

PENINSULA HEALTH CARE DISTRICT

Financial Statements
June 30, 2004

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, 2004, 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 State Controllers Minimum Audit Requirements for California Special Districts. 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 general purpose financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall general purpose 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, 2004, 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.

As described in Note 1, the District has implemented a new financial reporting model, as required by the provisions of GASB Statement No. 34, Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments, as of June 30, 2004.

The management's discussion and analysis on pages 2 through 4, are not a required part of the basic financial statements but are supplementary information required by 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 22, 2004

PENINSULA HEALTH CARE DISTRICT

MANAGEMENT'S DISCUSSION AND ANALYSIS

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, 2004. This information is presented in conjunction with the audited financial statements that follow this section.

FINANCIAL HIGHLIGHTS

- The District's cash balances increased by \$1.7 million
- The District's net fixed assets decreased by \$.4 million
- The District's fund balance increased by \$1.3 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.

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 include 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 Sheet includes all of the District's governmental fund assets and liabilities and provides information about the nature and amounts of resources (assets) and obligations to creditors (liabilities).
- The Statement of Revenues, Expenditures and Changes in Fund Balance reports the District's governmental 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>2003-2004</u>	<u>2002-2003</u>	<u>Dollar Change</u>	<u>Percent Change</u>
Current Assets	\$19,450,932	\$17,747,454	\$1,703,478	9.60%
Capital Assets	<u>22,192,520</u>	<u>22,608,472</u>	<u>(415,952)</u>	(1.84%)
Total Assets	<u>\$41,643,452</u>	<u>\$40,355,926</u>	<u>\$1,287,526</u>	3.19%
Current Liabilities	<u>\$1,041,667</u>	<u>\$1,041,666</u>	<u>\$ 1</u>	-
Total Liabilities	<u>\$1,041,667</u>	<u>\$1,041,666</u>	<u>\$ 1</u>	-
Invested in Capital Assets	\$22,192,520	\$22,608,472	\$ (415,952)	(1.84%)
Unrestricted	<u>18,409,265</u>	<u>16,705,788</u>	<u>\$1,703,477</u>	10.19%
Total Net Assets	<u>\$40,601,785</u>	<u>\$39,314,260</u>	<u>\$1,287,525</u>	3.27%

Total net assets increased by \$1.3 million. The increase reflects an increase in cash of \$1.7 million and a net reduction in capital assets of \$.4 million.

REVIEW OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS

	<u>2003-2004</u>	<u>2002-2003</u>	<u>Dollar Change</u>	<u>Percent Change</u>
Revenues				
Tax revenue	\$3,341,139	\$3,274,641	\$66,498	2.03%
Lease income	1,785,714	1,785,714	-	-
Interest income	444,078	461,056	(16,978)	(3.68%)
Gains and losses	5,200	(7,842)	13,042	(166.3%)
Other revenue	<u>9,270</u>	<u>5,332</u>	<u>3,938</u>	73.86%
Total revenue	<u>5,585,401</u>	<u>5,518,901</u>	<u>66,500</u>	1.20%
Expenditures				
Administration	29,343	31,312	(1,969)	(6.29%)
Communications	53,196	35,691	17,505	49.05%
Consulting	123,571	70,158	53,413	76.13%
Depreciation	2,201,155	2,491,535	(290,380)	(11.65%)
Grants	1,582,177	849,718	732,459	86.20%
Legal fees	160,369	238,249	(77,880)	(32.69%)
Promotions	45,547	69,095	(23,548)	(34.08%)
Other	<u>102,518</u>	<u>188,706</u>	<u>(86,188)</u>	(45.67%)
Total expenditures	<u>4,297,876</u>	<u>3,974,464</u>	<u>323,412</u>	8.14%
Change in net assets	1,287,525	1,544,437	(256,912)	(16.63%)
Net assets beginning of year	39,314,260	<u>37,769,823</u>	<u>1,544,437</u>	4.09%
Net assets end of year	<u>\$40,601,785</u>	<u>\$39,314,260</u>	<u>\$1,287,525</u>	3.27%

REVIEW OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS

While revenues showed only a very modest increase, expenses increased by \$300,000. The largest increase was in grants, which reflects a new grant made to the Children's Health Initiative. Legal fees were less primarily because conflicts of interest issues had been resolved in the prior year. The increase in consulting is attributable to work done by outside consultants to support the ongoing negotiations with Mills-Peninsula Health Services. The decrease in other expense results from the nonrecurring effect of election costs in the prior year.

The District's net assets increased by \$1.3 million.

CAPITAL ASSETS

	<u>2003-2004</u>	<u>2002-2003</u>	<u>Dollar Change</u>	<u>Percent Change</u>
Land and improvements	\$ 731,046	\$ 731,046	\$ -	-
Buildings and improvements	57,470,335	56,527,454	942,881	1.67%
Equipment	20,044,999	20,469,828	(424,829)	2.08%
Construction in progress	<u>-</u>	<u>88,774</u>	<u>(88,774)</u>	(100.00%)
Subtotal	78,246,380	77,817,102	429,278	.55%
Less accumulated depreciation	<u>56,053,860</u>	<u>55,208,630</u>	<u>845,230</u>	1.53%
Capital Assets, net of depreciation	<u>\$22,192,520</u>	<u>\$22,608,472</u>	<u>\$(415,952)</u>	(1.84%)

The change of \$.4 million resulted from the excess of depreciation over assets acquired during the year. Assets acquired include building improvements and equipment that were accepted as payment of rent in accordance with the terms of the lease.

ECONOMIC AND OTHER FACTORS

The District must rebuild its hospital by 2013 to be in compliance with State mandated seismic regulations. Accordingly the District is currently negotiating with Mills-Peninsula Health Services for the construction of a new hospital on District owned land and a new long-term lease. Faced with the uncertainties of the future the District has committed to building a reserve fund for the future capital needs of the District.

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, 1783 El Camino Real, Burlingame, CA 94010.

PENINSULA HEATH CARE DISTRICT

Statement of Net Assets
June 30, 2004

	<u>Governmental</u> <u>Activities</u>	<u>Business -Type</u> <u>Activities</u>	<u>Total</u>
Current Assets			
Cash and cash equivalents	\$ 18,051,489	\$ 1,279,493	\$ 19,330,982
Interest receivable	101,500	-	101,500
Prepaid expense	18,450	-	18,450
Total Current Assets	<u>18,171,439</u>	<u>1,279,493</u>	<u>19,450,932</u>
Property, Plant and Equipment, Net	<u>-</u>	<u>22,192,520</u>	<u>22,192,520</u>
Total Assets	<u>18,171,439</u>	<u>23,472,013</u>	<u>41,643,452</u>
Current Liabilities			
Deferred revenue	<u>-</u>	<u>1,041,666</u>	<u>1,041,666</u>
Total Current Liabilities	<u>-</u>	<u>1,041,666</u>	<u>1,041,666</u>
Net Assets			
Unrestricted	18,171,439	237,827	18,409,266
Invested in capital assets	<u>-</u>	<u>22,192,520</u>	<u>22,192,520</u>
Total Net Assets	<u>\$ 18,171,439</u>	<u>\$ 22,430,347</u>	<u>\$ 40,601,786</u>

See accompanying notes.

PENINSULA HEALTH CARE DISTRICT

**Statement of Activities
Year Ended June 30, 2004**

<u>Functions/Programs</u>	<u>Expenses</u>	<u>Program Revenues</u>			<u>Net (Expenses) Revenues and Changes in Net Assets</u>		
		<u>Charges for Services and Sales</u>	<u>Operating Grants and Contributions</u>	<u>Capital Grants and Contributions</u>	<u>Governmental Activities</u>	<u>Business Type Activities</u>	<u>Total</u>
Governmental Activities:							
Community grants	\$ 1,582,177	\$ -	\$ -	\$ -	\$ (1,582,177)	\$ -	\$ (1,582,177)
General administration:							
Administration fees	29,343	-	-	-	(29,343)	-	(29,343)
Communications	53,196	-	-	-	(53,196)	-	(53,196)
Consulting	123,571	-	-	-	(123,571)	-	(123,571)
Legal fees	59,415	-	-	-	(59,415)	-	(59,415)
Promotions	45,547	-	-	-	(45,547)	-	(45,547)
Other	102,518	-	-	-	(102,518)	-	(102,518)
Total Governmental Activities	<u>1,995,767</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>(1,995,767)</u>	<u>-</u>	<u>(1,995,767)</u>
Business type activities:							
Leasing	-	1,785,714	-	-	-	1,785,714	1,785,714
Depreciation	2,201,155	-	-	-	-	(2,201,155)	(2,201,155)
Legal	100,953	-	-	-	-	(100,953)	(100,953)
Gain (Loss) on disposal of assets	-	5,200	-	-	-	5,200	5,200
Other	-	9,270	-	-	-	9,270	9,270
Total Business Type Activities	<u>2,302,108</u>	<u>1,800,184</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>(501,924)</u>	<u>(501,924)</u>
Total Primary Government	<u>\$ 4,297,875</u>	<u>\$ 1,800,184</u>	<u>\$ -</u>	<u>\$ -</u>	<u>(1,995,767)</u>	<u>(501,924)</u>	<u>(2,497,691)</u>
General revenues:							
Property taxes					3,341,139	-	3,341,139
Interest and investment earnings					444,078	-	444,078
Transfers between funds					(842,604)	842,604	-
Subtotal, General Revenues					<u>2,942,613</u>	<u>842,604</u>	<u>3,785,217</u>
Change in net assets					946,846	340,680	1,287,526
Net Assets - Beginning of Year					<u>17,224,593</u>	<u>22,089,667</u>	<u>39,314,260</u>
Net Assets, End of Year					<u>\$ 18,171,439</u>	<u>\$ 22,430,347</u>	<u>\$ 40,601,786</u>

See accompanying notes.

Peninsula Health Care District

**Governmental Fund
Balance Sheet
June 30, 2004**

	<u>General Fund</u>
Current Assets	
Cash and cash equivalents	\$ 18,051,489
Interest receivable	101,500
Prepaid expense	<u>18,450</u>
Total Assets	<u>\$ 18,171,439</u>
Fund Balance	
Unreserved/undesignated	\$ 900,000
Designated for future capital needs	<u>17,271,439</u>
Total Fund Balance	<u>\$ 18,171,439</u>

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

See accompanying notes.

Peninsula Health Care District

**Governmental Fund
Statement of Revenues, Expenditures and Changes in Fund Balance
Year Ended June 30, 2004**

	<u>General Fund</u>
Revenues	
Tax revenue	\$ 3,341,139
Interest income	<u>444,078</u>
Total Revenues	<u>3,785,217</u>
Expenditures	
Administration fees	29,343
Communications	53,196
Consulting	123,571
Grants	1,582,177
Legal fees	59,415
Promotions	45,547
Other	<u>102,518</u>
Total Expenditures	<u>1,995,767</u>
Excess (Deficiency) of Revenue Over (Under) Expenditures	1,789,450
Transfers (To) From Other Funds	<u>(842,604)</u>
Excess (Deficiency) of Revenue Over (Under) Expenditures and Transfers (To) From Other Funds	946,846
Fund Balance, Beginning of Year	<u>17,224,593</u>
Fund Balance, End of Year	<u>\$ 18,171,439</u>

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

See accompanying notes.

PENINSULA HEATH CARE DISTRICT

**Statement of Cash Flows
Proprietary Fund
Year Ended June 30, 2004**

	<u>Proprietary Fund</u>
Cash Flows From Operating Activities:	
Receipts:	
Transfers from the General Fund	\$ 842,604
Other revenues	<u>9,270</u>
Total receipts	<u>851,874</u>
Expenditures Made For:	
Legal fees	<u>100,953</u>
Total expenditures for operations	<u>100,953</u>
Net Cash Provided by Operating Activities	750,921
Cash Flows From Capital Financing Activities	
Proceeds from sale of equipment	<u>5,711</u>
Net Cash Provided by Capital Financing Activities	<u>5,711</u>
Net Increase in Cash	756,632
Cash, Beginning of Year	<u>522,861</u>
Cash, End of Year	<u>\$ 1,279,493</u>
Reconciliation of operating income to net cash provided by operating activities:	
Operating loss	\$ (501,924)
Adjustments to reconcile operating loss to net cash used in operating activities:	
Depreciation expense	2,201,155
Gain on disposal of assets	(5,200)
Property, plant and equipment accepted in payment of lease	(1,785,714)
Transfers from General Fund	<u>842,604</u>
Net cash provided by operating activities	<u>\$ 750,921</u>
Supplemental Disclosure of Non-cash Activities:	
Property, Plant and equipment accepted in payment of lease	<u>\$ 1,785,714</u>

See accompanying notes.

PENINSULA HEALTH CARE DISTRICT

Notes to Financial Statements
June 30, 2004

1. Significant Accounting Policies

a. Reporting Entity

Peninsula Health Care District (the "District") is a political subdivision of the State of California. It was organized in 1947 and owns the land, buildings and equipment of Peninsula Hospital (the "Hospital"). The District operated the Hospital until January 31, 1985, at which time the operation of the Hospital was transferred, through a leasing arrangement, to Mills-Peninsula Health Services (previously known as Mills-Peninsula Hospitals). The District is not subject to state or federal taxes on income.

b. Basis of Accounting/Measurement Focus

The accounts of the District are organized and operated on the basis of funds. A fund is an independent fiscal and accounting entity with a self-balancing set of accounts. Fund accounting segregates funds according to their intended purpose and is used to aid management in demonstrating compliance with finance-related legal and contractual provisions. The minimum number of funds are maintained consistent with legal and managerial requirements.

The District applies all applicable FASB pronouncements issued after November 30, 1989 that do not conflict with or contradict GASB pronouncements in accounting and reporting for its proprietary operations. The District has implemented GASB Statement No. 34, and its statements are presented according to those requirements. Statement No. 34 established standards for external financial reporting for all state and local governmental entities, which includes a management discussion and analysis section, a statement of net assets, a statement of activities and changes in net assets, and a statement of cash flows. It requires the classification of net assets into three components: invested in capital assets, net of related debt; restricted; and unrestricted. Government-wide financial statements include a Statement of Net Assets and a Statement of Activities. These statements present summaries of Governmental and Business-Type Activities for the District. These statements are accounted for on an "economic resources" measurement focus and the accrual basis of accounting. Fund financial statements are presented for the governmental fund. The governmental fund statements are accounted for on a spending or "current financial resources" measurement focus and the modified accrual basis of accounting. There are no reconciling items between the government-wide and the governmental fund financial statements because the District has no items that result in different presentations between the measurement focus and basis of accounting.

c. Cash and Cash Equivalents

The District maintains deposit accounts at Bank of America. Cash deposits in banks are fully insured or collateralized with securities, but not held in the name of the District. California state law requires public fund deposits in excess of insured balances to be collateralized by government securities with a value equal to 110% of the deposits or first trust deed mortgage notes with a value equal to 150% of the deposits.

PENINSULA HEALTH CARE DISTRICT

Notes to Financial Statements
June 30, 2004

1. Significant Accounting Policies

c. Cash and Cash Equivalents (continued)

The District considers all highly liquid investments with a maturity of less than three months at the time of purchase to be cash equivalents. The District maintains investments in the State of California Local Agency Investment Fund (LAIF), and the San Mateo County Investment Fund (SMC). These funds are invested in accordance with California Government Code Sections 16430, and 53600. Investments in LAIF and SMC are recorded at cost, which approximates market.

d. Property, Plant, and Equipment

Property, plant and equipment are recorded at cost, or in the case of donated items, on the basis of fair value at the date of donation. Expenditures which increase values, change capacities or extend useful lives are capitalized.

e. 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. The district received approximately 60% in 2004 and 59% in 2003 of its financial support from property taxes. 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, therefore there are no taxes receivable, uncollectible, or deferred taxes.

f. 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.

g. Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

PENINSULA HEALTH CARE DISTRICT

**Notes to Financial Statements
June 30, 2004**

2. Cash and Cash Equivalents

Cash and cash equivalents as of June 30, 2004 consisted of the following:

Cash in bank (FDIC insured up to \$100,000)	\$ <u>1,279,493</u>
Investments in State of California Local Agency Investment Fund (LAIF) and San Mateo County Investment Fund (SMC):	
Investment in LAIF	4,325,875
Investment in SMC	<u>13,725,614</u>
Total investment in pooled funds	<u>18,051,489</u>
 Total Cash and Investments	 \$ <u>19,330,982</u>

Investment activities of the District are governed by sections of the California Government Code which specify the authorized investments that may be made. At June 30, 2004 all deposits and investments of the District were authorized investments.

There is a possible concentration of credit risk arising from cash deposits in excess of the \$100,000 federal depository insured amount. The District's deposits are categorized as either (1) insured or collateralized with securities held by the District or its agent in the District's name, (2) collateralized with securities held by the pledging financial institution's trust department or agent in the District's name, or (3) uncollateralized or collateralized but not held in the name of the District. The carrying amount of bank balances before adjustments were \$1,303,517 at June 30, 2004. Of the total bank balance at June 30, 2004, \$100,000 was insured (Category 1) and \$1,203,517 was collateralized (Category 3).

The District's investments are generally categorized as either (1) insured or registered, for which the securities are held by the District or its agent in the District's name, (2) uninsured and unregistered, for which the securities are held by the broker or dealer or by its trust department or agent in the District's name, or (3) uninsured and unregistered, for which the securities are held by the broker or dealer or by its trust department or agent, but not in the District's name. Investments in LAIF and SMC are not categorized.

During 1995, the Board set aside \$900,000 in cash and investments as unreserved and undesignated. The remainder of the balance in cash and investments is designated by the Board for future capital needs.

PENINSULA HEALTH CARE DISTRICT

**Notes to Financial Statements
June 30, 2004**

3. Property, Plant and Equipment

Capital Assets	<u>Beginning</u>	<u>Additions</u>	<u>Retirements</u>	<u>Ending</u>
Land and land improvements	\$ 731,046	\$ -	\$ -	\$ 731,046
Buildings and improvements	56,527,454	1,145,590	-	57,673,044
Equipment	20,469,828	1,096,676	1,355,925	20,210,579
Construction-in-progress	88,774	(88,774)	-	-
	<u>77,817,102</u>	<u>2,153,492</u>	<u>1,355,925</u>	<u>78,614,669</u>

Accumulated Depreciation

Land improvements	697,627	16,032	-	713,659
Buildings and improvements	35,654,909	1,960,809	-	37,615,718
Equipment	18,856,094	592,603	1,355,925	18,092,772
	<u>55,208,630</u>	<u>2,569,444</u>	<u>1,355,925</u>	<u>56,422,149</u>
Property, Plant and Equipment, Net	<u>\$ 22,608,472</u>	<u>\$ (415,952)</u>	<u>\$ -</u>	<u>\$ 22,192,520</u>

Depreciation is computed using the straight-line method over the estimated useful lives of the assets.

	Lives of Assets
Equipment	3-7
Buildings and Improvements	15-48

4. Property Purchase and Lease Commitments

The District is the lessee of a building near the Hospital. An affiliate of Mills-Peninsula Health Services subleases the building under terms which require identical payments to those required under the primary lease. The lease payments are made by the sublessee directly to the primary lessor; however, the District is still obligated to make such payments should the sublessee not fulfill its obligation. The revenue and expense for these transactions are not recorded in the financial statements because the District considers the payment by the sublessee as an abatement of the rent obligation of the District. The future minimum lease payments required under both the primary lease and sublease should the sublessee not fulfill its obligation, which expires in 2013, are approximately as follows:

Year ending June 30:	
2005	\$ 113,848
2006	113,848
2007	113,848
2008	113,848
2009	123,335
Thereafter	<u>521,808</u>
Total	<u>\$ 1,100,535</u>

PENINSULA HEALTH CARE DISTRICT

**Notes to Financial Statements
June 30, 2004**

4. Property Purchase and Lease Commitments (continued)

The District has an option to purchase this building and the building's owner has the right, under certain circumstances, to require such purchase. The purchase price, defined by agreement, is \$828,800 as of June 30, 2004. Under the consolidation agreement, if the building is purchased by the District, the District must transfer ownership of the building to Mills-Peninsula Health Services without further consideration.

5. Lease Agreement

The District leases the Hospital's land, buildings and equipment to Mills-Peninsula Health Services (lessee) under an agreement which extends through January 2015. Annual rent payments of \$1,785,714 are required through 2014. The lessee is obligated for all operating, maintenance and other costs of the facility. The lease is the subject of litigation discussed in Note 6 below.

The lessee is entitled to transfer capital improvements and equipment purchased for the Hospital, subject to approval of the District, as rent payments or prepayments. The title to such plant additions remains with the lessee until the termination of the lease, at which time title passes to the District. The District records the original cost and accumulated depreciation through the date of transfer in order to maintain the continuity of the depreciable lives and depreciation method.

6. Litigation

In June 1997, the District initiated litigation in the San Mateo County Superior Court (Case No. 401125) against Mills-Peninsula Health Services (MPHS) seeking on conflicts of interest grounds to void the 1985 lease of Peninsula Hospital to MPHS and certain related transfers. MPHS obtained a ruling that the District's action was barred by a stipulated judgment in a separate 1995 action brought by the San Mateo County District Attorney in the San Mateo Superior Court (Case No. 392588). The District moved to have the 1995 stipulated judgment set aside and moved for reconsideration of the ruling dismissing its action to void the lease. The trial court granted the District's motion to set aside the 1995 stipulated judgment on the ground that it was void, and MPHS appealed. On June 28, 2000, the Court of Appeal ruled in favor of the District and affirmed the trial court ruling setting aside the 1995 stipulated judgment. As a consequence, the stipulated judgment is no longer a bar to the District's 1997 action to void the lease. The parties continue attempts to settle the matter through negotiations.

In September 1998, Mills-Peninsula Health Services served the District with a demand for arbitration over certain rent provisions in the lease agreement (Note 4). MPHS alleged that the District breached the lease by refusing to approve certain proposed capital expenditures that would have resulted in a prepaid rent credit to MPHS. The District filed a cross-claim seeking a determination that the lease does not require the District to approve prepaid rent for more than one year in advance, and that the lease does not authorize MPHS to prepay rent in a manner that compels wasteful use of public funds. On August 24, 2000, a settlement agreement was reached. Among its provisions, the District agreed to accept assets with a cost of \$8,928,570, subject to adjustment, as payment for the rent obligation from February 1, 1998 through January 31, 2003.

PENINSULA HEALTH CARE DISTRICT

Notes to Financial Statements

June 30, 2004

7. Subsequent Event

Subsequent to the end of the year the District entered into a letter of intent with Mills-Peninsula Health Services related to the construction and operations of a new hospital to be constructed to replace the existing facility. This agreement will substantially change the terms of the existing agreements between the entities. It will also resolve the issues that are the subject of the litigation discussed in Note 6 above.

Required Supplementary Information

PENINSULA HEATH CARE DISTRICT

**General Fund
Budgetary Comparison Schedule
June 30, 2004**

	<u>Budgeted Amounts Original and Final</u>	<u>Actual</u>	<u>Variance</u>
Revenues			
Tax revenue	\$ 3,200,000	\$ 3,341,139	\$ 141,139
Interest income	<u>529,456</u>	<u>444,078</u>	<u>(85,378)</u>
Total Revenues	<u>3,729,456</u>	<u>3,785,217</u>	<u>55,761</u>
Expenditures			
Administration fees	250,000	29,343	220,657
Communications	60,000	53,196	6,804
Consulting	127,600	123,571	4,029
Grants	1,900,000	1,582,177	317,823
Legal fees	160,000	59,415	100,585
Other	127,400	102,518	24,882
Promotions	<u>-</u>	<u>45,547</u>	<u>(45,547)</u>
Total Expenditures	<u>2,625,000</u>	<u>1,995,767</u>	<u>629,233</u>
Excess of Revenue Over Expenditures	1,104,456	1,789,450	684,994
Transfers (To) From Other Funds	<u>-</u>	<u>(842,604)</u>	<u>(842,604)</u>
Excess of Revenue Over Expenditures and Transfers (To) Other Funds	1,104,456	946,846	(157,610)
Fund Balance, Beginning of Year	<u>17,224,593</u>	<u>17,224,593</u>	<u>-</u>
Fund Balance, End of Year	<u>\$ 18,329,049</u>	<u>\$ 18,171,439</u>	<u>\$ (157,610)</u>

See accompanying notes.