded that in cases in which an entity cannot reasonably measure its progress toward complete satisfaction of a performance obligation, but nevertheless expects eventually to recover the costs incurred in satisfying the performance obligation, the entity should recognize at least some amount of revenue to reflect the fact that it is making progress in satisfying the performance obligation. Consequently, the Boards decided that in those cases, an entity should recognize revenue for the satisfaction of the performance obligation only to the extent of the costs incurred. (That method is consistent with previous revenue recognition guidance in both IFRS and U.S. GAAP for measuring progress.)…"

The FASB ASU No. 2014-09 "*Revenue from Contracts with Customers*" -BC323, "*Relationship between Contract Assets and Receivables*" states, "In many cases, that contract asset is an unconditional right to consideration—a receivable—because only the passage of time is required before payment of that consideration is due…"

The FASB ASU No. 2014-09 "*Revenue from Contracts with Customers*" -BC326, "*Relationship between Contract Assets and Receivables*" states, "…an entity will have an unconditional right to consideration, even though the entity may be required to refund some or all of that consideration in the future. In those cases, the possible obligation to refund consideration in the future will not affect the entity's present right to be entitled to the gross amount of consideration…"

The Center contracts with the State Department of Developmental Services (DDS) to operate a regional center in accordance with the provisions of the Lanterman Developmental Disabilities Services Act of the Welfare and Institutions Code. The Center is substantially committed to the contract to provide services for the developmentally disabled (identified consumers) and their families in two Counties of the State. The DDS compensates the Center for the services provided to the identified consumers and their families, and also provides a general operating budget for the Center to run the regional center. Under the terms of the DDS contracts, the Center's expenses incurred in the performance of the contracts are compensable by the DDS. Such expenses are billable and reimbursable under the DDS contract when they are paid.

The receivable from the State of compensable costs incurred totaling $13,567,651 as of June 30, 2017 was an equal amount of the accumulated net post-retirement benefit costs incurred since the plan started in 1988. The projected net post-retirement benefit obligation is an actuarial valuation based from census data of eligible active and retired employees of the Center in which their services were already provided in accordance with the DDS contracts. The Center is not required to pay in full the plan obligation but could contribute to the plan in its sole discretion. Further, the RMR Plan has a provision that the plan ceases to exist once all the assets of the plan are fully spent. Hence, it is a self-liquidating plan. The Center did not contribute to the RMR Plan for the year ending June 30, 2017.

The Center has a promise to compensation or right to consideration from the DDS when services were provided according to the DDS contract. The Center's management is of the opinion that the promise to compensation or right to consideration becomes unconditional when the Center satisfies its performance obligation and compensable expenses are incurred under the terms of the DDS contracts. The Center's management is of the opinion that the payment provisions are not a condition required to realize a receivable to the extent of the incurred costs.

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The payment provisions describe the required procedures for the Center to claim and get reimbursements after the Center has paid for the services in performance of the DDS contracts. The Center's management is of the opinion that these are administrative tasks unrelated for the Center to carry out the purpose of the DDS contract (performance of services) and has nothing to do in determining whether the Center has a promise to compensation or right to consideration for the Center to realize a receivable.