



Peninsula Health Care District

Financial Statements

June 30, 2010

PENINSULA HEALTH CARE DISTRICT

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INDEPENDENT AUDITOR'S REPORT

Board of Directors
Peninsula Health Care District
Burlingame, California

We have audited the accompanying financial statements of the governmental activities and business-type activities of Peninsula Health Care District (the District) as of and for the year ended June 30, 2010, 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, 2010, 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 November 30, 2010, 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.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the District's basic financial statements. The required supplementary information, management's discussion and analysis on pages 3 through 12 and budgetary comparison information on page 35, 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. The supplementary budgetary information on pages 34 and 35 is presented for purposes of additional analysis and is not a required part of the basic financial statements. 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 and supplementary information. However, we did not audit the information and express no opinion on it.

VAVRMEK, TRINE, DAY & Co. LLP

Palo Alto, California
November 30, 2010



Peninsula Health Care District

MANAGEMENT'S DISCUSSION AND ANALYSIS
JUNE 30, 2010

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, 2010. This information is presented in conjunction with the audited financial statements that follow this section.

FINANCIAL HIGHLIGHTS

- The District's current assets increased by \$4.0 million
- The District's net capital assets decreased by \$4.5 million
- The District's current liabilities decreased by \$9.4 thousand
- The District's governmental fund balance increased by \$4.0 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. There were no reconciling items for the current fiscal year.

PENINSULA HEALTH CARE DISTRICT

MANAGEMENT'S DISCUSSION AND ANALYSIS JUNE 30, 2010

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 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, 2010

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>2009-2010</u>	<u>2008-2009</u>	<u>Dollar Change</u>	<u>Percent Change</u>
Current Assets	\$ 46,222,339	\$ 42,248,117	\$ 3,974,222	9.41%
Capital Assets	7,532,776	12,081,872	(4,549,096)	-37.65%
Total Assets	<u>\$ 53,755,115</u>	<u>\$ 54,329,989</u>	<u>\$ (574,874)</u>	-28.25%
Current Liabilities	\$ 295,540	\$ 304,895	\$ (9,355)	-3.07%
Total Liabilities	<u>\$ 295,540</u>	<u>\$ 304,895</u>	<u>\$ (9,355)</u>	-3.07%
Invested in Capital Assets	\$ 7,532,776	\$ 12,081,872	\$ (4,549,096)	-37.65%
Unrestricted	45,926,799	41,943,222	3,983,577	9.50%
Total Net Assets	<u>\$ 53,459,575</u>	<u>\$ 54,025,094</u>	<u>\$ (565,519)</u>	-28.15%

Unrestricted Board Assets increased by \$4.0 million and Capital Assets decreased by \$4.5 million due primarily to the \$4.5 million in Depreciation from the accelerated schedule implemented to correspond with the anticipated opening of the new hospital by January 1, 2011. Total Net Assets decreased by \$0.6 million.

PENINSULA HEALTH CARE DISTRICT

MANAGEMENT'S DISCUSSION AND ANALYSIS JUNE 30, 2010

REVIEW OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS

	<u>2009-2010</u>	<u>2008-2009</u>	<u>Dollar Change</u>	<u>Percent Change</u>
Revenues				
Tax Revenue	\$ 4,392,336	\$ 4,521,513	\$ (129,177)	-2.86%
Lease Income	1,917,118	1,822,430	94,688	5.20%
Interest Earnings	331,522	897,582	(566,060)	-63.06%
Investment Loss	-	(897,895)	897,895	
Other Revenue	64,972	36,227	28,745	79.35%
Other Non-Operating Income	-	1,498,924	(1,498,924)	
Total Revenue	<u>6,705,948</u>	<u>7,878,781</u>	<u>(1,172,833)</u>	-14.89%
Expenditures				
Administrative Personnel	345,628	305,198	40,430	13.25%
Tax Administrative Fee	33,702	31,445	2,257	7.18%
Communications	128,328	83,691	44,637	53.34%
Consulting	(1,400)	4,841	(6,241)	-128.92%
Depreciation	4,549,096	4,675,113	(126,017)	-2.70%
Grants	1,885,814	1,737,645	148,169	8.53%
Legal Fees	125,305	93,519	31,786	33.99%
Promotion	47,731	66,134	(18,403)	-27.83%
Rent	19,570	18,864	706	3.74%
Property Expenses	45,846	50,650	(4,804)	-9.48%
Other	91,847	100,687	(8,840)	-8.78%
Total Expenditures	<u>7,271,467</u>	<u>7,167,787</u>	<u>103,680</u>	1.45%
Change in Net Assets	(565,519)	710,994	(1,276,513)	
Net Assets beginning of Year	<u>54,025,094</u>	<u>53,314,100</u>	<u>710,994</u>	1.33%
Net Assets End of Year	<u>\$ 53,459,575</u>	<u>\$ 54,025,094</u>	<u>\$ (565,519)</u>	-1.05%

REVENUES

Total revenues decreased approximately 15% from prior year due to the negative impact of the national economic crisis on tax revenues and interest earnings, and the absence of any real estate sale activity by the District in 2010. When the real estate sale proceeds, and one time investment loss, are taken out of revenues for 2009, 2010 is actually \$298,000 better than prior year's performance.

- Tax revenues were down nearly 3% due to the drop in home sales, home values, and property reassessment activity.

PENINSULA HEALTH CARE DISTRICT

MANAGEMENT'S DISCUSSION AND ANALYSIS

JUNE 30, 2010

- Interest earnings were down more than 63% from the prior year due to interest rates falling to lows of 0.79% for the San Mateo County Pooled Fund (CSCPF) and 0.53% for the Local Agency Investment Fund (LAIF).
- Lease income increased more than 5% due to a full twelve months' rent for 1875 Trousdale- including a 2.6% rent increase that went into effect 3/1/10, and a 3% rent increase at 1600 Trousdale effective 4/1/10. There was no scheduled increase in the Master Agreement for FY 2010 for the hospital land lease.
- Other Revenue is comprised of loan payments from the MD and RN participants who took positions outside of the District thereby triggering the repayment clause in their agreements; and, Burlingame Storm Drain fee reimbursements from MPHS/Sutter – the tenant leasing all of the District properties.
- Other Non-Operating Income There was none in FY 2010. FY 2009 shows income from the sale of the District's parcel at 1848/50 El Camino, Burlingame.

EXPENDITURES

Total Expenditures increased \$104,000 in FY 2010; however, it is more relevant to management performance to analyze Expenditures without the hospital-related depreciation expense. Total Expenditures in FY 2010 increased by \$230,000 when compared to FY 2009 when depreciation is excluded from both. The areas of increase were:

- \$148,000 for Community Grants: The same amount was budgeted for both FY 2009 and FY 2010 - \$2 million. Budgeted funds were not fully utilized in 2009 due to the slow start up of the Community Network for the Underserved OB program and lower than anticipated use of the RN Loan Forgiveness funds. In FY 2010, the OB program used \$129,000 more of its approved grant. Also in 2010, by Board action, the \$19,000 unused funds in the RN Loan Forgiveness Program were transferred into the CEO Discretionary Fund, thus allowing the full amount budgeted for RN loans to be invested into the community.
- \$40,400 for the Administrative Personnel costs. This increase was generated by the new CalPERS pension plan that went into effect 10/1/09 and salary increases and related taxes for staff.
- \$31,800 for Legal Fees due to the on-going legal matter of Peninsula Guardians vs. the Peninsula HealthCare District. A new brief was submitted to the state court of appeal in May.
- \$44,700 for Communications/Outreach due to participation in an H1N1 prevention campaign at the height of flu epidemic and support of countywide Women's Health Summit focused on an underserved segment of our community.

There were a number of areas of expense that were held to amounts less than the prior year. These were:

- \$18,400 less for Promotions
- \$6,240 less for General Consulting
- \$8,840 less for "Other" (E.g. Travel & Meetings, Property Development, Web services)
- \$4,800 less for Property Expense

In summary, Total Expenditures increased over the prior year due to investments in community health projects, implementation of an employee pension benefit and salary increases, and response to the on-going legal matter sustained by a small group of local residents.

PENINSULA HEALTH CARE DISTRICT

MANAGEMENT'S DISCUSSION AND ANALYSIS JUNE 30, 2010

BUDGET

Actual performance was \$250,000 positive to budget when comparing to the consolidated budgets for both the General and Proprietary Funds. This schedule can be found in the Supplementary Section of this report, page 35.

- **Total Revenues** fell \$19,300 **below** budget due primarily to the significant shortfall in Investment Income. Positive performance in Tax and Other Revenues were insufficient to offset the negative \$431,000 interested earnings performance as compared to budget. Budgeted earning rates were set at the lowest level in the prior year; this was believed to be a conservative budget strategy. Actual performance fell well below anticipated returns as noted in the prior section.
- **Total Expenses** were \$273,000 **under** to budget. This was due primarily to the underutilization of grant funds as discussed above; and less than planned depreciation, property development, consulting, and real estate legal expenses. The two areas that exceeded budget were :
 - Administrative Personnel by \$70,000 due to:
 - Enrollment of employees in the CalPERS pension program (Unbudgeted)
 - CEO salary increase and performance bonus (Unbudgeted)
 - Communications by \$50,828 due to:
 - The volume of health education items purchased and distributed related to the H1N1 flu epidemic.
 - Participation in a unique Women's Health Summit that addressed health disparities in the County.

In summary, the District Board's mission and strategic initiatives were carried out; the District stepped up its outreach activities in partnership with the County Health Department to address the flu epidemic, and at the same time, controlled expenses to achieve a positive bottom line that exceed budget and exceeded the target contribution to the important Board Reserves necessary to meet future financial obligations delineated in the Master Agreement between the District and MPHD/Sutter Health.

CAPITAL ASSETS

	<u>2009-2010</u>	<u>2008-2009</u>	Dollar <u>Change</u>	Percent <u>Change</u>
Land and Improvements	\$ 5,401,004	\$ 5,401,004	\$ -	0.00%
Building and Improvements	58,412,125	58,412,125	-	0.00%
Equipment	21,160,795	21,412,834	(252,039)	-1.18%
Subtotal	<u>84,973,924</u>	<u>85,225,963</u>	<u>(252,039)</u>	<u>-0.30%</u>
Less Accumulated Depreciation	77,441,148	73,144,091	4,297,057	5.87%
Capital Assets - Net of Depreciation	<u>\$ 7,532,776</u>	<u>\$ 12,081,872</u>	<u>\$ (4,549,096)</u>	<u>-37.65%</u>

Additional information on capital assets can be found in footnote #3.

PENINSULA HEALTH CARE DISTRICT

MANAGEMENT'S DISCUSSION AND ANALYSIS JUNE 30, 2010

ECONOMIC AND OTHER FACTORS

Economic

The on-going national economic crisis had a direct and significant impact on the District's tax revenues and investment income. A number of important steps were taken by the Board in FY 2010 to ensure prudent fiduciary oversight of assets given the challenges. The Board:

1. Took advantage of the California Prop 1A securitization opportunity to insulate tax revenues against the State's withholding of 8% of the property tax as announced in the summer of 2009.
2. Invited back Verite Consulting financial advisor who was instrumental in developing the Board's 2007 strategic financial plan and reserve targets. He analyzed actual FY 2008 and FY 2009 performance relative to strategic goals and found contributions to the Board Reserves to be on target. He also recommended revisions to revenue and investment earning assumptions, and adjusted targets based on these changes. His recommendations were approved by the Board at its October 2009 meeting.
3. Engaged an urban economist/real estate expert to prepare a property analysis to help define "highest and best use" opportunities for existing District parcels and possible future purchases.
4. Established a Long Term Planning Committee with community leaders from a wide range of professions and engaged them in discussions and deliberations on financial, property development, and other strategic matters. This committee serves as advisory to the Board.
5. Set up a process, in collaboration with MPHS, to examine all fixed asset items purchased and owned by the District for use in the Peninsula Hospital to determine disposition when new hospital opens and to determine any retained and/or salvage value for the District.
6. Included Asset Management as an area of focus for the CEO's work plan and for calendar year 2010.
7. Budgeted FY 2011 tax revenues at 9% below FY 2010 actual in anticipation of continued stress on real estate sales and assessed values.
8. Approved a conservative, responsible budget for FY 2011 that reduced operating overhead expenses, increased community grant level to \$2.15 million to incorporate a new MD recruitment loan while maintaining the same level of available funds for community grants, and achieving the targeted addition to the financial reserves for Paramount Default.

Directors and Officers:

The District Board is assured another two years of director stability. No challengers filed for the November 2010 election; therefore, all three of the incumbents who were up for re-election will be sworn in for 4-year terms at the December 9, 2010 Board meeting. They are Don Newman, M.D., Helen Galligan, R.N. and Lawrence Cappel, PhD. Board officers remained unchanged in FY 2010, except for Treasurer. Director Cappel was appointed in June 2009 to complete the term of Director Susan Smith, who resigned due to poor health. He was elected to serve as Board Treasurer in August 2009, a position held by Ms. Smith for nearly twenty years. An orientation was conducted and included the District's CEO, Accountant, and Auditors.

PENINSULA HEALTH CARE DISTRICT

MANAGEMENT'S DISCUSSION AND ANALYSIS

JUNE 30, 2010

Board succession planning is an on-going part of the leadership work. This is carried out through Director and CEO visibility, increased community awareness of the work and value of the District, participation on civic and community boards, and recruitment of community leaders to serve on the District Board's committees.

The new Board committee structure was put into place in 2009 and has served the work of the Board well.

- The Long Term Planning Committee includes representatives from banking, development, construction, public agency financing, healthcare policy/leadership in medicine, and community advocacy and has been instrumental in reviewing the Investment Policy, reviewing the assumptions used in the Financial Policy and benchmarks, and advising on the property development analysis project.
- The Community Health Investment Committee serves in an advisory capacity to the Board's community grants, MD recruitment, and RN Forgivable Loan Programs. Its members include representatives from the California Healthcare Foundation, Northern California Grantmakers, business community, city government and healthcare consulting. Its work was particularly challenging this year. The number of grant applications was double the prior year and the requested amounts totaled three times the District's budget. Decisions were made based on the Board's health priorities, funding criteria, organizations' stability and performance record, numbers served, and site visits
- The Sutter Oversight Committee monitors MPHS/Sutter's compliance to the Master Agreement with focus on core services, stakeholder satisfaction (MD, employee, and patient) and Sutter's financial health. This year's work focused on the MPHS patient satisfaction survey process and what, if any, significant impact on access to needed services would be created by MPHS's decision to close its Acute Rehab Center and integrate patients needing more therapies into its Skilled Nursing Facility.

Board development and on-going education is also an important focus. Materials are regularly distributed to Directors to help keep them informed about local, State, and National policy issues that would impact the community's health and healthcare system. Guest speakers are invited to present to the Board at the beginning of every public board meeting on a broad range of locally significant health topics. Examples from FY 2010 include:

- *"The National Surgical Improvement Project"* by Dr. Bruce Allen, community surgeon;
- *"What Creates Healthy People"* by Jean Fraser, Chief of the County Health System;
- *"Dentistry and Medicine- A New Crossing Point"* by Dr. Dick Gregory, community dentist; and,
- *"Play that Works-Igniting a Lifetime of Movement in Every Kid"* by Ellen LaPointe, VP for HopeLab, a non-profit research organization.

Directors and the CEO have participated in Association of Healthcare District activities and all have completed the required AB 1234 Ethics Training. The CEO completed the Special Districts and Governance Institute's Leadership & Management Certificate Program.

Strategic Planning:

The Board is in the third and final year of its 2007-2010 Strategic Plan and has achieved its goals.

- Goal 1: Preserve Peninsula Hospital as a community asset. The new hospital is scheduled to open, on the District's land, February 2010. It will be owned and operated by Sutter Health. All core clinical services, as defined in the 50-year master agreement, have been preserved.

PENINSULA HEALTH CARE DISTRICT

MANAGEMENT'S DISCUSSION AND ANALYSIS

JUNE 30, 2010

- Goal 2: Collaborate with others in identifying and addressing health priorities for all residents of the District. The CEO actively participates throughout the community to stay informed about health needs, represent the District and its value to the health of the community, and work with others to address needs. She has been invited to serve on a number of countywide committees including the Board of Supervisors new Community Health Reform Advocacy Committee and Leadership San Mateo Curriculum Committee. The Board's second annual Community Partners event attracted state, county and city leaders. Board meetings routinely have a community education topic with quality presenters.
- Goal 3: Improve access to health services and information for all District residents. Examples of achievement for FY 2010 include health care coverage for 560 children, clinic visits for 4500 seniors and low-income families, crisis intervention and safe housing for 400 at-risk youth and young adults, and health information to many thousands of residents through outreach events, District media (newsletter, website, Facebook), and the Board Community Education Program at regular Board meetings.
- Goal 4: Ensure sufficient resources to achieve our mission and strategic initiatives. The Board set Reserve Fund for Paramount Default benchmarks in 2007 and has met these targets each year. Targets were reviewed and adjusted to reflect economic environment. The members of the Board's Long Term Planning Committee bring a broad range of expertise and experience to the Board deliberations on asset management as noted above.

The Board's Strategic Plan 2011-2015 development process has been launched; the new plan is targeted for completion and presentation to the Board for approval by July 2011.

FUTURE CHALLENGES

The national Affordable Care Act of 2010 will have a profound impact on the demand for services while straining the available funding and workforce available to address the needs. As proposed, 70,000 San Mateo County residents will be newly insured and thus, have access to primary care. This should have a positive impact on the overall health of the community; however, there is much work ahead to prepare for full implementation in 2014. Examples of challenges include: shortage of primary care physicians, geographic mal-distribution of specialists, increased financial burden on employers which may decrease covered benefits, projected shortage of nurses and other healthcare workers in 2014, and the number of illegal residents that will not be covered.

San Mateo County is well-situated to prepare for and address many of the challenges as evidenced by its successful track record of collaborative, broad-based solutions to community health issues. A good example is the Children's Health Initiative launched in 2002, where public and private providers and funders came together to establish a system that would ensure access to health care coverage for every low income child between the ages of 6-18. Today, San Mateo County is one of only two in California that have been able to sustain universal coverage for children with no waiting list. Another example of successful collaboration is the partnership created between the College of San Mateo and the PHCD in 2001 to address a major nursing shortage. The District provided funding to add faculty and supplies to increase the CSM nursing program by 12 students and at the same time launched its RN Loan Forgiveness Program, which has helped 60 residents complete nurse training – more than half attended the CSM program. District leaders also participated on the 2007-2008 Board of Supervisors' Blue Ribbon Task Force on Healthcare for Uninsured Adults, currently participate on two county committees looking at health reform: impact and workforce implications, and have been exploring with other healthcare leaders how to address the increasing need for assisted living, dementia care, and dental services for frail seniors.

PENINSULA HEALTH CARE DISTRICT

MANAGEMENT'S DISCUSSION AND ANALYSIS JUNE 30, 2010

There is, however, a disturbing trend that will impact our residents' access to healthcare and could directly impact the District and its financial obligations under the Master Agreement with Sutter Health. Mills-Peninsula Health Services closed its in-patient Acute Rehabilitation Center and Pediatric Unit this year, and has announced plans to get out of the Skilled Nursing and Renal Dialysis business. These actions were taken to eliminate current "money loser" programs in anticipation of drastic cuts in Medicare reimbursement to hospitals under the new Act. The services above are not "core" services as defined in the Master Agreement between our organizations; the District has no role in the decision or authority to challenge it. However, if one were a core service, the Board would need to evaluate the impact on health services to our residents and make the determination to help fund the operating costs of that service. The Affordable Care Act's expansion of care access without containment of cost, as well as, Sutter Health's trend toward regionalization of services, present future risk to Sutter's ability or willingness to maintain all core services at the new hospital and increased risk of triggering financial obligations for the District. District and MPHS leaders meet regularly to keep communications open and productive, and to help track real and perceived threats to the financial strength of MPHS.

In Summary

The District Board and Management provide committed, competent leadership over the real and financial assets of the District, while engaging actively with community health partners in identifying and addressing the health needs of its residents.

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: CEO, Peninsula Health Care District, 1600 Trousdale Drive, Suite 1210, Burlingame, CA 94010.

PENINSULA HEALTH CARE DISTRICT

**STATEMENT OF NET ASSETS
JUNE 30, 2010**

	Governmental Activities	Business-Type Activities	Total
ASSETS			
Current Assets			
Cash and Investments	\$ 45,677,377	\$ 267,239	\$ 45,944,616
Interest Receivable	82,943	-	82,943
Property Taxes Receivable	178,280	-	178,280
Prepaid Expense	16,500	-	16,500
Total Current Assets	<u>45,955,100</u>	<u>267,239</u>	<u>46,222,339</u>
Property, Plant, and Equipment - Net			
Depreciable	-	2,862,818	2,862,818
Non-Depreciable	-	4,669,958	4,669,958
Total Property, Plant, and Equipment - Net	<u>-</u>	<u>7,532,776</u>	<u>7,532,776</u>
Total Assets	<u>\$ 45,955,100</u>	<u>\$ 7,800,015</u>	<u>\$ 53,755,115</u>
LIABILITIES			
Current Liabilities			
Accounts Payable	\$ 14,031	\$ 2,609	\$ 16,640
Accrued Payroll	14,270	-	14,270
Deferred Revenues	-	264,630	264,630
Total Current Liabilities	<u>28,301</u>	<u>267,239</u>	<u>295,540</u>
NET ASSETS			
Invested in Capital Assets	-	7,532,776	7,532,776
Unrestricted	45,926,799	-	45,926,799
Total Net Assets	<u>\$ 45,926,799</u>	<u>\$ 7,532,776</u>	<u>\$ 53,459,575</u>

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

PENINSULA HEALTH CARE DISTRICT

**STATEMENT OF ACTIVITIES
YEAR ENDING JUNE 30, 2010**

<u>Functions/Programs</u>	<u>Expenses</u>	<u>Program Revenue Charges for Services and Sales</u>
Governmental Activities:		
Community Grants	\$ 1,885,814	\$ -
General Administration:		
Administrative Personnel	345,628	-
Tax Administration Fee	33,702	-
Communication	128,328	-
Legal Fees	31,425	-
Promotion	47,731	-
Rent	19,570	-
Other	90,447	-
Total Governmental Activities	<u>2,582,645</u>	<u>-</u>
Business Type Activities:		
Leasing	-	1,917,118
Depreciation	4,549,096	-
Legal Fees	93,880	-
Property Expenses	45,846	-
Total Business Activities	<u>4,688,822</u>	<u>1,917,118</u>
Total Primary Government	<u>\$ 7,271,467</u>	<u>\$ 1,917,118</u>

General Revenues:
Property Taxes
Interest 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
\$ (1,885,814)	\$ -	\$ (1,885,814)
(345,628)	-	(345,628)
(33,702)	-	(33,702)
(128,328)	-	(128,328)
(31,425)	-	(31,425)
(47,731)	-	(47,731)
(19,570)	-	(19,570)
(90,447)	-	(90,447)
<u>(2,582,645)</u>	<u>-</u>	<u>(2,582,645)</u>
-	1,917,118	1,917,118
-	(4,549,096)	(4,549,096)
-	(93,880)	(93,880)
-	(45,846)	(45,846)
<u>-</u>	<u>(2,771,704)</u>	<u>(2,771,704)</u>
<u>(2,582,645)</u>	<u>(2,771,704)</u>	<u>(5,354,349)</u>
4,392,336	-	4,392,336
331,522	-	331,522
64,972	-	64,972
1,777,392	(1,777,392)	-
<u>6,566,222</u>	<u>(1,777,392)</u>	<u>4,788,830</u>
3,983,577	(4,549,096)	(565,519)
41,943,222	12,081,872	54,025,094
<u>\$ 45,926,799</u>	<u>\$ 7,532,776</u>	<u>\$ 53,459,575</u>

PENINSULA HEALTH CARE DISTRICT

**GOVERNMENTAL FUND
BALANCE SHEET
JUNE 30, 2010**

	<u>General Fund</u>
ASSETS	
Current Assets	
Cash and Investments	\$ 45,677,377
Interest Receivable	82,943
Property Taxes Receivable	178,280
Prepaid Expense	16,500
Total Assets	<u><u>\$ 45,955,100</u></u>
 LIABILITIES AND FUND BALANCE	
Current Liabilities	
Accounts Payable	\$ 14,031
Accrued Payroll	14,270
Total Liabilities	<u>28,301</u>
 Fund Balance	
Designated for Future Capital Needs	<u>45,926,799</u>
Total Fund Balance	<u>45,926,799</u>
Total Liabilities and Fund Balance	<u><u>\$ 45,955,100</u></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, 2010**

	<u>General Fund</u>
Revenues	
Tax Revenue	\$ 4,392,336
Interest Earnings	331,522
Other Revenue	64,972
Total Revenues	<u>4,788,830</u>
 Expenditures	
Community Grants	1,885,814
General Administration:	
Administrative Personnel	345,628
Tax Administration Fee	33,702
Communications	128,328
Legal Fees	31,425
Promotion	47,731
Rent	19,570
Other	90,447
Total Expenditures	<u>2,582,645</u>
 Excess of Revenue Over Expenditures	2,206,185
 Transfers In	<u>1,777,392</u>
 Net Change in Fund Balance	3,983,577
 Fund Balance - Beginning of Year	<u>41,943,222</u>
 Fund Balance - End of Year	<u><u>\$ 45,926,799</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, 2010**

	<u>Business-Type Activities</u>
	<u>Enterprise Fund</u>
	<u>Leasing</u>
ASSETS	
Current Assets	
Cash and Investments	\$ 267,239
Total Current Assets	<u>267,239</u>
Property, Plant, and Equipment - Net	
Depreciable	2,862,818
Non-Depreciable	4,669,958
Total Property, Plant, and Equipment - Net	<u>7,532,776</u>
Total Assets	<u><u>\$ 7,800,015</u></u>
LIABILITIES AND NET ASSETS	
Current Liabilities	
Accounts Payable	\$ 2,609
Deferred Revenues	264,630
Total Liabilities	<u>267,239</u>
Net Assets	
Invested in Capital Assets	7,532,776
Total Net Assets	<u><u>\$ 7,532,776</u></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, 2010**

	<u>Business-Type Activities</u>
	<u>Enterprise Fund</u>
	<u>Leasing</u>
Operating Revenues	
Leasing Income	\$ 1,917,118
Operating Expenses	
Depreciation	4,549,096
Legal Fees	93,880
Property Expenses	45,846
Total Operating Expenditures	<u>4,688,822</u>
Operating Loss	(2,771,704)
Transfers Out	<u>(1,777,392)</u>
Change in Net Assets	(4,549,096)
Net Assets - Beginning of Year	<u>12,081,872</u>
Net Assets - End of Year	<u>\$ 7,532,776</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, 2010**

	<u>Business-Type Activities</u> <u>Enterprise Fund</u>
Cash Flows from Operating Activities:	
Leasing Income	\$ 1,917,118
Legal Fees	(107,276)
Property Expenses	(48,936)
Net Cash Provided by Operating Activities	<u>1,760,906</u>
 Cash Flows from Noncapital Financing Activities	
Transfers to the General Fund	(1,777,392)
Net Cash Used in Noncapital Financing Activities	<u>(1,777,392)</u>
 Net Decrease in Cash and Cash Equivalents	(16,486)
 Cash and Cash Equivalents - Beginning of Year	<u>283,725</u>
 Cash and Cash Equivalents - End of Year	<u>\$ 267,239</u>
 Reconciliation of Operating Loss to Net Cash Provided by Operating Activities	
Loss from Operations	\$ (2,771,704)
Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities	
Depreciation	4,549,096
Decrease in Accounts Payable	(16,486)
Net Cash Provided by Operating Activities	<u>\$ 1,760,906</u>

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

PENINSULA HEALTH CARE DISTRICT

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2010

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, 2010

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 allocates indirect expenses to functions in the Statement of Activities. There were no significant indirect expenses in the current year. 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, 2010

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, 2010, 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 \$264,630 at June 30, 2010 represents two months prepaid rent from Mills Peninsula Health Services (MPHS) as discussed in Note 6.

PENINSULA HEALTH CARE DISTRICT

NOTES TO FINANCIAL STATEMENTS JUNE 30, 2010

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. The County of San Mateo remits taxes based on assessed valuations under the Teeter Plan, therefore, taxes receivable, uncollectible, or deferred do not affect the distribution to the District. The County remits all taxes due to the District when due, or within 60 days of year end.

The State of California reduced the amount of property tax revenues distributed to the District during the current year pursuant to Sections 100.5 and 100.06 of the California Revenue and Taxation Code. The District had an option to receive repayments from the State of California or to sell the "Proposition 1A" receivable in order to obtain money to fund public capital improvements or working capital pursuant to Section 25.5 of Article XIII of the California Constitution and 100.6 of the California Revenue and Taxation Code. The District elected to sell the receivable and the proceeds of \$330,331 are reported in the financial statements as Tax Revenue.

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, 2010, are classified in the accompanying financial statements as follows:

Governmental Activities	\$ 45,677,377
Business-Type Activities	<u>267,239</u>
Total Deposits and Investments	<u><u>\$ 45,944,616</u></u>

PENINSULA HEALTH CARE DISTRICT

NOTES TO FINANCIAL STATEMENTS JUNE 30, 2010

Deposits and investments as of June 30, 2010, consist of the following:

	Fair Value	Amortized Cost Basis
Cash in Banks	\$ 140,940	\$ 140,940
Investment in Local Agency Investment Fund	30,239,276	30,189,651
Investment in San Mateo County Pool	15,669,767	15,614,025
Total Deposits and Investments	<u>\$ 46,049,983</u>	<u>\$ 45,944,616</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. All investments were in the County and State investment pools.

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, 2010**

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.

PENINSULA HEALTH CARE DISTRICT

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2010

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	\$ 15,669,767	1.0
Local Agency Investment Pool	30,239,276	0.6
Total	<u>\$ 45,909,043</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.

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, 2010, the District's bank balance of \$196,397 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, 2010**

NOTE 3 – CAPITAL ASSETS

Activity in capital assets for the year ended June 30, 2010 was as follows:

Capital Assets	<u>Beginning</u>	<u>Additions</u>	<u>Retirements</u>	<u>Ending</u>
Land	\$ 4,669,958	\$ -	\$ -	\$ 4,669,958
Land Improvements	731,046	-	-	731,046
Buildings and Improvements	58,412,125	-	-	58,412,125
Equipment	21,412,834	-	252,039	21,160,795
	<u>85,225,963</u>	<u>-</u>	<u>252,039</u>	<u>84,973,924</u>
Accumulated Depreciation				
Land Improvements	731,046	-	-	731,046
Buildings and Improvements	51,577,150	4,185,227	-	55,762,377
Equipment	20,835,895	363,869	252,039	20,947,725
	<u>73,144,091</u>	<u>4,549,096</u>	<u>252,039</u>	<u>77,441,148</u>
Capital Assets - Net	<u>\$ 12,081,872</u>	<u>\$ (4,549,096)</u>	<u>\$ -</u>	<u>\$ 7,532,776</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.

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.

NOTE 4 - FUND BALANCES

The Governmental Fund balance is designated by the Board for future capital and contingent liabilities in accordance with the 2007-2010 Strategic Plan discussed in Note 7.

PENINSULA HEALTH CARE DISTRICT

NOTES TO FINANCIAL STATEMENTS JUNE 30, 2010

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 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 1875 Trousdale. 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. 1875 Trousdale is leased under a December 23, 2008 agreement with an initial five (5) year term three options for one year each. Under the leases, the lessee (MPHS) is obligated for all operating, maintenance and other costs of the facility.

PENINSULA HEALTH CARE DISTRICT

**NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2010**

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

Year ended June 30,	<u>1600</u> <u>Trousdale</u>	<u>1875</u> <u>Trousdale</u>	<u>1501</u> <u>Trousdale</u>	<u>Totals</u>
2010	\$ 175,740	\$ 153,600	\$ 1,587,778	\$ 1,917,118
2011	181,011	156,240	1,587,778	1,925,029
2012	138,790	156,240	1,587,778	1,882,808
2013		104,160	1,587,778	1,691,938
2014			1,587,778	1,587,778
2015			1,587,778	1,587,778
2016-2020			7,938,890	7,938,890
2021-2025			7,938,890	7,938,890
2026-2030			7,938,890	7,938,890
2031-2035			7,938,890	7,938,890
2036-2040			7,938,890	7,938,890
Thereafter			34,137,227	34,137,227

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.

PENINSULA HEALTH CARE DISTRICT

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2010

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.

Board Designated Reserve for Contingencies.

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. The Strategic Plan was reviewed during the current year and no changes were considered necessary.

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, 2010 the District has determined that five grants were in default amounting to \$36,464. During the year the District recovered \$8,525 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.

PENINSULA HEALTH CARE DISTRICT

NOTES TO FINANCIAL STATEMENTS JUNE 30, 2010

NOTE 9 – RETIREMENT PLAN

The District contracted with the California Public Employees' Retirement System (CalPERS) during the current year and began contributions to the plan in October 2009.

Plan Description.

CalPERS is a cost-sharing multiple-employer public employee retirement system defined benefit pension plan administered by CalPERS. The plan provides retirement and disability benefits, annual cost-of-living adjustments, and survivor benefits to plan members and beneficiaries. Benefit provisions are established by State statutes, as legislatively amended, within the Public Employees' Retirement Laws. CalPERS issue a separate comprehensive annual financial report that includes financial statements and required supplementary information. Copies of the CalPERS' annual financial report may be obtained from the CalPERS Executive Office, 400 P Street, Sacramento, CA 95811.

The District has elected a 2 percent at 60 modified formulae and 3 percent cost of living adjustment plan. In addition to currently active employees, 92 past employees who had previously been covered by CalPERS under a previous District plan and one current employee who had been covered by another employer CalPERS plan, are covered under the current plan which resulted in an actuarially determined unfunded liability of \$85,000. The unfunded liability will be amortized by District contributions over the period ending 2021. District employees contribute 7 percent to the retirement plan.

Funding Policy

The actuarial methods and assumptions used for determining the rate are those adopted by the CalPERS Board of Administration. The required employer contribution rate for the current fiscal year was 15.949 percent of covered payroll which included 3.89 percent to amortize the unfunded liability. These rates are subject to change based upon assumptions and demographic changes in July 2012. The District's contribution to CalPERS for the fiscal years ending June 30, 2010 was \$27,830 and equaled 100 percent of the required contributions.

NOTE 10 - LITIGATION

The District is the sole remaining 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 Third Amended Complaint, contends that certain materials the District distributed in connection with an August 2006 election were improper. In that election, the voters approved a ground lease transaction facilitating the construction by MPHS of a state-of-the-art hospital for the residents of the District on land leased to it by the District. Plaintiff's challenges to that ground lease transaction have been defeated. In the only remaining claim, Plaintiff seeks a declaration that the expenditures for the 2006 campaign materials were improper and seeks attorney's fees.

PENINSULA HEALTH CARE DISTRICT

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2010

The District brought a special motion to strike the complaint under section 425.16 of the Code of Civil Procedure, the “anti-SLAPP” statute, on the grounds that the materials the District distributed are protected speech. The trial court denied the motion. The District appealed, and the matter is before the Court of Appeal. Estimation of the likelihood of an unfavorable outcome of this litigation would be unduly speculative. The District’s exposure to damages at this point in the litigation according to its attorneys is limited to attorney’s fees incurred by the Plaintiff. The District could be awarded some of its legal fees if it prevails on the pending special motion to strike.

NOTE 11 – COMMITMENTS

The District has approved \$900,979, \$366,000 and \$237,000 in grants to community organizations for funding during the 2010-11, 2011-2012 and 2012-13 fiscal years respectively.

NOTE 12 – SUBSEQUENT EVENT

As discussed in notes 3 and 7, substantially District provided equipment and other moveable assets will be disposed of during the 2010-11 fiscal year.

MPHS agreed in principal with the District that all District provided equipment and other moveable assets not intended to be retained by the hospital would be disposed of by sale to the highest bid from at least two salvage companies based upon the asset listing at June 30, 2010. The District will receive the bid amount whether or not the assets are specifically identified or located during the disposal process.

MPHS subsequently conducted a physical inventory of all equipment and other moveable assets provided in prior years to the hospital by the District to determine assets the hospital intended to keep in service or that would be disposed of. The inventory provided to the District indicated that substantial assets either could not be located or had been previously disposed of. The District considers the MPHS inventory procedures flawed but that a re-inventory of the equipment would not be cost effective for purposes of financial statement presentation since all of the questioned assets had been fully depreciated with no book value. As adjustment would have no effect on the net book value, the District has elected not to adjust the asset values and associated accumulated depreciation in Note 3. The District is currently in the process of determining the effect of receiving salvage value based upon the current asset listing versus a salvage value based upon an unknown date of disposal for the assets that may have been previously disposed of or could not be located by MPHS, based on the MPHS inventory, and intends to take whatever steps are necessary to ensure the District receives appropriate compensation.

Required Supplementary Information

PENINSULA HEALTH CARE DISTRICT

**GENERAL FUND
BUDGETARY COMPARISON SCHEDULE
JUNE 30, 2010**

	Budgetary Amounts <u>Original and Final</u>	<u>Actual</u>	<u>Variance</u>
Revenues			
Tax Revenue	\$ 4,000,000	\$ 4,392,336	\$ 392,336
Interest Earnings	764,120	331,522	(432,598)
Investment Loss	-	-	-
Other Revenue	30,000	64,972	34,972
Total Revenues	<u>4,794,120</u>	<u>4,788,830</u>	<u>(5,290)</u>
Expenditures			
Grants	2,000,000	1,885,814	114,186
Administrative Personnel	276,000	345,628	(69,628)
Tax Administration Fees	35,000	33,702	1,298
Communications	77,500	128,328	(50,828)
Legal Fees	40,000	31,425	8,575
Promotion	75,000	47,731	27,269
Rent	25,000	19,570	5,430
Other	150,700	90,447	60,253
Total Expenditures	<u>2,679,200</u>	<u>2,582,645</u>	<u>96,555</u>
Excess Revenue Over Expenditures	2,114,920	2,206,185	91,265
Transfer From Other Funds *	<u>1,777,392</u>	<u>1,777,392</u>	<u>-</u>
Excess of Revenue Over Expenditures and Transfers To Other Funds	3,892,312	3,983,577	91,265
Fund Balance - Beginning of Year	<u>41,943,222</u>	<u>41,943,222</u>	<u>-</u>
Fund Balance - End of Year	<u>\$ 45,835,534</u>	<u>\$ 45,926,799</u>	<u>\$ 91,265</u>

* The District does not budget transfers.

Supplementary Information

PENINSULA HEALTH CARE DISTRICT

**PROPRIETARY FUND
BUDGETARY COMPARISON SCHEDULE
JUNE 30, 2010**

	<u>Budgetary Amounts</u> <u>Original and Final</u>	<u>Actual</u>	<u>Variance</u>
Revenues			
Leasing Income	\$ 1,931,100	\$ 1,917,118	\$ (13,982)
Total Revenues	<u>1,931,100</u>	<u>1,917,118</u>	<u>(13,982)</u>
Expenditures			
Depreciation	4,700,000	4,549,096	150,904
Legal Fees	65,000	93,880	(28,880)
Property Expenses	<u>100,000</u>	<u>45,846</u>	<u>54,154</u>
Total Expenditures	<u>4,865,000</u>	<u>4,688,822</u>	<u>176,178</u>
Excess Expenditures Over Revenue	(2,933,900)	(2,771,704)	162,196
Transfer to Other Funds *	<u>(1,777,392)</u>	<u>(1,777,392)</u>	<u>-</u>
Excess of Revenue Over Expenditures and Transfers To Other Funds	(4,711,292)	(4,549,096)	162,196
Fund Balance - Beginning of Year	<u>12,081,872</u>	<u>12,081,872</u>	<u>-</u>
Fund Balance - End of Year	<u>\$ 7,370,580</u>	<u>\$ 7,532,776</u>	<u>\$ 162,196</u>

* The District does not budget transfers.

PENINSULA HEALTH CARE DISTRICT

**ALL FUNDS
BUDGETARY COMPARISON SCHEDULE
JUNE 30, 2010**

	<u>Budgetary Amounts</u> <u>Original and Final</u>	<u>Actual</u>	<u>Variance</u>
Revenues			
Tax Revenue	\$ 4,000,000	\$ 4,392,336	\$ 392,336
Leasing Income	1,931,100	1,917,118	(13,982)
Interest Earnings	764,120	331,522	(432,598)
Other Revenue	30,000	64,972	34,972
Total Revenues	<u>6,725,220</u>	<u>6,705,948</u>	<u>(19,272)</u>
Expenditures			
Grants	2,000,000	1,885,814	114,186
Depreciation	4,700,000	4,549,096	150,904
Administrative Personnel	276,000	345,628	(69,628)
Tax Administration Fees	35,000	33,702	1,298
Communications	77,500	128,328	(50,828)
Legal Fees	105,000	125,305	(20,305)
Promotion	75,000	47,731	27,269
Property Expenses	100,000	45,846	54,154
Rent	25,000	19,570	5,430
Other	150,700	90,447	60,253
Total Expenditures	<u>7,544,200</u>	<u>7,271,467</u>	<u>272,733</u>
Excess Expenditures Over Revenue	(818,980)	(565,519)	253,461
Fund Balance - Beginning of Year	<u>54,025,094</u>	<u>54,025,094</u>	<u>-</u>
Fund Balance - End of Year	<u>\$ 53,206,114</u>	<u>\$ 53,459,575</u>	<u>\$ 253,461</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, 2010, which collectively comprise the Peninsula Health Care District's basic financial statements and have issued our report thereon dated November 30, 2010. 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 deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect and correct misstatements on a timely basis. *A material weakness* is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and 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, and the State Controller's Office, and is not intended to be and should not be used by anyone other than these specified parties.

VAVRMEK, TRINE, DAY & Co. LLP

Palo Alto, California
November 30, 2010