

PENINSULA HEALTH CARE DISTRICT

Financial Statements

June 30, 2008

PENINSULA HEALTH CARE DISTRICT

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INDEPENDENT AUDITORS' REPORT

Board of Directors
Peninsula Health Care District
Burlingame, California

We have audited the accompanying financial statements of the governmental activities, business-type activities, and each major fund of Peninsula Health Care District (the District) as of and for the year ended June 30, 2008, which collectively comprise the District's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the District's management. Our responsibility is to express 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 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 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 the governmental activities, the business-type activities, and each major fund of Peninsula Health Care District as of June 30, 2008, and the respective changes in financial position and cash flows, where applicable, thereof for the year 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 August 13, 2008, on our consideration of the District's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The required supplementary information, such as management's discussion and analysis on pages 2 through 8 and budgetary comparison information on page 29, are not a required part of the basic financial statements, but are supplementary information required by the accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Vavrinek, Trine, Day & Co., LLP

Vavrinek, Trine, Day & Co., LLP
Palo Alto, California
November 14, 2008

PENINSULA HEALTH CARE DISTRICT

MANAGEMENT'S DISCUSSION AND ANALYSIS JUNE 30, 2008

This discussion and analysis of the Peninsula Health Care District's (District) financial performance provides an overview of the District's financial activities for the fiscal year ended June 30, 2008. This information is presented in conjunction with the audited financial statements that follow this section.

FINANCIAL HIGHLIGHTS

- The District's current assets increased by \$1.8 million
- The District's net capital assets decreased by \$1.4 million
- The District's current liabilities increased by \$.4 million
- The District's fund balance decreased by \$.03 million

USING THIS ANNUAL REPORT

This annual report includes this management's discussion and analysis report, the independent auditor's report and the basic financial statements of the District. The financial statements also include notes that explain some of the information in the financial statements in more detail.

OVERVIEW OF BASIC FINANCIAL STATEMENTS

The District's basic financial statements comprise the Government-Wide Statement of Net Assets and Statement of Activities; the Governmental Fund Balance Sheet and Statement of Revenues, Expenditures and Changes in Fund Balance; and the Proprietary Fund Statement of Net Assets, and Statement of Revenues, Expenditures and Changes in Fund Net Assets, and Statement of Cash Flows; and the Notes to the Financial Statements.

Government-Wide Financial Statements

Government-Wide Financial Statements utilize the economic resources measurement focus using the full accrual basis of accounting similar to commercial enterprises. The Statement of Net Assets includes all of the District's assets and liabilities. All of the current year's revenues and expenses are accounted for in the Statement of Activities, regardless of when cash is received or paid.

The Fund Financial Statements include statements for governmental and proprietary activities. The Governmental Activities are prepared using the current financial resources measurement focus and modified accrual basis of accounting. The Proprietary Activities are prepared using the economic resources measurement focus and the accrual basis of accounting. Reconciliation of Fund Financial Statements to the Government-Wide Financial Statements is provided to explain the differences created by the integrated approach.

For the current year the only difference between the Government-Wide Financial Statements and the Fund Financial Statements is the classifications within the fund balances. Under GASB 34 board designated reserves of fund balances are considered unrestricted. The Fund Financial Statements reduce the unrestricted portion of the

PENINSULA HEALTH CARE DISTRICT

MANAGEMENT'S DISCUSSION AND ANALYSIS JUNE 30, 2008

fund balance by the amounts designated for specific purposes by the District. Therefore, the following discussion and analysis will generally be equally applicable to the Government-Wide and Fund Financial Statements.

Fund Financial Statements

A fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. The District uses Government and Proprietary fund accounting to ensure and demonstrate compliance with financial-related legal requirements. The Governmental Fund is used to account for the District's basic services and the Proprietary Fund is used to account for the District's leasing activity.

Governmental fund accounting uses a flow of current resources measurement focus and the modified accrual basis of accounting. Modified accrual accounting recognizes revenues when available for current operations, normally those revenues that will be received within 90 days of year end. For the current year, substantially all revenues receivable at year end were collected within the 90 day period resulting in no difference between modified and full accrual in these financial statements. Proprietary (Enterprise) fund accounting uses the full accrual basis of accounting.

The District's financial statements include:

Balance Sheet

The Governmental Fund Balance Sheet presents information on the District's assets and liabilities, with the difference between the two reported as fund balance. Over time, increases or decreases in fund balance may serve as a useful indicator of the financial health of the District. To assess the overall health of the District, achievement of the District's mission needs to be considered as well.

Statement of Revenues, Expenditures, and Changes in Fund Balance

While the balance sheet provides information about the nature and amount of resources and obligations at year-end, the Statement of Revenues, Expenditures, and Changes in Fund Balance presents the results of the District's operations over the course of the fiscal year and information as to how the fund balance changed over the year. This can be used as an indicator of the extent to which the District has successfully recovered its costs through user fees (rental income) or other funds received (tax revenues). All changes in fund balance are reported during the period on the modified accrual method of accounting which had no significant differences from full accrual accounting, in which the underlying event giving rise to the change occurs, regardless of the timing of the related cash flows. Thus, revenues and expenses are reported in this statement for some items that will result in cash flows in future fiscal periods.

The Proprietary Fund Statement of Cash Flows presents changes in cash and cash equivalents resulting from operational, capital, non-capital, and investing activities. This statement summarizes the annual flow of cash receipts and cash payments, without consideration of the timing of the event giving rise to the obligation or receipt and excludes non-cash accounting measures of depreciation or amortization of assets.

PENINSULA HEALTH CARE DISTRICT

MANAGEMENT'S DISCUSSION AND ANALYSIS JUNE 30, 2008

Notes to Basic Financial Statements

The notes provide additional information that is essential to a full understanding of the data provided in the basic financial statements. The notes to basic financial statements can be found following the financial statements in the audited financial statements.

REQUIRED FINANCIAL STATEMENTS

The District's financial statements report information utilizing methods similar to those used by private sector companies.

- The Statement of Net Assets includes all of the assets and liabilities of the District using the accrual basis of accounting, which is similar to the accounting used by most private sector companies.
- In the Statement of Activities, all of the District's current year revenues and expenses taken into account regardless of when cash is received or paid.
- The Balance Sheets include all of the District's governmental and proprietary fund assets and liabilities and provide information about the nature and amounts of resources (assets) and obligations to creditors (liabilities).
- The Statements of Revenues, Expenditures and Changes in Fund Balance report the District's governmental and proprietary fund revenues by major source along with expenses.
- The Statement of Cash Flows reports the District's cash flows from operating activities, investing, capital and non-capital activities for the business-type fund.

STATEMENT OF NET ASSETS

	<u>2007-2008</u>	<u>2006-2007</u>	Dollar <u>Change</u>	Percent <u>Change</u>
Current Assets	\$ 37,179,900	\$ 35,411,313	\$ 1,768,587	4.99%
Capital Assets	16,804,542	18,201,483	(1,396,941)	-7.67%
Total Assets	<u>\$ 53,984,442</u>	<u>\$ 53,612,796</u>	<u>\$ 371,646</u>	-2.68%
Current Liabilities	\$ 670,342	\$ 270,124	\$ 400,218	148.16%
Total Liabilities	<u>\$ 670,342</u>	<u>\$ 270,124</u>	<u>\$ 400,218</u>	148.16%
Invested in Capital Assets	\$ 16,804,542	\$ 18,201,483	\$ (1,396,941)	-7.67%
Unrestricted	36,509,558	35,141,189	1,368,369	3.89%
Total Net Assets	<u>\$ 53,314,100</u>	<u>\$ 53,342,672</u>	<u>\$ (28,572)</u>	-3.78%

Total net assets were essentially flat, decreasing by less than \$.03 million. Current Assets increased by \$1.8 million and Capital Assets increased by \$3.3 million with the purchase and improvements to 1875 Trousdale; however, Depreciation was over \$4.7 million due to the accelerated schedule implemented to have the hospital and equipment fixed asset lives correspond with the anticipated opening of the new hospital by January 1, 2011. This resulted in the Total Net Asset reduction.

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**MANAGEMENT'S DISCUSSION AND ANALYSIS
JUNE 30, 2008**

REVIEW OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS

	<u>2007-2008</u>	<u>2006-2007</u>	Dollar <u>Change</u>	Percent <u>Change</u>
Revenues				
Tax Revenue	\$ 4,056,106	\$ 3,806,039	\$ 250,067	6.57%
Lease Income	1,781,364	1,598,705	182,659	11.43%
Interest Income	1,461,255	1,416,995	44,260	3.12%
Other Non-Operating Income	-	8,351,165	(8,351,165)	
Other Revenue	32,843	17,648	15,195	86.10%
Total Revenue	<u>7,331,568</u>	<u>15,190,552</u>	<u>(7,858,984)</u>	-51.74%
Expenditures				
Administrative Personnel	248,935	95,990	152,945	159.33%
Tax Administrative Fee	28,433	27,707	726	2.62%
Communications	12,776	191,565	(178,789)	-93.33%
Consulting	38,605	172,753	(134,148)	-77.65%
Depreciation	4,708,227	3,667,042	1,041,185	28.39%
Grants	1,985,025	1,479,490	505,535	34.17%
Legal Fees	110,345	319,860	(209,515)	-65.50%
Promotion	80,790	102,750	(21,960)	-21.37%
Rent	27,219	-	27,219	
Property Expenses	3,081	-	3,081	
Other	116,704	326,647	(209,943)	-64.27%
Total Expenditures	<u>7,360,140</u>	<u>6,383,804</u>	<u>976,336</u>	15.29%
Change in Net Assets	(28,572)	8,806,748	(8,835,320)	-100.32%
Net Assets beginning of Year	53,342,672	44,535,924	8,806,748	19.77%
Net Assets End of Year	<u>\$ 53,314,100</u>	<u>\$ 53,342,672</u>	<u>\$ (28,572)</u>	-0.05%

REVENUES

All sources of revenue increased. Gross Tax Revenues were up 6.6% which is consistent with assessed property tax values within the District. Lease Income increased 11.4% due to receiving a full 12-month's rent for the two properties returned to the District as part of the 50-year Master Lease Agreement (1848 El Camino and 1600 Trousdale), as well as the 6 months rent generated by the new property, 1875 Trousdale – purchased by the District in August 2007. Other Revenue increased \$15,000 primarily due to improved RN student loan tracking and application of repayment terms of the Loan Agreement. Interest Income is the one category that fell short of expectations due to general economic conditions and the impact on the performance of the District's two, low-risk

PENINSULA HEALTH CARE DISTRICT

MANAGEMENT'S DISCUSSION AND ANALYSIS

JUNE 30, 2008

government funds: the State's Local Agency Investment Fund and the County's Pooled Fund. Performance was \$240,000 below budget and only \$44,260 or 3.12% above prior year. Total Revenues were \$490,000 above 2007 when the \$8.4 million Non-operating entry for the property sale in 2006 is excluded.

EXPENDITURES

Total Expenditures, net of Depreciation, decreased from \$2.7 million in 2007 to \$2.65 million in 2008 and that included the Board's decision to increase the community grants by \$500,000. 2008 was a unique time in the District's history, one in which it achieved complete operating independence from MPHS and Peninsula Medical Center. The new District office was established, equipped, staffed, and supported by District-specific vendor relationships (e.g. Data Connect for IT, AT&T for phones, IKON copier, Pitney Bowes mail meter, etc.) This change is reflected in the 68% increase in the Operating categories of Administration Personnel, Tax Administration Fee and Rent totaling \$180,900. However, the effectiveness of the Board's new direction and this new operating structure is documented by the decreased reliance on consulting services for Communications, General Consulting, and Promotion, which resulted in a 39% decrease in those operating expense categories from \$467,000 in 2007 to \$132,000 in 2008. Legal Fees were also reduced by 65%. This occurred because of the maturing of the Master Lease and Construction Agreement Document's implementation, the reduction in activity required by the Guardian Law Suit, and the leadership and screening provided by the Board's chief executive before seeking legal counsel. Other Expenses decreased by 64% because fiscal year ended June 30, 2008 was a non-election year, which reduced this expense category by nearly \$200,000.

BUDGET

A comparison of the budgeted to actual revenues and expenditures is provided in the supplementary section for the general fund. Total Revenues were \$50,000 over budget and Operating Expenses were \$160,000 under budget resulting in a positive performance of \$210,000. Administrative Personnel expenses were \$40,000 under budget. This was due to the earlier than planned transition of the CEO from an independent contractor to a benefited District employee (February 1 vs. May 1). Also, the Board gave the CEO a \$10,000 performance grant to recognize the quality and quantity of work accomplished. This change and grant were thoroughly discussed and approved by the Board and documented in its minutes of January 31, 2008. Other changes are discussed above in the revenue and expenditures sections.

CAPITAL ASSETS

	<u>2007-2008</u>	<u>2006-2007</u>	Dollar <u>Change</u>	Percent <u>Change</u>
Land and Improvements	\$ 5,609,237	\$ 2,432,211	\$ 3,177,026	130.62%
Building and Improvements	58,470,861	58,336,601	134,260	0.23%
Equipment	21,412,834	21,412,834	-	0.00%
Subtotal	<u>85,492,932</u>	<u>82,181,646</u>	<u>3,311,286</u>	<u>4.03%</u>
Less Accumulated Depreciation	<u>68,688,390</u>	<u>63,980,163</u>	<u>4,708,227</u>	<u>7.36%</u>
Capital Assets - Net of Depreciation	<u>\$ 16,804,542</u>	<u>\$ 18,201,483</u>	<u>\$ (1,396,941)</u>	<u>-7.67%</u>

The decrease in capital assets reflects the purchase of, and improvements in, the new District property at 1875 Trousdale (see discussion under "Revenue") net of depreciation (see discussion under "Expenditures").

PENINSULA HEALTH CARE DISTRICT

MANAGEMENT'S DISCUSSION AND ANALYSIS JUNE 30, 2008

ECONOMIC AND OTHER FACTORS

The District Board successfully completed and approved its Strategic Plan at the August 23, 2007 Board Meeting. A key initiative in the Plan was to establish a Financial Policy that would guide the Board's investments and operating decisions to achieve the needed reserves required to meet the financial obligations detailed in the 50-year Master Agreements (Note 7). Assisted by the consulting services of nationally recognized experts in healthcare and financial planning, a projected 50-year target was set at \$500M and three models to achieve the target were evaluated. The Board approved its Financial Policy by Resolution #2007-1 at the December 13, 2007 meeting. Under this policy, annual operating expenses must not exceed 10% of the value of the net assets at year end of the prior year. This guideline is intended to stimulate revenue growth, protect current assets, increase support for community health programs and services, while controlling other operating expenses.

Another key strategic initiative was the launching of a Property Development Master Planning Process that would guide the use of current properties and to establish a plan for the 5 acres adjacent to the new hospital, which will revert back to District use upon the demolition of the current hospital. This planning process was launched in May 2008 and is facilitated by Hammel, Green and Abrahamson, Inc., architects with extensive healthcare experience. In support of this strategic initiative, 1875 Trousdale was purchased (It sits on the corner of those 5 acres), 1848 El Camino was sold as it was across a major street from the hospital campus and limited in its strategic usefulness, and District interest has been expressed to the current owner of 1825 Trousdale (Also adjacent to the 5 acres and next door to 1875 Trousdale).

On a more operational front, the District engaged the services of an independent contractor CPA in July 2007, who took over the District's accounting needs from the MPHS staff. The District's Internal Control Policy was revised, with detailed input from the Treasurer, new Accountant, and the Auditors to reflect the operational changes created by the new management structure and to ensure tightly controlled, well understood procedures.

On the macro front, the national economic crisis has had a direct impact on the District, with the District's San Mateo Pooled Fund taking a \$900,000 loss in October 2008 due to the County's Lehman Bros. holdings. The numbers of uninsured and under-insured residents in the County is increasing and the safety net health care providers are experiencing more demand than there is capacity and with the inadequate government funding being cut even further. These dynamics require active engagement of District leaders in the community effort to seek and implement creative solutions to address this growing health system crisis. Board leaders have served on the County's Blue Ribbon Task Force for Adult Healthcare Coverage, the Healthy San Mateo Collaborative and the Hospital Consortium. Board meetings regularly include guest speakers from the County health system and the community provider network. The Board has taken a firm, educational, and detailed approach in responding to the 2007 and 2008 Civil Grand Jury Reports – both focused on using healthcare district assets to help offset the health system demands on the County's General Fund. District leaders have significantly increased their activity and visibility in the community.

In summary, there are many economic and other factors challenging all of the healthcare system, as well as, our District. However, the PHCD has a stable, committed Board of Directors (both incumbents went unchallenged this year), with a clear, shared vision, a thoroughly vetted Strategic Plan and an effective management structure to carry out the plan.

PENINSULA HEALTH CARE DISTRICT

MANAGEMENT'S DISCUSSION AND ANALYSIS JUNE 30, 2008

FINANCIAL CONTACT

The financial report is designed to provide interested parties with a general overview of the District's finances and to demonstrate the District's accountability for the funds it receives. If you have any questions about this report or need additional financial information, contact: Treasurer, Peninsula Health Care District, 1600 Trousdale Drive, Suite 1210, Burlingame, CA 94010.

PENINSULA HEALTH CARE DISTRICT

**STATEMENT OF NET ASSETS
JUNE 30, 2008**

	<u>Governmental Activities</u>	<u>Business-Type Activities</u>	<u>Total</u>
Current Assets			
Cash and Cash Equivalents	\$ 36,222,001	\$ 660,687	\$ 36,882,688
Interest Receivable	280,712	-	280,712
Prepaid Expense	16,500	-	16,500
Total Current Assets	<u>36,519,213</u>	<u>660,687</u>	<u>37,179,900</u>
Property, Plant, and Equipment - Net			
Depreciable	-	11,926,351	11,926,351
Non-Depreciable	-	4,878,191	4,878,191
Total Property, Plant, and Equipment - Net	<u>-</u>	<u>16,804,542</u>	<u>16,804,542</u>
Total Assets	<u>36,519,213</u>	<u>17,465,229</u>	<u>53,984,442</u>
Current Liabilities			
Accounts Payable	1,482	5,510	6,992
Accrued Payroll	8,173	-	8,173
Deferred Revenues	-	655,177	655,177
Total Current Liabilities	<u>9,655</u>	<u>660,687</u>	<u>670,342</u>
Net Assets			
Invested in Capital Assets	-	16,804,542	16,804,542
Unrestricted	36,509,558	-	36,509,558
Total Net Assets	<u>\$ 36,509,558</u>	<u>\$ 16,804,542</u>	<u>\$ 53,314,100</u>

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

PENINSULA HEALTH CARE DISTRICT

**STATEMENT OF ACTIVITIES
YEAR ENDING JUNE 30, 2008**

<u>Functions/Programs</u>	<u>Expenses</u>	<u>Program Revenue</u> <u>Charges for Services and Sales</u>
Governmental Activities:		
Community Grants	\$ 1,985,025	\$ -
General Administration:		
Administrative Personnel	248,935	-
Tax Administration Fee	28,433	-
Communication	12,776	-
Consulting	38,605	-
Legal Fees	56,954	-
Promotion	80,790	-
Rent	27,219	-
Other	116,704	-
Total Governmental Activities	<u>2,595,441</u>	<u>-</u>
Business Type Activities:		
Leasing	-	1,781,364
Depreciation	4,708,227	-
Legal Fees	53,391	-
Property Expenses	3,081	-
Total Business Activities	<u>4,764,699</u>	<u>1,781,364</u>
Total Primary Government	<u>\$ 7,360,140</u>	<u>\$ 1,781,364</u>

General Revenues:
Property Taxes
Interest and Investment Earnings
Other
Transfers Between Funds
Subtotal - General Revenue
Change in Net Assets
Net Assets - Beginning of Year
Net Assets - End of Year

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

**Net (Expenses) Revenue and
Changes in Net Assets**

Governmental Activities	Business Type Activities	Total
\$ (1,985,025)	\$ -	\$ (1,985,025)
(248,935)	-	(248,935)
(28,433)	-	(28,433)
(12,776)	-	(12,776)
(38,605)	-	(38,605)
(56,954)	-	(56,954)
(80,790)	-	(80,790)
(27,219)	-	(27,219)
(116,704)	-	(116,704)
<u>(2,595,441)</u>	<u>-</u>	<u>(2,595,441)</u>
-	1,781,364	1,781,364
-	(4,708,227)	(4,708,227)
-	(53,391)	(53,391)
-	(3,081)	(3,081)
<u>-</u>	<u>(2,983,335)</u>	<u>(2,983,335)</u>
<u>(2,595,441)</u>	<u>(2,983,335)</u>	<u>(5,578,776)</u>
4,056,106	-	4,056,106
1,461,255	-	1,461,255
32,843	-	32,843
<u>(1,343,735)</u>	<u>1,343,735</u>	<u>-</u>
<u>4,206,469</u>	<u>1,343,735</u>	<u>5,550,204</u>
1,611,028	(1,639,600)	(28,572)
34,898,530	18,444,142	53,342,672
<u>\$ 36,509,558</u>	<u>\$ 16,804,542</u>	<u>\$ 53,314,100</u>

PENINSULA HEALTH CARE DISTRICT

**GOVERNMENTAL FUND
BALANCE SHEET
JUNE 30, 2008**

	<u>General Fund</u>
Current Assets	
Cash and Investments	\$ 36,222,001
Interest Receivable	280,712
Prepaid Expense	16,500
Total Assets	<u>\$ 36,519,213</u>
Current Liabilities	
Accounts Payable	\$ 1,482
Accrued Payroll	8,173
Total Liabilities	<u>9,655</u>
Fund Balance	
Designated for Future Capital Needs	<u>36,509,558</u>
Total Fund Balance	<u>36,509,558</u>
Total Liabilities and Fund Balance	<u>\$ 36,519,213</u>

There were no reconciling items between the Governmental Fund Balance Sheet and the Statement of Net Assets

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

PENINSULA HEALTH CARE DISTRICT

**GOVERNMENTAL FUND
STATEMENT OF REVENUES, EXPENDITURES AND CHANGES
IN FUND BALANCE
YEAR ENDED JUNE 30, 2008**

	<u>General Fund</u>
Revenues	
Tax Revenue	\$ 4,056,106
Interest Income	1,461,255
Other Revenue	32,843
Total Revenues	<u>5,550,204</u>
Expenditures	
Administrative Personnel	248,935
Tax Administration Fee	28,433
Communications	12,776
Consulting	38,605
Grants	1,985,025
Legal Fees	56,954
Promotion	80,790
Rent	27,219
Other	116,704
Total Expenditures	<u>2,595,441</u>
Excess of Revenue Over Expenditures	2,954,763
Transfers Out	<u>(1,343,735)</u>
Net Change in Fund Balance	1,611,028
Fund Balance - Beginning of Year	<u>34,898,530</u>
Fund Balance - End of Year	<u>\$ 36,509,558</u>

There were no reconciling items between the Governmental Fund Statement of Revenues, Expenditures and Changes in Fund Balance and the Statement of Activities

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

PENINSULA HEALTH CARE DISTRICT

**STATEMENT OF NET ASSETS
PROPRIETARY FUND
JUNE 30, 2008**

	<u>Business-Type Activities</u>
	<u>Enterprise Fund</u>
	<u>Leasing</u>
Current Assets	
Cash and Cash Equivalents	\$ 660,687
Total Current Assets	<u>660,687</u>
Property, Plant, and Equipment - Net	
Depreciable	11,926,351
Non-Depreciable	4,878,191
Total Property, Plant, and Equipment - Net	<u>16,804,542</u>
Total Assets	<u>17,465,229</u>
Current Liabilities	
Accounts Payable	5,510
Deferred Revenues	655,177
Total Liabilities	<u>660,687</u>
Fund Balance	
Invested in Capital Assets	16,804,542
Unrestricted	-
Total Fund Balance	<u>\$ 16,804,542</u>

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

PENINSULA HEALTH CARE DISTRICT

**STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND
NET ASSETS
PROPRIETARY FUND
YEAR ENDED JUNE 30, 2008**

	<u>Business-Type Activities</u>
	<u>Enterprise Fund</u>
	<u>Leasing</u>
Operating Revenues	
Leasing Income	\$ 1,781,364
Operating Expenses	
Depreciation	4,708,227
Legal Fees	53,391
Property Expenses	3,081
Total Operating Expenditures	<u>4,764,699</u>
Operating Loss	(2,983,335)
Transfers In	<u>1,343,735</u>
Change in Net Assets	(1,639,600)
Net Assets - Beginning of Year	<u>18,444,142</u>
Net Assets - End of Year	<u>\$ 16,804,542</u>

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

PENINSULA HEALTH CARE DISTRICT

**STATEMENT OF CASH FLOWS
PROPRIETARY FUND
YEAR ENDED JUNE 30, 2008**

	<u>Business-Type Activities</u> <u>Proprietary Fund</u>
Cash Flows from Operating Activities:	
Leasing Revenues	\$ 1,754,186
Legal Fees	(53,931)
Property Expenses	(3,081)
Net Cash Provided by Operating Activities	<u>1,697,174</u>
Cash Flows from Noncapital Financing Activities	
Transfers from the General Fund	1,343,735
Net Cash Provided by Noncapital Financing Activities	<u>1,343,735</u>
Cash Flows from Capital Financing Activities	
Deposit on Sale of Property	378,000
Purchases of Property	(3,256,931)
Net Cash Used in Capital Financing Activities	<u>(2,878,931)</u>
Net Increase in Cash and Cash Equivalents	161,978
Cash and Cash Equivalents - Beginning of Year	<u>498,709</u>
Cash and Cash Equivalents - End of Year	<u>\$ 660,687</u>
Reconciliation of Net Income to Net Cash Provided by Operating Activities	
Loss from Operations	\$ (2,983,335)
Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities	
Depreciation	4,708,227
Property Received as Leasing Revenues	(27,178)
Decrease in Accounts Payable	(540)
Net Cash Provided by Operating Activities	<u>\$ 1,697,174</u>

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

PENINSULA HEALTH CARE DISTRICT

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2008

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Financial Reporting Entity

Peninsula Health Care District (the "District") is a political subdivision of the State of California organized in 1947. The District is not subject to state or federal taxes. The mission of the District is to ensure Peninsula Medical Services provides needed core services, to support programs that share their vision, and to do so in collaboration with other providers and qualified members of the community.

The District Board will carry out this mission through:

- Preserving Peninsula Hospital as a community asset,
- Achieving measurable improvements in identified health problems in the District,
- Improving availability of and access to health information and services for all residents of the district, and
- Ensuring sufficient resources to achieve the Board's vision, mission and strategic initiatives.

Basis of Presentation - Fund Accounting

The accounting system is organized and operated on a fund basis. A fund is defined as a fiscal and accounting entity with a self-balancing set of accounts, which are segregated for the purpose of carrying on specific activities or attaining certain objectives in accordance with special regulations, restrictions, or limitations. The District's funds are grouped into two broad fund categories: governmental and proprietary.

Governmental Funds Governmental funds are those through which most governmental functions typically are financed. Governmental fund reporting focuses on the sources, uses, and balances of current financial resources. Expendable assets are assigned to the various governmental funds according to the purposes for which they may or must be used. Current liabilities are assigned to the fund from which they will be paid. The difference between governmental fund assets and liabilities is reported as fund balance. The following is the District's major governmental fund:

General Fund The General Fund accounts for all financial resources except those required to be accounted for in another fund. The General Fund balance is available to the District for any purpose provided it is expended or transferred according to the general laws of California.

Proprietary Funds Proprietary fund reporting focuses on the determination of operating income, changes in net assets, financial position, and cash flows. The District applies all GASB pronouncements, as well as the Financial Accounting Standards Board pronouncements issued on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements. Proprietary funds are classified as enterprise or internal service. The District has the following proprietary fund:

Enterprise Fund Enterprise funds may be used to account for any activity for which a fee is charged to external users for goods or services. The enterprise fund of the District accounts for the financial transactions related to the property leasing operations of the District.

PENINSULA HEALTH CARE DISTRICT

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2008

Basis of Accounting/Measurement Focus

Government-Wide Financial Statements The government-wide financial statements are prepared using the economic resources measurement focus and the accrual basis of accounting. This is the same approach used in the preparation of the proprietary fund financial statements, but differs from the manner in which governmental fund financial statements are prepared.

The government-wide statement of activities presents a comparison between expenses, both direct and indirect, and program revenues for each segment of the business-type activities of the District and for each governmental function. Direct expenses are those that are specifically associated with a service, program, or department and are therefore, clearly identifiable to a particular function. The District does not allocate indirect expenses to functions in the Statement of Activities, except for depreciation. Program revenues include charges paid by the recipients of the goods or services offered by the programs and grants and contributions that are restricted to meeting the operational or capital requirements of a particular program. Revenues that are not classified as program revenues are presented as general revenues. The comparison of program revenues and expenses identifies the extent to which each program or business segment is self-financing or draws from the general revenues of the District.

Net assets should be reported as restricted when constraints placed on net asset use are either externally imposed by creditors (such as through debt covenants), grantors, contributors, or laws or regulations of other governments or imposed by law through constitutional provisions or enabling legislation. The District had no restrictions at year end.

Fund Financial Statements Fund financial statements report detailed information about the District. The focus of governmental and enterprise fund financial statements is on major funds rather than reporting funds by type. Each major fund is presented in a separate column.

Governmental Funds All governmental funds are accounted for using the flow of current financial resources measurement focus and the modified accrual basis of accounting. With this measurement focus, only current assets and current liabilities generally are included on the balance sheet. The statement of revenues, expenditures, and changes in fund balance reports on the sources (revenues and other financing sources) and uses (expenditures and other financing uses) of current financial resources. This approach differs from the manner in which the governmental activities of the government-wide financial statements are prepared. Governmental fund financial statements, therefore, include reconciliations with brief explanations to better identify the relationship between the government-wide financial statements, prepared using the economic resources measurement focus and the accrual basis of accounting, and the governmental fund financial statements, prepared using the flow of current financial resources measurement focus and the modified accrual basis of accounting. For the current year there were no differences requiring a reconciliation.

Proprietary Funds Proprietary funds are accounted for using the flow of economic resources measurement focus and the accrual basis of accounting. All assets and all liabilities associated with the operation of this fund are included in the statement of net assets. The statement of changes in fund net assets presents increases (revenues) and decreases (expenses) in net total assets. The statement of cash flows provides information about how the District finances and meets the cash flow needs of its proprietary fund.

PENINSULA HEALTH CARE DISTRICT

NOTES TO FINANCIAL STATEMENTS JUNE 30, 2008

Cash and Cash Equivalents

The District's cash and cash equivalents are considered to be cash on hand, demand deposits, and short-term investments with original maturities of three months or less from the date of acquisition. Cash equivalents also include cash with county treasury and state fund balances for purposes of the statement of cash flows

Investments

Investments held at June 30, 2008, with original maturities greater than one year are stated at fair value. Fair value is estimated based on quoted market prices at year-end. All investments not required to be reported at fair value are stated at cost or amortized cost.

Capital Assets and Depreciation

The accounting and reporting treatment applied to the capital assets associated with a fund are determined by its measurement focus. Capital assets are long-lived assets of the District. Improvements are capitalized; the costs of normal maintenance and repairs that do not add to the value of the asset or materially extend an asset's life are not capitalized, but are expensed as incurred.

The valuation basis for capital assets is historical cost, or where historical cost is not available, estimated historical cost based on replacement cost. The District capitalizes purchases exceeding \$5,000.

Governmental Fund Capital Assets. When purchased, such assets are recorded as expenditures in the governmental funds and capitalized in the government-wide statement of net assets. The District's Governmental Fund has no capital assets. All capital asset purchases were recorded in the Proprietary Fund during the current year.

Proprietary Fund Capital Assets. Fixed assets purchased in the proprietary fund are capitalized.

Depreciation is computed using the straight-line method. Estimated useful lives of the various classes of depreciable capital assets are as follows:

	<u>Lives of Assets</u>
Equipment	3-7
Buildings and Improvements	15-48

PENINSULA HEALTH CARE DISTRICT

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2008

Deferred Revenue

Deferred revenue arises when potential revenue does not meet both the "measurable" and "available" criteria for recognition in the current period or when resources are received by the District prior to the incurrence of qualifying expenditures. In subsequent periods, when both revenue recognition criteria are met, or when the District has a legal claim to the resources, the liability for deferred revenue is removed from the balance sheet and revenue is recognized. Deferred Revenue of \$655,177 at June 30, 2008 represents two months prepaid rent from Mills Peninsula Health Services (MPHS) as discussed in Note 6 for \$250,000, deposits received for the sale of property of \$378,000 as discussed in Note 11, and tenant funded improvements of \$27,177 recorded as a District asset and to be applied against rent in the following year as discussed in Note 5.

Budgetary Data

The amounts reported as the original budgeted amounts in the budgetary statements reflect the amounts when the original appropriations were adopted. The amounts reported as the final budgeted amounts in the budgetary statements reflect the amounts after all budget amendments have been accounted for. In the budgetary comparison schedule the original and final budgeted amounts are the same.

Tax Revenue

The District has the authority to collect taxes on property within its political subdivision. Taxes are received from the County of San Mateo, which has responsibility for their collection. Secured property taxes attach as an enforceable lien on property as of March 1. Taxes are payable in two installments due November 15 and March 15. Unsecured property taxes are payable in one installment on or before August 15. The County of San Mateo bills and collects the taxes for the District. Tax revenues are recognized by the District when received. The County remits all taxes due to the District when due, or within 60 days of year end. The County of San Mateo remits taxes based on assessed valuations under the Teeter Plan, therefore, there are no taxes receivable, uncollectible, or deferred.

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 amounts reported in the financial statements and accompanying notes. Actual results may differ from those estimates.

PENINSULA HEALTH CARE DISTRICT

NOTES TO FINANCIAL STATEMENTS JUNE 30, 2008

NOTE 2 – DEPOSITS AND INVESTMENTS

Summary of Deposits and Investments

Deposits and investments as of June 30, 2008, are classified in the accompanying financial statements as follows:

Governmental Activities	\$ 36,222,001
Business-Type Activities	660,687
Total Deposits and Investments	<u>\$ 36,882,688</u>

Deposits and investments as of June 30, 2008, consist of the following:

	Fair Value	Amortized Cost Basis
Cash on Hand and in Banks	\$ 507,990	\$ 507,990
Investment in Local Agency Investment Fund	20,475,113	20,476,132
Investment in San Mateo County Pool	15,860,542	15,898,566
Total Deposits and Investments	<u>\$ 36,843,645</u>	<u>\$ 36,882,688</u>

Policies and Practices

The District is authorized under California Government Code to make direct investments in local agency bonds, notes, or warrants within the State; U.S. Treasury instruments; registered State warrants or treasury notes; securities of the U.S. Government, or its agencies; bankers acceptances; commercial paper; certificates of deposit placed with commercial banks and/or savings and loan companies; repurchase or reverse repurchase agreements; medium term corporate notes; shares of beneficial interest issued by diversified management companies, certificates of participation, obligations with first priority security; and collateralized mortgage obligations.

Investment in County Treasury – The District is a voluntary participant in the San Mateo County Investment Pool. The fair value of the District's investment in the pool is reported in the accounting financial statements at amounts based upon the District's pro-rata share of the amortized cost basis provided by the County Treasurer for the entire portfolio which approximates fair value. The balance available for withdrawal is based on the accounting records maintained by the County Treasurer, which is recorded on the amortized cost basis.

Investment in the State Investment Pool - The District is a voluntary participant in the Local Agency Investment Fund (LAIF) that is regulated by California government code Section 16429 under the oversight of the Treasurer of the State of California. The District's investment in the pool is reported in the accompanying financial statement at amounts based upon the District's pro-rata share of the amortized cost basis provided by LAIF for the entire LAIF portfolio which approximates fair value. The balance available for withdrawal is based on the accounting records maintained by LAIF, which is recorded on the amortized cost basis.

PENINSULA HEALTH CARE DISTRICT

**NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2008**

General Authorizations

Limitations as they relate to interest rate risk, credit risk, and concentration of credit risk are indicated in the schedules below:

Authorized Investment Type	Maximum Remaining Maturity	Maximum Percentage of Portfolio	Maximum Investment In One Issuer
Local Agency Bonds, Notes, Warrants	5 years	None	None
Registered State Bonds, Notes, Warrants	5 years	None	None
U.S. Treasury Obligations	5 years	None	None
U.S. Agency Securities	5 years	None	None
Banker's Acceptance	180 days	40%	30%
Commercial Paper	270 days	25%	10%
Negotiable Certificates of Deposit	5 years	30%	None
Repurchase Agreements	1 year	None	None
Reverse Repurchase Agreements	92 days	20% of base	None
Medium-Term Notes	5 years	30%	None
Mutual Funds	N/A	20%	10%
Money Market Mutual Funds	N/A	20%	10%
Mortgage Pass-Through Securities	5 years	20%	None
County Pooled Investment Funds	N/A	None	None
Local Agency Investment Fund (LAIF)	N/A	None	None
Joint Powers Authority Pools	N/A	None	None

Interest Rate Risk

Interest rate risk is the risk that changes in market interest rates will adversely affect the fair value of an investment. Generally, the longer the maturity of an investment, the greater the sensitivity of its fair value to changes in market interest rates. The District manages its exposure to interest rate risk by investing substantially all of its funds in County and State investment pools.

Segmented Time Distribution

Information about the sensitivity of the fair values of the District's investments to market interest rate fluctuations is provided by the following schedule that shows the distribution of the District's investments by maturity. The data was provided by the investment pools:

PENINSULA HEALTH CARE DISTRICT

**NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2008**

<u>Investment Type</u>	<u>Fair Value</u>	<u>Weighted Average Maturity in Years</u>
San Mateo County Pool	\$ 15,860,541	1.2
Local Agency Investment Pool	20,475,113	0.5
Total	<u>\$ 36,335,654</u>	

Credit Risk

Credit risk is the risk that an issuer of an investment will not fulfill its obligation to the holder of the investment. This is measured by the assignment of a rating by a nationally recognized statistical rating organization. Presented below is the minimum rating required by the California Government Code, the Districts' investment policy, or debt agreements, and the actual rating as of the year-end for each investment type. Investments in the County and State investment pools are not required to be rated.

<u>Investment Type</u>	<u>Fair Value</u>	<u>Minimum Legal Rating</u>	<u>Unrated</u>
San Mateo County Pool	\$ 15,860,541	N/A	\$ 15,860,541
Local Agency Investment Pool	20,475,113	N/A	20,475,113
Total	<u>\$ 36,335,654</u>		<u>\$ 36,335,654</u>

Custodial Credit Risk - Deposits

This is the risk that in the event of a bank failure, the District's deposits may not be returned to it. The District does not have a policy for custodial credit risk for deposits. However, the California Government Code requires that a financial institution secure deposits made by state or local governmental units by pledging securities in an undivided collateral pool held by a depository regulated under state law (unless so waived by the governmental unit). The market value of the pledged securities in the collateral pool must equal at least 110 percent of the total amount deposited by the public agencies. California law also allows financial institutions to secure public deposits by pledging first trust deed mortgage notes having a value of 150 percent of the secured public deposits and letters of credit issued by the Federal Home Loan Bank of San Francisco having a value of 105 percent of the secured deposits. As of June 30, 2008, the District's bank balance of \$665,071 was either FDIC insured or collateralized with securities held by the pledging financial institution's trust department or agent, but not in the name of the District.

Custodial Credit Risk – Investments

The custodial risk for investments is the risk that, in the event of the failure of the counterparty (e.g. broker-dealer) to a transaction, a government will not be able to recover the value of its investment or collateral securities that are in the possession of another party. The District manages custodial risk by investing its assets in County and State investment pools. The California government Code and the District's investment policy do not contain legal or policy requirements that would limit the exposure to custodial risk for investments.

PENINSULA HEALTH CARE DISTRICT

**NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2008**

NOTE 3 – CAPITAL ASSETS

Activity in capital assets for the year ended June 30, 2008 was as follows:

Capital Assets	Beginning	Additions	Retirements	Ending
Land	\$ 1,701,165	\$ 3,177,026	\$ -	\$ 4,878,191
Land Improvements	731,046	-	-	731,046
Buildings and Improvements	58,336,601	134,260	-	58,470,861
Equipment	21,412,834	-	-	21,412,834
	<u>82,181,646</u>	<u>3,311,286</u>	<u>-</u>	<u>85,492,932</u>
Accumulated Depreciation				
Land Improvements	730,971	75	-	731,046
Buildings and Improvements	43,561,955	4,101,848	-	47,663,803
Equipment	19,687,237	606,304	-	20,293,541
	<u>63,980,163</u>	<u>4,708,227</u>	<u>-</u>	<u>68,688,390</u>
Capital Assets - Net	<u>\$ 18,201,483</u>	<u>\$ (1,396,941)</u>	<u>\$ -</u>	<u>\$ 16,804,542</u>

As discussed in Note 7, the existing hospital building will be demolished and substantially all of the equipment disposed of after the construction and equipping of the new hospital. The new hospital is being built and will be operated by MPHS on land leased from the District. Accordingly, as of November 2006, the District changed the estimated depreciable lives of its capital assets associated with the operations of the existing hospital to be fully depreciated by December 2010. Salvage value of equipment is not expected to be material.

The agreements between MPHS and the District contain certain covenants restricting the use of District property and providing MPHS with first right of refusal should the District offer the property for sale.

PENINSULA HEALTH CARE DISTRICT

**NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2008**

NOTE 4 - FUND BALANCES

The Governmental Fund balance with reservations/designations is composed of the following elements:

	<u>General Fund</u>
Unreserved	
Designated	
Future capital needs	\$ 36,509,558
Total Designated	<u>36,509,558</u>
Undesignated	-
Total Unreserved	<u>36,509,558</u>
Total	<u><u>\$ 36,509,558</u></u>

NOTE 5 – LEASE AGREEMENTS

The District leases the hospital facilities and equipment located at 1501 Trousdale to MPHS—under a lease agreement entered into in 1985 (the “Existing Hospital Lease”). The rent payments under Existing Hospital Lease were modified under the Pre-Closing Agreement between MPHS and the District (for the period between September 2005 and October 2006) and by the Construction Ground Lease (which became effective on November 1, 2006). Under the Pre-Closing Agreement, MPHS made monthly rent payments of \$125,000 for the months September 2005 through October 2006. In November 2006, upon the Construction Ground Lease becoming effective (and the District lease to MPHS of additional land – the site for the new hospital), rental payments converted to annual payments, at a rate of \$1,500,000/year. To convert to annual rent payments MPHS was required to pay all rent due through August 31, 2007. Beginning in September 2007, MPHS makes annual lease payments of \$1,500,000, adjusted, based on CPI, on every three-year anniversary of the first modification of rent payments under the Pre-Closing Agreement (September 1, 2005), with the first such adjustment to occur on September 1, 2008. The lessee is obligated for all operating, maintenance and other costs of the facility.

When the new hospital has been completed and available for use, currently estimated to be January 2011, a fifty-year Ground Lease will become effective. The Ground Lease replaces and supersedes the Construction Ground Lease, but continues the same lease payments and three-year CPI adjustments. The initial lease payment under the Ground Lease is the same as the last annual lease payment payable under the Construction Ground Lease (the

PENINSULA HEALTH CARE DISTRICT

**NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2008**

initial rate of \$1,500,000, as adjusted over the life of the Construction Ground Lease) and will continue to be adjusted based on CPI. The Ground Lease grants MPHS an option to extend the Ground Lease for an additional 25-year period.

The District leases two additional buildings to MPHS, 1600 Trousdale (Note 4) and 1848-50 El Camino Real. The 1600 Trousdale lease commenced on April 1, 2007, has an initial term of two (2) years, with MPHS having three options to extend for one year each at fair market value, subject to the District’s right to terminate the lease early upon 180 days’ prior written notice. The 1848-50 El Camino Real lease commenced on November 1, 2006, has an initial term of one (1) year, with MPHS having an option to extend for one year, subject to either party’s right to terminate the lease early upon 180 days’ prior written notice. MPHS exercised its extension option for an additional year. Under both leases, the lessee (MPHS) is obligated for all operating, maintenance and other costs of the facility. The 1848-50 El Camino Real property was sold on July 3, 2008 as discussed in Note 11.

The District leases 1875 Trousdale under a December 26, 2007 agreement with an initial one year term. Extension terms are under negotiation. Under the lease agreement the tenant may offset the cost of building improvements against rent. During the current fiscal year the tenant disbursed \$92,555 for improvements on the property. The District recorded \$79,906 as tenant improvements, reimbursed the tenant \$38,200, and recorded \$27,178 as rental income to the current year and \$27,177 to deferred rental income.

Payments received during the current year and expected base rents through the end of the existing leases are:

	<u>1600</u> <u>Trousdale</u>	<u>1875</u> <u>Trousdale</u>	<u>1848 -1850</u> <u>El Camino</u>	<u>1501</u> <u>Trousdale</u>	<u>Totals</u>
Year ended June 30,					
2008	\$ 165,653	\$ 27,178	\$ 88,533	\$ 1,500,000	\$ 1,781,364
2009	170,622	27,178		1,573,149	1,770,949
2010	175,741			1,587,778	1,763,519
2011	181,013			1,587,778	1,768,791
2012	138,791			1,587,778	1,726,569
2013				1,587,778	1,587,778
2014-2018				7,938,890	7,938,890
2019-2023				7,938,890	7,938,890
2024-2028				7,938,890	7,938,890
2029-2033				7,938,890	7,938,890
2034-2038				7,938,890	7,938,890
Thereafter				37,312,783	37,312,783

PENINSULA HEALTH CARE DISTRICT

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2008

NOTE 6 - DEFINITIVE AGREEMENTS

The Definitive Agreements between the District and MPHS became effective on November 1, 2006. Under these agreements, MPHS will construct and equip a new hospital on land leased from the District, and then demolish the existing hospital facility. These agreements also settled litigation initiated in 1997 against MPHS seeking to rescind 1985 lease agreement and related property transfers.

NOTE 7 - CONTINGENCIES

Under the Definitive Agreements, the District is obligated as follows:

If MPHS cannot complete the new hospital and other improvements because MPHS cannot, despite reasonable efforts, obtain the required approvals therefore, then MPHS may terminate the Definitive Agreements and the District must reimburse MPHS for the costs and expenses that MPHS incurred up to the date of termination for the development and construction of new hospital improvements on the District's property.

If MPHS fails to complete the new hospital and other improvements due to a breach by MPHS of its obligations under the Definitive Agreements, the District has the option to terminate the Definitive Agreement and acquire from MPHS all of the approvals and constructed improvements for the new hospital and complete the construction itself. In such case, the District must reimburse MPHS for all of the costs and expenses that MPHS incurred for the development and construction of new hospital improvements on the District's property. The first \$5,000,000 of such reimbursement is due three (3) months after the termination date, with any additional reimbursement amount due twelve (12) months after the termination date.

At the end of the Ground Lease, or upon the District's early termination of the Definitive Agreements (which is only allowed if MPHS commits a "Paramount Default" as defined in Section 5.01.B of the Master Agreement of the Definitive Agreements at any time after MPHS opens the new hospital), the District is obligated to reimburse MPHS for certain items. Depending on the circumstances and timing of the termination of the Ground Lease, these obligations could include the Net Book Value (NBV) all Post Term Assets (certain equipment and hospital building improvements either specifically approved by the District board in the 25-year period prior to lease end, required by law, or necessitated by uninsured damage to the new hospital), and/or the Fair Market Value (FMV) of the use of certain hospital building improvements and equipment for whatever term of the Ground Lease remained as of the date of termination.

The Board has addressed the contingencies by adopting the 2007-2010 Strategic Plan in August 2007 and a resolution to establish a long term financial policy to implement the plan and assure preservation of Peninsula Hospital and certain core services both during the term of the lease and at lease end and to improve the health status of District residents and meet critical health care needs of the communities served by the District. The resolution establishes a firm policy goal for the District to accumulate reserves of approximately \$500 million, in 2010 dollars, by the end of the lease; maintain a debt to capitalization ratio that will not exceed 50%; and budget an amount up to 10% of the prior year-end accumulated reserves.

PENINSULA HEALTH CARE DISTRICT

NOTES TO FINANCIAL STATEMENTS JUNE 30, 2008

NOTE 8 – RESTRICTED GRANTS AND LOANS

As part of the District’s mission to promote the healthcare interests of the communities it serves, it grants money to nursing students and physicians within the district. The grants are subject to repayment if certain agreed upon requirements are not met.

In order to encourage the pursuit of nursing careers and graduate nurses to locate within the jurisdiction of the District, grants of up to \$4,000 are made to selected nursing students enrolled in two-year nursing programs. If the student completes the program and then completes two post graduate years in a nursing position within specified communities, the District forgives the loan in full. Grants of up to \$20,000 are made to selected nursing students enrolled in four-year nursing programs at local universities or colleges. If the student completes the four-year program and then completes four post graduate years in a nursing position within specified communities, the District forgives the loan in full.

These payments are recorded as grant expenditures. If a student or physician does not fulfill their obligation then all or part of the payment (based on the agreed upon schedules) is recognized as a loan receivable with a related recognition of revenue.

As of June 30, 2008 the District has determined that six grants were in default amounting to \$53,482. During the year the District recovered \$15,523 and has established payment plans. Because of the uncertainty of recovering the amounts owed, the District has fully reserved the receivable and will report recoveries when received. The amount of reserves will be reevaluated after the District is able to establish a collection history.

NOTE 9 - LITIGATION

The District is defendant in a lawsuit: Peninsula Guardians, Inc. v. Warren Slocum, San Mateo County Chief Election Officer, Peninsula Health Care District, and Mills-Peninsula Health Services [“MPHS”], No. SCV-456563 (San Mateo County, California Superior Court).

Plaintiff, by its current Verified Second Amended Petition and Complaint (“Second Amended Complaint”), seeks a judgment declaring invalid and enjoining transactions necessary for the voter-approved construction by MPHS of a state-of-the-art hospital on land leased to it by the District. Plaintiff does not seek monetary damages from the District.

The District has prevailed on demurrers brought at the trial court and the actions have been dismissed. Plaintiff, however, has recently filed appeals and the matter is before the Court of Appeals. In the opinion of the District’s attorneys, the likelihood of a materially adverse outcome is remote; and in the event of an adverse judicial determination regarding the lawfulness of the MPHS-District arrangements, all reasonably possible scenarios

PENINSULA HEALTH CARE DISTRICT

NOTES TO FINANCIAL STATEMENTS JUNE 30, 2008

involve restructuring of the District-MPHS business relationship so that it is lawful and MPHS continues to operate a hospital on land owned by the District.

NOTE 10 – COMMITMENTS

The District has approved \$896,331 and \$226,669 in grants to community organizations for funding during the 2008-09 and 2009-10 fiscal years respectively.

NOTE 11 – SUBSEQUENT EVENTS

On July 3, 2008 the District sold the property located at 1848-1850 El Camino Real, Burlingame, CA to Cecil Chan for \$1,700,000. The District had received \$378,000 in deposits prior to June 30, 2008 which were recorded as deferred revenue. The lease agreement in effect between the District and the lessee, Mills Peninsula Health Services was assigned to the buyer.

On October 24, 2008 the District was notified by the San Mateo County Board of Supervisors that, due to the collapse of Lehman Brothers, a loss of \$897,895 would be allocated to the District's interest in the San Mateo County Investment Pool.

Required Supplementary Information

PENINSULA HEALTH CARE DISTRICT

**GENERAL FUND
BUDGETARY COMPARISON SCHEDULE
JUNE 30, 2008**

	<u>Budgetary Amounts</u> <u>Original and Final</u>	<u>Actual</u>	<u>Variance</u>
Revenues			
Tax Revenue	\$ 3,800,000	\$ 4,056,106	\$ 256,106
Interest Income	1,700,000	1,461,255	(238,745)
Other Revenue	-	32,843	32,843
Total Revenues	<u>5,500,000</u>	<u>5,550,204</u>	<u>50,204</u>
Expenditures			
Administrative Personnel	288,500	248,935	39,565
Tax Administration Fees	35,000	28,433	6,567
Communications	75,000	12,776	62,224
Consulting	50,000	38,605	11,395
Grants	2,000,000	1,985,025	14,975
Legal Fees	50,000	56,954	(6,954)
Promotions	150,000	80,790	69,210
Rent	18,500	27,219	(8,719)
Other	88,000	116,704	(28,704)
Total Expenditures	<u>2,755,000</u>	<u>2,595,441</u>	<u>159,559</u>
Excess Revenue Over Expenditures	2,745,000	2,954,763	209,763
Transfer From Other Funds *	<u>(1,343,735)</u>	<u>(1,343,735)</u>	<u>-</u>
Excess of Revenue Over Expenditures and Transfers To Other Funds	1,401,265	1,611,028	209,763
Fund Balance - Beginning of Year	<u>34,898,530</u>	<u>34,898,530</u>	<u>-</u>
Fund Balance - End of Year	<u>\$ 36,299,795</u>	<u>\$ 36,509,558</u>	<u>\$ 209,763</u>

* The District does not budget transfers.

Auditor's Report on Internal Control and Compliance



**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***

Board of Directors
Peninsula Health Care District
Burlingame, California

We have audited the financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of Peninsula Health Care District as of and for the year ended June 30, 2008, which collectively comprise the Peninsula Health Care District's basic financial statements and have issued our report thereon dated November 14, 2008. 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 Peninsula Health Care District's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Peninsula Health Care District's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Peninsula Health Care District's internal control over financial reporting.

A control deficiency 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 misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the District's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the District's financial statements that is more than inconsequential will not be prevented or detected by the District's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the District's internal control.

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

Compliance and Other Matters

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

This report is intended solely for the information and use of the governing board, management, the State Controller's Office, Federal awarding agencies, and pass-through entities, and is not intended to be and should not be used by anyone other than these specified parties.

Vavrinek, Irine, Day : Co., LLP

Palo Alto, California
November 14, 2008