

**PENINSULA HEALTH CARE DISTRICT**

**Financial Statements**

**June 30, 2007**

# PENINSULA HEALTH CARE DISTRICT

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## INDEPENDENT AUDITORS' REPORT

Board of Directors  
Peninsula Health Care District  
Burlingame, California

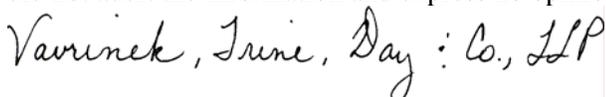
We have audited the accompanying financial statements of the governmental activities, business-type activities, and each major fund of Peninsula Health Care District (the District) as of and for the year ended June 30, 2007, which collectively comprise the District's basic financial statements as listed 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, 2007, 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 October 15, 2007, 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 7 and budgetary comparison information on page 27, 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  
Palo Alto, California

October 15, 2007

# **PENINSULA HEALTH CARE DISTRICT**

## **MANAGEMENT'S DISCUSSION AND ANALYSIS JUNE 30, 2007**

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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, 2007. This information is presented in conjunction with the audited financial statements that follow this section.

### **FINANCIAL HIGHLIGHTS**

- The District's current assets increased by \$10.3 million
- The District's net capital assets decreased by \$1.3 million
- The District's current liabilities increased by \$.26 million
- The District's fund balance increased by \$8.8 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, 2007

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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, 2007

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### 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>2006-2007</u>	<u>2005-2006</u>	Dollar <u>Change</u>	Percent <u>Change</u>
Current Assets	\$ 35,411,313	\$ 25,079,960	\$ 10,331,353	41.19%
Capital Assets	18,201,483	19,465,688	(1,264,205)	-6.49%
Total Assets	<u>\$ 53,612,796</u>	<u>\$ 44,545,648</u>	<u>\$ 9,067,148</u>	34.70%
Current Liabilities	<u>\$ 270,124</u>	<u>\$ 9,724</u>	<u>\$ 260,400</u>	2677.91%
Total Liabilities	<u>\$ 270,124</u>	<u>\$ 9,724</u>	<u>\$ 260,400</u>	2677.91%
Invested in Capital Assets	\$ 18,201,483	\$ 19,465,688	\$ (1,264,205)	-6.49%
Unrestricted	35,141,189	25,070,236	10,070,953	40.17%
Total Net Assets	<u>\$ 53,342,672</u>	<u>\$ 44,535,924</u>	<u>\$ 8,806,748</u>	33.68%

Total net assets increased \$8.8 million. This is due to an increase in total assets of \$9 million netted against an increase in liabilities of \$.26 million. Current Assets increased by \$10.3 million, primarily from an increase in cash that reflects the proceeds of the sale of the District's interest in the medical office building at 1720 El Camino Real, Burlingame. The increase in current liabilities is attributable to rent prepaid by Mills-Peninsula Health Services (MPHS) pursuant to the new agreements that went into effect in November, 2006.

# PENINSULA HEALTH CARE DISTRICT

## MANAGEMENT'S DISCUSSION AND ANALYSIS JUNE 30, 2007

### REVIEW OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS

	<u>2006-2007</u>	<u>2005-2006</u>	<u>Dollar Change</u>	<u>Percent Change</u>
Revenues				
Tax Revenue	\$ 3,806,039	\$ 3,669,899	\$ 136,140	3.71%
Lease Income	1,598,705	1,547,619	51,086	3.30%
Interest Income	1,416,995	800,598	616,397	76.99%
Other Non-Operating Income	8,351,165	-	8,351,165	
Other Revenue	17,648	22,600	(4,952)	-21.91%
Total Revenue	<u>15,190,552</u>	<u>6,040,716</u>	<u>9,149,836</u>	151.47%
Expenditures				
Administration	123,697	30,823	92,874	301.31%
Communications	191,565	90,552	101,013	111.55%
Consulting	172,753	3,143	169,610	5396.44%
Depreciation	3,667,042	1,889,498	1,777,544	94.07%
Grants	1,479,490	1,534,811	(55,321)	-3.60%
Legal Fees	319,860	109,693	210,167	191.60%
Promotions	102,750	58,454	44,296	75.78%
Other	326,647	145,145	181,502	125.05%
Total Expenditures	<u>6,383,804</u>	<u>3,862,119</u>	<u>2,521,685</u>	65.29%
Change in Net Assets	8,806,748	2,178,597	6,628,151	304.24%
Net Assets beginning of Year	<u>44,535,924</u>	<u>42,357,327</u>	<u>2,178,597</u>	5.14%
Net Assets End of Year	<u>\$ 53,342,672</u>	<u>\$ 44,535,924</u>	<u>\$ 8,806,748</u>	19.77%

### REVENUES

Gross tax revenues increased by approximately \$136,000, which seems appropriate, given the appreciation of local real estate in the District's area and the resulting impact on the tax base. Lease income is up approximately \$50,000 from the additional rent received from the properties that were returned to the District. Properties originally transferred to Mills-Peninsula Health Services in 1985 were returned as part of the 50-year Master Lease Agreement that went into effect in November, 2006. Interest income is up \$616,000 due to the increase in cash and favorable interest rates. The \$8.3 million increase in other non-operating income reflects the sale and transfer of properties discussed above.

### EXPENDITURES

Operating expenses were up approximately \$2.5 million; \$1.8 million due to additional depreciation resulting from the returned properties and an adjustment that was made to reflect the change in the useful life of the fixed assets to end in 2010 when the original hospital will no longer be used. Administrative expenses were up more than \$90,000 due to two months of the new Executive Director's salary, the relocation and start-up costs to establish a District office independent of MPHS facilities, and miscellaneous expense due to a number of special Board and Strategic Planning Town Hall meetings. Communications and Promotions expenses were approximately \$294,000 in total, \$145,300 more than the prior year. This was due to a number of unusual and non-recurring activities. These included developing and implementing a public information and education

# PENINSULA HEALTH CARE DISTRICT

## MANAGEMENT'S DISCUSSION AND ANALYSIS

JUNE 30, 2007

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campaign for the special election held in August 2006 related to the Ballot Measure V that called for a public vote on the District's agreement with Sutter-MPHS to build a new Peninsula Hospital on the District's land; preparing a communications plan with detailed Media Binder of important facts and data about the District and then implementing this plan in direct response to LAFCo's District Review and the San Mateo Board of Supervisor's Blue Ribbon Task Force on health care for the indigent- both with a focus on the District's role and assets, and the facilitation and management of a number of strategic planning Town Hall meetings open to the public during the Board's plan development process. Consulting expense was nearly \$170,000 over the prior year due primarily to the services provided by a strategic planning consultant and various real estate consultants. Legal fees were more than \$200,000 over the prior year primarily due to the litigation with the Guardians, and completion of documents relating to the final closing of the Agreement with MPHS. The increase in Other Expenses is primarily due to the cost of the regular November election for District Board seats which occurs every two years and fees charged by an executive search firm which fees should be nonrecurring.

### BUDGET

A comparison of our budgeted to actual revenues and expenditures is provided in the supplementary section for the general fund. The fund balance increase was \$5.6 million greater than budgeted. Most of the increase was due to \$4.5 million of additional transfers from the enterprise fund representing the combined effect of the property sale and transfers from MPHS, and the associated increase in depreciation from adjusting the asset lives for the destruction of the current hospital facility when the new hospital opens. Further information is provided in the notes to the financial statements.

Other changes are discussed above in the revenue and expenditures sections. All significant events contributing to the differences between budget and actual were discussed and approved as necessary by the board during the year

### CAPITAL ASSETS

	<u>2006-2007</u>	<u>2005-2006</u>	Dollar <u>Change</u>	Percent <u>Change</u>
Land and Improvements	\$ 2,432,211	\$ 731,046	\$ 1,701,165	232.70%
Building and Improvements	58,336,600	57,415,515	921,085	1.60%
Equipment	<u>21,412,835</u>	<u>21,450,367</u>	<u>(37,532)</u>	-0.17%
Subtotal	82,181,646	79,596,928	2,584,718	3.25%
Less Accumulated Depreciation	<u>63,980,163</u>	<u>60,131,240</u>	<u>3,848,923</u>	6.40%
Capital Assets - Net of Depreciation	<u>\$ 18,201,483</u>	<u>\$ 19,465,688</u>	<u>\$ (1,264,205)</u>	-6.49%

The decrease in capital assets reflects the addition of the properties returned to the District (see discussion under "Revenue") net of depreciation (see discussion under "Expenditures").

# **PENINSULA HEALTH CARE DISTRICT**

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

**JUNE 30, 2007**

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### **ECONOMIC AND OTHER FACTORS**

The District Board successfully negotiated, approved, and executed a 50-Year Master Lease Agreement with Mills-Peninsula Health Services that will result in the construction of a new, state-of-the-art, seismically sound Peninsula Hospital, on the District's land, at no cost to the District's tax payers, by 2010. This agreement was resoundingly supported by 92% of those who voted in the Special Election, August 2006. The District Board completed the implementation of this Agreement with the transfer of properties this fiscal year, as discussed above.

The Board's role changed under the terms of the new Master Agreement with emphasis now placed on the oversight of MPHS' commitment to core clinical services, property management of the lots turned back to the District at the time of the signing and into the future, (An additional four-plus acres will be returned to the District in 2010), and the need for aggressive management of property and cash assets to ensure growth so that the Board will be positioned to meet its financial obligations over the 50-year Agreement. In November 2006, the Board determined that it needed staff leadership and independence from MPHS to carry out its responsibilities. The Board retained a recruiting firm to search for and hire an Executive Director, and then charged the Executive Director with establishing an independent office outside of the hospital. The Executive Director started May 1 and the new office was opened July 2, 2007. Going forward, this independence will create increased Administrative and Operating costs for the District.

In November 2006, the Board also determined that it was critical to launch a strategic planning process. The Board retained a consulting firm to facilitate the Board's thorough analysis of its role and responsibilities, its communities' demographics and health status, health care industry trends, and related policy changes anticipated at a local, State, and National level. As part of this planning process, significant attention was paid to financial models, portfolio management strategies, and the development of financial guidelines that will give structure to the asset management over the years of the Agreement. It is anticipated that the Board will be prepared to approve a Financial Policy and launch a Property Development Master Planning Process no later than December 2007.

The Master Lease Agreement defines significant financial obligations over the 50-year term that will require the Board to manage assets with foresight in order to be prepared for the potential of "paramount default" by Sutter/MPHS and the inevitability of its obligations for capital improvements to the hospital in 25 years and its taking back ownership of the hospital at the end of the 50-year term – the latter two being a case of not "if", but "when".

### **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, 2007

	<u>Governmental Activities</u>	<u>Business-Type Activities</u>	<u>Total</u>
<b>Current Assets</b>			
Cash and Cash Equivalents	\$ 34,475,154	\$ 498,709	\$ 34,973,863
Interest Receivable	419,000	-	419,000
Prepaid Expense	18,450	-	18,450
Total Current Assets	<u>34,912,604</u>	<u>498,709</u>	<u>35,411,313</u>
<b>Property, Plant, and Equipment - Net</b>			
Depreciable	-	16,500,318	16,500,318
Non-Depreciable	-	1,701,165	1,701,165
Total Property, Plant, and Equipment - Net	<u>-</u>	<u>18,201,483</u>	<u>18,201,483</u>
Total Assets	<u>34,912,604</u>	<u>18,700,192</u>	<u>53,612,796</u>
<b>Current Liabilities</b>			
Accounts Payable	14,074	6,050	20,124
Deferred Revenues	-	250,000	250,000
Total Current Liabilities	<u>14,074</u>	<u>256,050</u>	<u>270,124</u>
<b>Net Assets</b>			
Invested in Capital Assets	-	18,201,483	18,201,483
Unrestricted	34,898,530	242,659	35,141,189
Total Net Assets	<u>\$ 34,898,530</u>	<u>\$ 18,444,142</u>	<u>\$ 53,342,672</u>

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

**PENINSULA HEALTH CARE DISTRICT**

**STATEMENT OF ACTIVITIES  
YEAR ENDING JUNE 30, 2007**

<u>Functions/Programs</u>	<u>Expenses</u>	<u>Program Revenue</u> <u>Charges for</u> <u>Services and</u> <u>Sales</u>
<b>Governmental Activities:</b>		
Community Grants	\$ 1,479,490	\$ -
General Administration:		
Administration Fees	96,941	-
Communication	191,565	-
Consulting	172,753	-
Legal Fees	92,835	-
Promotions	102,750	-
Other	326,647	-
<b>Total Governmental Activities</b>	<u>2,462,981</u>	<u>-</u>
<b>Business Type Activities:</b>		
Leasing	-	1,598,705
Other Non-Operating Income	-	8,351,165
Depreciation	3,667,042	-
Administration Fees	26,756	-
Legal	227,025	-
<b>Total Business Activities</b>	<u>3,920,823</u>	<u>9,949,870</u>
<b>Total Primary Government</b>	<u>\$ 6,383,804</u>	<u>\$ 9,949,870</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**

<b>Governmental Activities</b>	<b>Business Type Activities</b>	<b>Total</b>
\$ (1,479,490)	\$ -	\$ (1,479,490)
(96,941)	-	(96,941)
(191,565)	-	(191,565)
(172,753)	-	(172,753)
(92,835)	-	(92,835)
(102,750)	-	(102,750)
(326,647)	-	(326,647)
<u>(2,462,981)</u>	<u>-</u>	<u>(2,462,981)</u>
-	1,598,705	1,598,705
-	8,351,165	8,351,165
-	(3,667,042)	(3,667,042)
-	(26,756)	(26,756)
-	(227,025)	(227,025)
<u>-</u>	<u>6,029,047</u>	<u>6,029,047</u>
<u>(2,462,981)</u>	<u>6,029,047</u>	<u>3,566,066</u>
3,806,039	-	3,806,039
1,416,995	-	1,416,995
17,648	-	17,648
7,632,530	(7,632,530)	-
<u>12,873,212</u>	<u>(7,632,530)</u>	<u>5,240,682</u>
10,410,231	(1,603,483)	8,806,748
24,488,299	20,047,625	44,535,924
<u>\$ 34,898,530</u>	<u>\$ 18,444,142</u>	<u>\$ 53,342,672</u>

# PENINSULA HEALTH CARE DISTRICT

## GOVERNMENTAL FUND BALANCE SHEET JUNE 30, 2007

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	<u>General Fund</u>
<b>Current Assets</b>	
Cash and Investments	\$ 34,475,154
Interest Receivable	419,000
Prepaid Expense	18,450
Total Assets	<u>\$ 34,912,604</u>
<b>Current Liabilities</b>	
Accounts Payable	\$ 14,074
Total Liabilities	<u>14,074</u>
<b>Fund Balance</b>	
Designated for Future Capital Needs	33,998,530
Unreserved/Undesignated	900,000
Total Fund Balance	<u>34,898,530</u>
Total Liabilities and Fund Balance	<u>\$ 34,912,604</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, 2007**

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	<u>General Fund</u>
<b>Revenues</b>	
Tax Revenue	\$ 3,806,039
Interest Income	1,416,995
Other Revenue	17,648
Total Revenues	<u>5,240,682</u>
<b>Expenditures</b>	
Administration Fees	96,941
Communications	191,565
Consulting	172,753
Grants	1,479,490
Legal Fees	92,835
Promotions	102,750
Other	326,647
Total Expenditures	<u>2,462,981</u>
Excess of Revenue Over Expenditures	2,777,701
Transfers In	<u>7,632,530</u>
Net Change in Fund Balance	10,410,231
Fund Balance - Beginning of Year	<u>24,488,299</u>
Fund Balance - End of Year	<u><u>\$ 34,898,530</u></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, 2007

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	<u>Business-Type Activities</u>
	<u>Enterprise Fund</u>
	<u>Leasing</u>
<b>Current Assets</b>	
Cash and Cash Equivalents	\$ 498,709
Total Current Assets	<u>498,709</u>
<b>Property, Plant, and Equipment - Net</b>	
Depreciable	16,500,318
Non-Depreciable	<u>1,701,165</u>
Total Property, Plant, and Equipment - Net	<u>18,201,483</u>
Total Assets	<u>18,700,192</u>
<b>Current Liabilities</b>	
Accounts Payable	6,050
Deferred Revenues	<u>250,000</u>
Total Liabilities	<u>256,050</u>
<b>Fund Balance</b>	
Invested in Capital Assets	18,201,483
Unrestricted	<u>242,659</u>
Total Fund Balance	<u>\$ 18,444,142</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, 2007

	<u>Business-Type Activities</u>
	<u>Enterprise Fund</u>
	<u>Leasing</u>
<b>Operating Revenues</b>	
Leasing Income	\$ 1,598,705
<b>Operating Expenses</b>	
Depreciation	3,667,042
Administration Fees	26,756
Legal Fees	227,025
Total Operating Expenditures	<u>3,920,823</u>
Operating Loss	(2,322,118)
<b>Non-Operating Revenues</b>	
Other Non-Operating Income	<u>8,351,165</u>
Income Before Transfers	6,029,047
Transfers Out	<u>(7,632,530)</u>
Change in Net Assets	(1,603,483)
Net Assets - Beginning of Year	<u>20,047,625</u>
Net Assets - End of Year	<u><u>\$ 18,444,142</u></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, 2007

	<u>Business-Type Activities</u> <u>Proprietary Fund</u>
<b>Cash Flows from Operating Activities:</b>	
Leasing Revenues	\$ 1,848,705
Legal Fees	(223,389)
Administration Fees	(23,687)
Net Cash Provided by Operating Activities	<u>1,601,629</u>
<b>Cash Flows from Noncapital Financing Activities</b>	
Transfers to the General Fund	(7,632,530)
Net Cash Used in Noncapital Financing Activities	<u>(7,632,530)</u>
<b>Cash Flows from Capital Financing Activities</b>	
Other Non-Operating Income	6,643,862
Purchases of Property	(698,603)
Net Cash Provided by Capital Financing Activities	<u>5,945,259</u>
<b>Net Decrease in Cash and Cash Equivalents</b>	(85,642)
<b>Cash and Cash Equivalents - Beginning of Year</b>	<u>584,351</u>
<b>Cash and Cash Equivalents - End of Year</b>	<u>\$ 498,709</u>
<b>Reconciliation of Net Income to Net Cash Provided by Operating Activities</b>	
Loss from Operations	\$ (2,322,118)
Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities	
Depreciation	3,667,042
Increase in Deferred Revenue	250,000
Increase in Accounts Payable	3,636
Non-Cash Administration Fees	3,069
Net Cash Provided by Operating Activities	<u>\$ 1,601,629</u>

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

# PENINSULA HEALTH CARE DISTRICT

## NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2007

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### 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 provide leadership in creating a culture of health awareness in which healthy living choices, disease prevention, health education, and access to necessary health care services are optimal for the people of the District.

The District Board will carry out this mission through:

- Preserving our hospital by overseeing and fulfilling the responsibilities and obligations enumerated in the Peninsula Hospital lease, and
- Providing and supporting services that improve health awareness and meet identified needs.

#### 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, 2007

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### **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, 2007

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### 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, 2007, 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

### 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 \$250,000 at June 30, 2007 represents two months prepaid rent from Mill Peninsula Health Services (MPHS) as discussed in Note 6.

# PENINSULA HEALTH CARE DISTRICT

## NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2007

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### 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.

### Administrative Services

Certain administrative functions are performed for the District by Mills-Peninsula Health Services for no compensation. The value of these services is not recorded in the financial statements as it is not readily determinable and is considered immaterial to the financial statements taken as a whole. Administrative functions will be assumed by the district in the 2007-08 fiscal year.

### 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.

## NOTE 2 – DEPOSITS AND INVESTMENTS

### Summary of Deposits and Investments

Deposits and investments as of June 30, 2007, are classified in the accompanying financial statements as follows:

Governmental Activities	\$ 34,475,154
Business-Type Activities	498,709
Total Deposits and Investments	<u>\$ 34,973,863</u>

# PENINSULA HEALTH CARE DISTRICT

## NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2007

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Deposits and investments as of June 30, 2007, consist of the following:

	Fair Value	Amortized Cost Basis
Cash on Hand and in Banks	\$ 498,709	\$ 498,709
Investment in Local Agency Investment Fund	19,271,448	19,280,221
Investment in San Mateo County Pool	15,176,302	15,194,933
Total Deposits and Investments	<u>\$ 34,946,459</u>	<u>\$ 34,973,863</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, 2007

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### General Authorizations

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

<u>Authorized Investment Type</u>	<u>Maximum Remaining Maturity</u>	<u>Maximum Percentage of Portfolio</u>	<u>Maximum Investment In One Issuer</u>
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.

**PENINSULA HEALTH CARE DISTRICT**

**NOTES TO FINANCIAL STATEMENTS**

**JUNE 30, 2007**

**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:

<u>Investment Type</u>	<u>Fair Value</u>	<u>Weighted Average Maturity in Years</u>
San Mateo County Pool	\$ 15,176,302	1.0
Investment Pool	19,271,448	0.5
Total	<u>\$ 34,447,750</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	\$ 15,176,302	N/A	\$ 15,176,302
Investment Pool	19,271,448	N/A	19,271,448
Local Agency Total	<u>\$ 34,447,750</u>		<u>\$ 34,447,750</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, 2007, the District's bank balance of \$917,760 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.

# PENINSULA HEALTH CARE DISTRICT

## NOTES TO FINANCIAL STATEMENTS JUNE 30, 2007

### 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.

### NOTE 3 – CAPITAL ASSETS

Activity in capital assets for the year ended June 30, 2007 was as follows:

<b>Capital Assets</b>	<b>Beginning</b>	<b>Additions</b>	<b>Retirements</b>	<b>Ending</b>
Land and Land Improvements	\$ 731,046	\$ 1,701,165	\$ -	\$ 2,432,211
Buildings and Improvements	57,415,515	921,085	-	58,336,600
Equipment	21,450,367	-	37,532	21,412,835
	<u>79,596,928</u>	<u>2,622,250</u>	<u>37,532</u>	<u>82,181,646</u>
<b>Accumulated Depreciation</b>				
Land Improvements	730,040	931	-	730,971
Buildings and Improvements	40,183,057	3,378,898	-	43,561,955
Equipment	19,218,143	506,626	37,532	19,687,237
	<u>60,131,240</u>	<u>3,886,455</u>	<u>37,532</u>	<u>63,980,163</u>
Capital Assets - Net	<u>\$ 19,465,688</u>	<u>\$ (1,264,205)</u>	<u>\$ -</u>	<u>\$ 18,201,483</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.

Certain properties transferred by the District to MPHS in 1985 were returned to the District. These properties were recorded at their net book value at the date of original transfer in 1985 of \$1,920,577 less \$219,412 accumulated depreciation. The net increase of \$1,701,165, representing the land transferred, has been recorded as non-operating income. Buildings and Accumulated Depreciation were increased by the \$219,412 resulting in no effect on District revenues.

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, 2007

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### NOTE 4 – PROPERTY PURCHASE AND LEASE COMMITMENTS

Between November 1, 2006 and late March 2007, the District was lessee of a building owned by a third party on land (1600 Trousdale) owned by the District. The District subleased both the land and building to MPHS, at a rental rate equal to the rent due under the lease with the building owner, and MPHS paid such rents directly to the building owner. In March 2007, the District purchased the building. Since April 1, 2007, the District has leased the entire property to MPHS at fair market value rent pursuant to a new lease agreement between the District and MPHS, as described in Note 6.

### NOTE 5 - FUND BALANCES

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

	<u>General Fund</u>
Unreserved	
Designated	
Future capital needs	\$ 33,998,530
Total Designated	<u>33,998,530</u>
Undesignated	<u>900,000</u>
Total Unreserved	<u>34,898,530</u>
Total	<u><u>\$ 34,898,530</u></u>

#### Future Capital Needs

During 1995, the Board set aside \$900,000 in cash and investments as unreserved and undesignated. The remainder of the balance is designated by the Board for future capital needs including potential obligations under the Definitive Agreements as described in Note 8.

### NOTE 6 – LEASE AGREEMENTS

The District leases the hospital facilities and equipment located at 1783 El Camino 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 will make annual lease payments of \$1,500,000, adjusted 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.

# PENINSULA HEALTH CARE DISTRICT

## NOTES TO FINANCIAL STATEMENTS JUNE 30, 2007

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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 replace and supersedes the Construction Ground Lease, but continues the same lease payments and three-year 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 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 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 has 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.

Payments received during the current year and expected base rents, without adjustment for CPI, through the end of the existing leases are:

	<u>1600 Trousdale</u>	<u>1848 -1850 El Camino</u>	<u>1783 El Camino</u>	<u>Totals</u>
<b>Year ended June 30,</b>				
2007	\$ 41,803	\$ 56,902	\$ 1,500,000	\$ 1,598,705
2008	164,527	86,400	1,500,000	1,750,927
2009	123,396	28,800	1,500,000	1,652,196
2010			1,500,000	1,500,000
2011			1,500,000	1,500,000
2012			1,500,000	1,500,000

### NOTE 7 - 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 1987 against MPHS seeking to rescind 1985 lease agreement and related property transfers. As a result of these agreements, the estimated lives of capital equipment were changed (Note 3); lease terms were changed (Note 6), and 1985 property transfers were rescinded and the property returned to the District or purchased by MPHS (Notes 3 and 8).

# PENINSULA HEALTH CARE DISTRICT

## NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2007

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### NOTE 8 - 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 District is in the process of determining the appropriate reserves, financial strategies and policies to meet the potential obligations under the agreements and to ensure that the community health care needs are met (see Note 5).

### NOTE 9 - NON-OPERATING REVENUE

Pursuant to the Definitive Agreements (Note 7) MPHS transferred or purchased property that had been subject of litigation since 1987 back to the District (Note 3). The income from the transactions has been recorded as Non-Operating Revenue.

Property Transfers	\$ 1,701,165
Sale of Property	6,650,000
Non-Operating Revenue	<u>\$ 8,351,165</u>

# **PENINSULA HEALTH CARE DISTRICT**

## **NOTES TO FINANCIAL STATEMENTS**

**JUNE 30, 2007**

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### **NOTE 10 – 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 \$2,000 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 \$5,000 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, 2007 the District has determined that five grants were in default amounting to \$37,000. During the year the District recovered \$9,687 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 11 - 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 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 12 – COMMITMENTS**

The District has approved \$831,511 in grants to community organizations for funding during the 2007-08 fiscal year.

**Required Supplementary Information**

# PENINSULA HEALTH CARE DISTRICT

## GENERAL FUND BUDGETARY COMPARISON SCHEDULE JUNE 30, 2007

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	<b>Budgetary Amounts <u>Original and Final</u></b>	<b><u>Actual</u></b>	<b><u>Variance</u></b>
<b>Revenues</b>			
Tax Revenue	\$ 3,400,000	\$ 3,806,039	\$ 406,039
Interest Income	1,000,000	1,416,995	416,995
Other Revenue	-	17,648	17,648
Total Revenues	<u>4,400,000</u>	<u>5,240,682</u>	<u>840,682</u>
<b>Expenditures</b>			
Administration Fees	-	96,941	(96,941)
Communications	210,000	191,565	18,435
Consulting	-	172,753	(172,753)
Grants	2,000,000	1,479,490	520,510
Legal Fees	75,000	92,835	(17,835)
Other	328,000	326,647	1,353
Promotions	156,000	102,750	53,250
Total Expenditures	<u>2,769,000</u>	<u>2,462,981</u>	<u>306,019</u>
<b>Excess Revenue Over Expenditures</b>	1,631,000	2,777,701	1,146,701
<b>Transfer From Other Funds</b>	<u>3,131,000</u>	<u>7,632,530</u>	<u>4,501,530</u>
<b>Excess of Revenue Over Expenditures and Transfers From Other Funds</b>	4,762,000	10,410,231	5,648,231
<b>Fund Balance - Beginning of Year</b>	<u>24,488,299</u>	<u>24,488,299</u>	<u>-</u>
<b>Fund Balance - End of Year</b>	<u>\$ 29,250,299</u>	<u>\$ 34,898,530</u>	<u>\$ 5,648,231</u>

## **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, 2007, which collectively comprise the Peninsula Health Care District's basic financial statements and have issued our report thereon dated October 15, 2007. 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, Irvine, Day : Co., LLP

Palo Alto, California  
October 15, 2007