

Agenda Item No. 5.A.

Board of Directors Meeting

Date 2-7-07

SEQUOIA HEALTHCARE DISTRICT

**FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2006**

SEQUOIA HEALTHCARE DISTRICT
Financial Statements
For the year ended June 30, 2006

Table of Contents

Page

INTRODUCTORY SECTION

Table of Contents	i
-------------------------	---

FINANCIAL SECTION

Independent Auditor's Report	1
---	----------

Management's Discussion and Analysis	3
---	----------

Financial Statements

Statement of Net Assets	12
-------------------------------	----

Statement of Activities	13
-------------------------------	----

Balance Sheet	14
---------------------	----

Statement of Revenues, Expenditures and Changes in Fund Balance	15
---	----

Proprietary Funds

Statement of Net Assets	16
-------------------------------	----

Statement of Revenue, Expenses and Changes in Fund Net Assets	17
---	----

Statement of Cash Flows	18
-------------------------------	----

Notes to Financial Statements	19
-------------------------------------	----

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INDEPENDENT AUDITOR'S REPORT

Board of Directors
Sequoia Healthcare District
Redwood City, California

We have audited the accompanying statements of financial position of Sequoia Healthcare District as of June 30, 2006 and the related statements of support, revenues and expenses and of cash flows for the year then ended. These financial statements are the responsibility of Sequoia Healthcare District's management. Our responsibility is to express an opinion on these financial statements based on our audit. The prior year summarized comparative information has been derived from Sequoia Healthcare District's 2005 financial statements and, in a report dated November 9, 2005 their former auditors expressed an unqualified opinion on those financial statements.

We conducted our audit in accordance with generally accepted auditing standards in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance as to 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 assessing significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly in all material respects the financial position of Sequoia Healthcare District as of June 30, 2006 and the results of its operations and its cash flows for the year then ended, in conformity with generally accepted accounting principles in the United States of America.

Our audit was conducted for the purpose of forming an opinion on the financial statements taken as a whole. The supplemental information is presented for purposes of additional analysis and is not a required part of the financial statements. Such information has been subjected to the auditing procedures applied in the audit of the financial statements and, in our opinion, are fairly stated in all material respects in relation to the financial statements taken as a whole.

Maze & Associates

August 24, 2006

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SEQUOIA HEALTHCARE DISTRICT
Management's Discussion and Analysis
June 30, 2006

INTRODUCTION

This report presents Management's analysis of Sequoia Healthcare District's (the "District") financial condition and activities as of and for the year ending June 30, 2006. Management's Discussion and Analysis ("MDA") is intended to serve as an introduction to the District's basic financial statements. This document has been prepared based on reporting requirements included in Statement No. 34 of the Governmental Accounting Standards Board (GASB). GASB 34 has made changes to the contents and the format of the financial statements of governmental agencies, which include the Government-wide Financial Statements on a full accrual basis including the cost of the capital assets and related depreciation.

This information should be read in conjunction with the District's audited financial statements.

The information in the MDA includes the following elements:

- Organization and Business
- Overview of Basic Financial Statements
- Financial Analysis
- Capital Assets
- Economic Factors and Future Plans
- Request for Information

ORGANIZATION AND BUSINESS

Sequoia Healthcare District is a governmental entity legally constituted as a special district under California law, and is located in Redwood City, California. Sequoia Healthcare District identifies local healthcare needs and collaboratively develops solutions. District tax revenues are used for programs and activities designed to achieve health, wellness and disease prevention in southern San Mateo County. Communities in the District include Redwood City, San Carlos, Belmont, Menlo Park, Woodside, Atherton and Portola Valley.

The District transferred specific assets, including operations, to Sequoia Health Services ("SHS") on September 30, 1996. SHS is a California nonprofit benefit corporation, whose members are the District and Catholic Healthcare West (CHW). The specific assets transferred include the Hospital's assets including property, plant and equipment, except for two medical office buildings, certain other properties and \$10 million in cash, cash equivalents and other assets due to applicable law. The Basic Financial Statements addressed in this MDA do not relate to the principle hospital operations or any other transferred assets to SHS.

Effective April 19, 2005, the District adopted policies and procedures pursuant to Section 32104 of the California Health and Safety Code. The purpose of these policies and procedures is to provide the Board of Directors the time and place of holding its regular meetings and the manner of calling the same, and establish rules for its proceedings and possibly adopt such rules and

SEQUOIA HEALTHCARE DISTRICT
Management's Discussion and Analysis
June 30, 2006

regulations not inconsistent with law as may be necessary for the exercise of the powers conferred and the performance of the duties imposed on the board.

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, Statement of Revenues, Expenses 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.

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. As indicated above, 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.

SEQUOIA HEALTHCARE DISTRICT
Management's Discussion and Analysis
June 30, 2006

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.

The Governmental Fund Balance Sheet provides detail of assets and liabilities and describes the components of the \$64.9 million fund balance. The fund balance includes \$40.0 million that is board designated for preservation of corpus and \$6.7 million that is board designated for the depreciation fund. The remaining \$18.2 million is unreserved or undesignated for a total fund balance of \$64.9 million.

Statement of Revenues, Expenses, 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.

Statement of Cash Flows

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.

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.

SEQUOIA HEALTHCARE DISTRICT
Management's Discussion and Analysis
June 30, 2006

Other Information

In addition to the basic financial statements and accompanying notes, this report may present certain required supplementary information comparing budget to actual results of operations. The District is not required to adopt an annual budget however during fiscal 2006 the District approved and adopted a budget.

FINANCIAL ANALYSIS

Financial Highlights

- The government-wide total assets of the District exceed the total liabilities by \$72.0 million (*net assets*) (Table 1).
- Net Assets increased by \$2.6 million or 3.7 percent during the fiscal year (Table 2).
- Capital asset purchases during the year were \$88,230. The Proprietary Fund generated lease revenues exceeding the costs, including depreciation, of \$474 thousand. Current year depreciation was \$759 thousand. Therefore, the net Property, plant and equipment decreased by \$673 thousand or 8.7 percent.
- During the year, overall revenues on the Statement of Activities decreased by \$595 thousand or 4.7 percent to \$12.1 million. The significant variances were a decrease in investment income of \$2.1 million due to market performance along with an increase of \$942 thousand for tax revenue and the \$645 thousand release of the Escheat liability. (Table 2).
- Total expenses on the Statement of Activities increased by \$1.5 million or 18.4 percent to \$9.6 million. The variance primarily represents an increase of grant expense of \$1.7 million due primarily to an increase in funding to the Children's Health Initiative, San Francisco State University Nursing Program, and Grants to Community Non-Profit Organizations (Table 2).

Financial Position

During the year, the District's net assets increased by \$2.6 million or 3.7 percent.

The fund balance of the general fund includes a board designated depreciation amount of \$6.7 million and a board designated \$40.0 million for preservation of corpus. The net assets include \$7.1 million for investment in capital assets and \$18.2 million in unrestricted funds.

The general fund unreserved/undesignated fund balance increased \$1.4 million from \$16.9 million to \$18.2 million.

Table 1 and 2 provide summarized Government-Wide comparative information reported by Fund statement classifications. The functional expenses are detailed on the Statement of Activities and consist of grants to the Sequoia Hospital and Community non-profit organizations and General Administration expenses.

SEQUOIA HEALTHCARE DISTRICT
Management's Discussion and Analysis
June 30, 2006

Net Assets

Table 1
Comparative Statement of Net Assets
June 30, 2006 and 2005
(in thousands)

	<u>2006</u>	<u>2005</u>	<u>Variance</u>	<u>%</u>
Current and other assets	\$ 65,195	\$ 62,336	\$ 2,859	4.6%
Capital assets, net	7,075	7,748	(673)	-8.7%
Total assets	<u>72,270</u>	<u>70,084</u>	<u>2,186</u>	<u>3.1%</u>
Current liabilities	299	35	264	754.3%
Long-term liabilities	-	645	(645)	-100.0%
Total liabilities	<u>299</u>	<u>680</u>	<u>(381)</u>	<u>-56.0%</u>
Net Assets:				
Depreciation fund	6,683	5,924	759	12.8%
Restricted	39,990	38,858	1,132	2.9%
Investment in capital assets	7,075	7,748	(673)	-8.7%
Unrestricted	18,224	16,874	1,350	8.0%
Total net assets	<u>\$ 71,972</u>	<u>\$ 69,404</u>	<u>\$ 2,568</u>	<u>3.7%</u>
Gov'tl Fund Balance	64,897	61,656	3,241	5.3%

Results of Operations

The following table shows changes in the District's net assets for the year. The net asset classifications are on the fund basis showing the Board Designations.

SEQUOIA HEALTHCARE DISTRICT
Management's Discussion and Analysis
June 30, 2006

Table 2
Comparative Statement of Activities
June 30, 2006 and 2005
(in thousands)

	<u>2006</u>	<u>2005</u>	<u>Variance</u>	<u>%</u>
Revenues and Support				
Contribution	\$ 21	\$ -	\$ 21	100.0%
Escheat Liability	645	-	645	100.0%
Rental	1,630	1,709	(79)	-4.6%
Tax	6,525	5,583	942	16.9%
Investment	61	2,209	(2,148)	-97.2%
Interest	226	200	26	13.0%
Pension	3,026	3,026	-	0.0%
Loss on Sale	(2)	-	(2)	-100.0%
Total Revenues	<u>12,132</u>	<u>12,727</u>	<u>(595)</u>	<u>-4.7%</u>
Expenses				
Administrative	3,636	3,795	(159)	-4.2%
Property	1,156	1,171	(15)	-1.3%
Grant	4,771	3,108	1,663	53.5%
Total Expenses	<u>9,563</u>	<u>8,074</u>	<u>1,489</u>	<u>18.4%</u>
Net Income	2,569	4,653	(2,084)	-44.8%
Net assets, Beg of Yr	69,403	64,750	4,653	7.2%
Net assets, End of Yr	<u>\$ 71,972</u>	<u>\$ 69,403</u>	<u>\$ 2,569</u>	<u>3.7%</u>

The District's total revenues and support of \$12.1 million for the year decreased by \$595 thousand and total expenses increased of \$1.5 million, resulting in a 44.8 percent decrease in net income.

The District's revenues and support are generated from three main categories: Rental income of the two medical office buildings, tax income (the District is apportioned a fraction of the 1 percent property Ad Valorem tax collected by the County of San Mateo) and interest earned from investments. Revenues also include Pension income of \$3.0 million, which is reimbursement from Sequoia Health Services (SHS) for funding of Sequoia Healthcare District's Employee Pension Plan. Note that an expense offset for the same amount is included on the expenses. Therefore, pension activity has no bottom line impact.

The increase in operational expenses is due to activity in each of the following expense categories:

SEQUOIA HEALTHCARE DISTRICT
Management's Discussion and Analysis
June 30, 2006

- Administrative: The variance between years is a \$159 thousand decrease which includes a \$121 thousand decrease in elections fees and a \$61 thousand decrease in legal fees.
- Property: Property expenses remained relatively constant between years.
- Grant: Grants comprised 49.9% of the District's expenses for the year. The District supports various health care programs in the local community. Of all the grants, five represent the majority of the expense. They include:
 1. Children's Health Initiative (CHI) (\$1,350,000). San Mateo County created CHI for the provision of health insurance for indigent and needy children throughout the county. The funds provided by Sequoia Healthcare District as a partner in this program are earmarked for District residents enrolled in the Children's Health Initiative insurance plan.
 2. Samaritan House (\$486,000). The purpose of this grant is to financially support Samaritan House Medical Clinic in Redwood City to provide clinical services for the medically underserved.
 3. Baccalaureate Nursing Program (\$1,004,253). The Nursing program is a ten-year grant program, in which the District will pay \$25,000 per student up to 40 students per year who attends the Bachelor of Science in Nursing Degree (BSN) program at Cañada College to offset the program's administrative costs in an effort to increase the number of nurses in this area since there is a nursing shortage in the healthcare industry.
 4. Sequoia Hospital Foundation (\$1,500,000). This contribution is a matching grant that supports capital expenditures for Sequoia Hospital to ensure the highest quality of care is maintained.
 5. Redwood City School District (\$193,333). The purpose of this grant is to support the School Nursing Program in the School District for the three school years starting 2004 through 2007.

CAPITAL ASSETS

During fiscal 2006, capital asset additions were \$88,230 relating to Building and Equipment costs. Additional information is included in Note 4.

ECONOMIC FACTORS AND FUTURE PLANS

It is a primary goal of the District to use its cash for health and wellness services to the community. For that reason, all the grants in effect in fiscal 2005 have continued in fiscal 2006. One example of this goal is that in Fiscal 2004, the District founded and approved funding for the Sequoia Hospital/SFSU Bachelor of Science in Nursing Satellite Program at Cañada College, designed to create 300-400 new registered nurses over the next ten years. .

SEQUOIA HEALTHCARE DISTRICT
Management's Discussion and Analysis
June 30, 2006

Based on the June 23, 2004 Resolution, the District, through membership of Sequoia Health Services, has resolved to help fund new construction of Sequoia Hospital ("Hospital Project") in the amount of \$25 million. As described in the Resolution, the Hospital Project is necessary based on needs to modernize the facility and comply with state laws regarding seismic upgrade standards. Based on an anticipated \$130 million cost to replace Sequoia Hospital, the District agreed to provide assistance in the form of a \$25 million grant ("District Project Funding"). It is expected that the District will pay 15 percent upon ground breaking, 25 percent upon completion of 40 percent of the construction, 25 percent upon completion of 65 percent of the construction, 25 percent upon receipt of certificate of substantial completion, and the balance (10 percent) upon receipt of all state and local approvals.

In addition, the District is pursuing the sale of its two medical office buildings.

REQUEST FOR INFORMATION

This financial report is designed to provide a general overview of the District's finances and demonstrate the District's accountability for the monies it receives. If you have any questions about this report or need additional information, please contact: the CEO, 170 Alameda de las Pulgas, Redwood City, CA 94602.

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SEQUOIA HEALTHCARE DISTRICT
STATEMENT OF NET ASSETS
JUNE 30, 2006

	Governmental Activities	Business-Type Activities	Total
ASSETS			
Current Assets			
Cash and cash equivalents (Note 2)	\$4,946,442		\$4,946,442
Investments (Note 2)	60,097,609		60,097,609
Accounts receivable	150,839		150,839
Noncurrent assets			
Capital assets (Note 4):			
Nondepreciable		\$2,638,927	2,638,927
Depreciable, net		4,436,318	4,436,318
Total Assets	65,194,890	7,075,245	72,270,135
LIABILITIES			
Accounts payable	23,113		23,113
Grants payable	275,000		275,000
Total Liabilities	298,113		298,113
NET ASSETS			
Invested in capital assets		7,075,245	7,075,245
Unrestricted	64,896,777		64,896,777
Total Net Assets	\$64,896,777	\$7,075,245	\$71,972,022

See accompanying notes to financial statements

SEQUOIA HEALTHCARE DISTRICT
STATEMENT OF ACTIVITIES
JUNE 30, 2006

Functions/Programs	Expenses	Program Revenues			Net (Expense) Revenue and Changes in Net Assets		Total
		Charges for Services and Sales	Operating Grants and Contributions	Capital Grants and Contributions	Governmental Activities	Business-type Activities	
Governmental Activities:							
Grant Expenses							
Grants to Sequoia Hospital Foundation	\$1,005,000				(\$1,005,000)		(\$1,005,000)
Grants to Community Non-Profit Organizations	3,713,586				(3,713,586)		(3,713,586)
Grant Administration	52,830				(52,830)		(52,830)
General Administration:							
Administrative Services	223,773				(223,773)		(223,773)
Hospital Replacement Project	116				(116)		(116)
Insurance and Benefits	99,936				(99,936)		(99,936)
Investment and Banking Fees	120,518				(120,518)		(120,518)
Legal	76,647				(76,647)		(76,647)
Office Supplies and Maintenance	5,196				(5,196)		(5,196)
Pension Contribution (Note 8)	3,026,000		\$3,026,000				
Public Relations	83,646				(83,646)		(83,646)
Total Governmental Activities	8,407,248		3,026,000		(5,381,248)		(5,381,248)
Business-type Activities:							
Leasing	1,156,366	\$1,630,182		\$20,912		\$494,728	494,728
Total Business-type Activities	1,156,366	1,630,182		20,912		494,728	494,728
Total	<u>\$9,563,614</u>	<u>\$1,630,182</u>	<u>\$3,026,000</u>	<u>\$20,912</u>	<u>(5,381,248)</u>	<u>494,728</u>	<u>(4,886,520)</u>
General revenues:							
Property taxes					6,525,471		6,525,471
Investment earnings and interest					498,716		498,716
Loss on sale of asset					(1,751)		(1,751)
Escheat Liability Revertment					644,508		644,508
Unrealized loss on investments					(212,133)		(212,133)
Transfers					1,167,009	(1,167,009)	
Total general revenues and transfers					8,621,820	(1,167,009)	7,668,695
Change in Net Assets					3,240,572	(672,281)	2,568,291
Net Assets-Beginning					61,656,205	7,747,526	69,403,731
Net Assets-Ending					<u>\$64,896,777</u>	<u>\$7,075,245</u>	<u>\$71,972,022</u>

See accompanying notes to financial statements

SEQUOIA HEALTHCARE DISTRICT
GOVERNMENTAL FUND
BALANCE SHEET
JUNE 30, 2006

	<u>General Fund</u>
ASSETS	
Cash and cash equivalents (Note 2)	\$4,946,442
Investments (Note 2)	60,097,609
Taxes receivable	<u>150,839</u>
Total Assets	<u>65,194,890</u>
LIABILITIES	
Accounts payable	23,113
Grants payable	<u>275,000</u>
Total Liabilities	<u>298,113</u>
FUND EQUITY	
Fund Balance	
Unreserved/Undesignated	18,223,815
Designated for Corpus (Note 5)	39,989,963
Designated for Depreciation (Note 5)	<u>6,682,999</u>
Total Fund Balance	<u>64,896,777</u>
Total Liabilities and Fund Balance	<u><u>\$65,194,890</u></u>

See accompanying notes to the financial statements

SEQUOIA HEALTHCARE DISTRICT
STATEMENT OF REVENUES, EXPENDITURES
AND CHANGES IN FUND BALANCE
FOR THE YEAR ENDED JUNE 30, 2006

	<u>General Fund</u>
REVENUES	
Taxes	\$6,525,471
Investment Income	272,988
Interest Income	225,728
Pension Reimbursement	3,026,000
Escheat Liability Revertment Income	644,508
Loss on sale of asset	(1,751)
Unrealized loss on investments	(212,133)
	<u>10,480,811</u>
Total Revenues	
EXPENDITURES	
Administrative Services	223,773
Grant Expense	4,771,416
Hospital Replacement Project	116
Insurance and Benefits	99,936
Investment and Banking Fees	120,518
Legal	76,647
Office Supplies and Maintenance	5,196
Pension Contribution	3,026,000
Public Relations	83,646
	<u>8,407,248</u>
Total Expenditures	
EXCESS (DEFICIENCY) OF REVENUES OVER EXPENDITURES	<u>2,073,563</u>
OTHER FINANCING SOURCES (USES)	
Transfers in	<u>1,167,009</u>
Total Other Financing Sources (Uses)	<u>1,167,009</u>
NET CHANGE IN FUND BALANCE	3,240,572
BEGINNING FUND BALANCE	<u>61,656,205</u>
ENDING FUND BALANCE	<u><u>\$64,896,777</u></u>

See accompanying notes to financial statements

SEQUOIA HEALTHCARE DISTRICT
 PROPRIETARY FUNDS
 STATEMENT OF NET ASSETS
 JUNE 30, 2006

	<u>Business-type Activities- Enterprise Fund</u>
ASSETS	
Noncurrent Assets:	
Capital Assets (Note 4):	
Buildings and Improvements	\$14,289,202
Land	2,638,927
Equipment	9,173
Less: Accumulated depreciation	<u>(9,862,057)</u>
Net Capital Assets	7,075,245
Total Assets	<u>7,075,245</u>
NET ASSETS	
Invested in capital assets, net of related debt	<u>7,075,245</u>
Total Net Assets	<u><u>\$7,075,245</u></u>

See accompanying notes to financial statements

SEQUOIA HEALTHCARE DISTRICT
 PROPRIETARY FUND
 STATEMENT OF REVENUE, EXPENSES
 AND CHANGES IN FUND NET ASSETS
 FOR THE YEAR ENDED JUNE 30, 2006

	Business-type Activities- Enterprise Funds
OPERATING REVENUES	
Rental Income	<u>\$1,630,182</u>
Total Operating Revenues	<u>1,630,182</u>
OPERATING EXPENSES	
Administrative Services	14,336
Depreciation (Note 4)	758,760
Insurance	13,080
Maintenance and Supplies	177,008
Utilities	<u>193,182</u>
Total Operating Expenses	<u>1,156,366</u>
Operating Income	<u>473,816</u>
NONOPERATING REVENUES (EXPENSES)	
Contributed capital	20,912
Transfers out	<u>(1,167,009)</u>
Total Nonoperating Expenses	(1,146,097)
Change in net assets	(672,281)
BEGINNING NET ASSETS	<u>7,747,526</u>
ENDING NET ASSETS	<u><u>\$7,075,245</u></u>

See accompanying notes to financial statements

SEQUOIA HEALTHCARE DISTRICT
 PROPRIETARY FUNDS
 STATEMENT OF CASH FLOWS
 FOR THE YEAR ENDED JUNE 30, 2006

	<u>Business-type Activities- Enterprise Funds</u>
CASH FLOWS FROM OPERATING ACTIVITIES	
Payments from tenants	\$1,630,182
Payments to suppliers	<u>(397,606)</u>
Cash Flows from Operating Activities	<u>1,232,576</u>
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES	
Transfers to the General Fund	<u>(1,167,009)</u>
Cash Flows from Noncapital Financing Activities	<u>(1,167,009)</u>
CASHFLOWS FROM INVESTING ACTIVITIES	
Purchase of capital assets, net	(86,479)
Contributed capital	<u>20,912</u>
Cash Flows from Investing Activities	<u>(65,567)</u>
Net Cash Flows	0
Cash and investments at beginning of period	<u>0</u>
Cash and investments at end of period	<u><u>\$0</u></u>
Reconciliation of Operating Income to Cash Flows	
from Operating Activities:	
Operating Income	\$473,816
Adjustments to reconcile operating income to cash flows	
from operating activities:	
Depreciation	<u>758,760</u>
Cash Flows from Operating Activities	<u><u>\$1,232,576</u></u>

See accompanying notes to financial statements

**SEQUOIA HEALTHCARE DISTRICT
NOTES TO FINANCIAL STATEMENTS**

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES
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A. Reporting Entity

Sequoia Healthcare District (the District), formerly known as Sequoia Hospital District (the Hospital), was established in 1947 in accordance with the provisions of the Health and Safety Code of the State of California. The District is a governmental entity legally constituted as a special district under California Law, and is located in Redwood City, California.

On September 30, 1996 the District transferred to Sequoia Health Services (SHS), a California nonprofit public benefit corporation, whose members are the District and Catholic Healthcare West (CHW), the Hospital's assets including property, plant and equipment, except for two medical office buildings, certain other properties, and \$10,000,000 in cash, cash equivalents and other assets that could not be assigned to SHS under applicable law. The total consideration for the Hospital's transfer of the assets to SHS was \$20,000,000, plus the adoption of amended and restated articles of incorporation and amended and restated bylaws, and SHS's assumption of liabilities and obligations of the Hospital.

The principal hospital operations were assumed by Sequoia Health Services on October 1, 1996. On that same day SHS entered into a management services agreement with CHW, a California nonprofit public benefit corporation. The parties entered into the agreement for the provision of management and administrative services by CHW to SHS. SHS is to be operated, along with other hospitals, within the CHW health care system.

The District's mission as adopted by the board is to improve the health and quality of life for all District residents through effective and innovative programs and activities that are designed to achieve health, wellness, and disease prevention. This is to include oversight and support of Sequoia Health Services.

B. Basis of Presentation

The District's basic financial statements are prepared in conformity with accounting principles generally accepted in the United States of America. The Government Accounting Standards Board is the acknowledged standard setting body for establishing accounting and financial reporting standards followed by governmental entities in the United States of America.

These Standards require that the financial statements described below be presented.

Government-wide Statements: The Statement of Net Assets and the Statement of Activities display information about the primary government (the District). These statements include the financial activities of the overall District. These statements distinguish between the *governmental* and *business-type activities* of the District. Governmental activities generally are financed through taxes, intergovernmental revenues, and other nonexchange transactions. Business-type activities are financed in whole or in part by fees charged to external parties.

SEQUOIA HEALTHCARE DISTRICT
NOTES TO FINANCIAL STATEMENTS

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

The Statement of Activities presents a comparison between direct expenses and program revenues for each segment of the business-type activities of the District and for each function of the District's governmental activities. Direct expenses are those that are specifically associated with a program or function and, therefore, are clearly identifiable to a particular function. Program revenues include (a) charges paid by the recipients of goods or services offered by the programs, (b) grants and contributions that are restricted to meeting the operational needs of a particular program and (c) fees, grants and contributions that are restricted to financing the acquisition or construction of capital assets. Revenues that are not classified as program revenues, including all taxes, are presented as general revenues.

Fund Financial Statements: The fund financial statements provide information about the District's funds. Separate statements for each fund category—*governmental and proprietary*—are presented. The emphasis of fund financial statements is on major individual governmental and enterprise funds, each of which is displayed in a separate column. All remaining governmental and enterprise funds are aggregated and reported as nonmajor funds.

Proprietary fund *operating* revenues, such as charges for services, result from exchange transactions associated with the principal activity of the fund. Exchange transactions are those in which each party receives and gives up essentially equal values. *Nonoperating* revenues, such as subsidies and investment earnings, result from nonexchange transactions or ancillary activities.

C. Major Funds

The District's major governmental and business-type funds be identified and presented separately in the fund financial statements. All other funds, called non-major funds, are combined and reported in a single column, regardless of their fund-type.

Major funds are defined as funds that have either assets, liabilities, revenues or expenditures/expenses equal to ten percent of their fund-type total and five percent of the grand total. The General Fund is always a major fund. The District may also select other funds it believes should be presented as major funds.

The District reported the following major governmental funds in the accompanying financial statements:

General Fund - The general operating fund of the District. It is used to account for all financial resources except those required to be accounted for in another fund.

D. Basis of Accounting

The government-wide and proprietary fund financial statements are reported using the *economic resources measurement focus* and the *full accrual basis*. Revenues are recorded when *earned* and expenses are recorded at the time liabilities are *incurred*, regardless of when the related cash flows take place.

**SEQUOIA HEALTHCARE DISTRICT
NOTES TO FINANCIAL STATEMENTS**

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)
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Governmental funds are reported using the *current financial resources* measurement focus and the *modified accrual* basis of accounting. Under this method, revenues are recognized when *measurable and available*. Measurable means the amount of the transaction can be determined and available means the amount is collectible within the current period or soon enough thereafter to be used to pay liabilities of the current period.

Non-exchange transactions, in which the District gives or receives value without directly receiving or giving equal value in exchange, include taxes, grants, entitlements, and donations. On the accrual basis, revenue from taxes is recognized in the fiscal year for which the taxes are levied or assessed.

Other revenues susceptible to accrual are property taxes, sales taxes, interest revenue and charges for services. Fines, license, and permit revenues are not susceptible to accrual because generally they are not measurable until received in cash.

Expenditures are generally recognized under the modified accrual basis of accounting when the related fund liability is incurred (generally thirty days). An exception to this general rule is principal and interest on governmental funds' long-term debt which is recognized when due. Financial resources usually are appropriated in other funds for transfer to a debt service fund in the period in which maturing debt principal and interest must be paid. Such amounts thus are not current liabilities of the debt service fund as their settlement will not require expenditure of existing fund assets.

Certain indirect costs are included in program expenses reported for individual functions and activities.

E. Property 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 56% in 2006 and 58% in 2005 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 31. The County of San Mateo bills and collects the taxes for the District. Tax revenues are recognized by the District when received.

F. Property and Equipment

Property and equipment is stated at cost. Donated assets are recorded at their estimated fair market values at date of donation. Depreciation is computed using the straight-line method over the estimated useful lives of the assets ranging from three to five years for office furniture and equipment, the life of the lease for leasehold improvements, and fifteen to twenty years for buildings and improvements. Expenses for maintenance and repairs are charged against operations as incurred.

**SEQUOIA HEALTHCARE DISTRICT
NOTES TO FINANCIAL STATEMENTS**

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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 certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

H. Depreciation Expense

Depreciation is accumulated using the straight-line method over the estimated useful life of the asset.

I. Risk Management

The District is exposed to various risks of loss from torts; theft of, damage to, and destruction of assets; business interruptions; errors and omissions; and natural disasters. Commercial insurance coverage is purchased for claims arising from such matters. Settled claims have not exceeded this commercial coverage in any of the three preceding years.

Coverage is provided as follows:

<u>Company Name</u>	<u>Type of Coverage</u>	<u>Limits</u>
BETA Healthcare Group	Comprehensive Liability	\$5,000,000
BETA Healthcare Group	D & O Liability	10,000,000
Driver Alliant Insurance Services, Inc.	Property	1,000,000,000
State Compensation Insurance Fund	Workers Compensation	1,000,000

NOTE 2 - CASH AND INVESTMENTS

A. Policies

California Law requires banks and savings and loan institutions to pledge government securities with a market value of 110% of the District's cash on deposit, or first trust deed mortgage notes with a market value of 150% of the deposit, as collateral for these deposits. Under California Law this collateral is held in a separate investment pool by another institution in the District's name and places the District ahead of general creditors of the institution.

The District invests in individual investments. Individual investments are evidenced by specific identifiable *securities instruments*, or by an electronic entry registering the owner in the records of the institution issuing the security, called the *book entry* system. In order to increase security, the District employs the Trust Department of a bank as the custodian of certain District managed investments, regardless of their form.

**SEQUOIA HEALTHCARE DISTRICT
NOTES TO FINANCIAL STATEMENTS**

NOTE 2 - CASH AND INVESTMENTS (Continued)

The District's investments are carried at fair value, as required by generally accepted accounting principles. The District adjusts the carrying value of its investments to reflect their fair value at each fiscal year end, and it includes the effects of these adjustments in income for that fiscal year.

The District considers all highly liquid investments with original maturities of three months or less to be cash equivalents. Cash and cash equivalents consist principally of money market accounts and short term certificates of deposit.

The District is in compliance with the Board approved Investment Policy and California Government Code requirements.

B. Classification

The District's cash and investments consist of the following at June 30, 2006:

Governmental Activities	<u>\$65,044,051</u>
Cash and Investments as of June 30, 2006, consist of the following:	
Cash on hand and in Banks	\$4,946,442
Investments	<u>60,097,609</u>
Total Deposits and Investments	<u>\$65,044,051</u>

C. Investments Authorized by the California Government Code and the District's Investment Policy

The District's Investment Policy and the California Government Code allow the District to invest in the following, provided the credit ratings of the issuers are acceptable to the District and approved percentages and maturities are not exceeded. The table below also identifies certain provisions of the California Government Code, or the District's Investment Policy where the District's Investment Policy is more restrictive.

<u>Authorized Investment Type</u>	<u>Maximum in Portfolio</u>	<u>Minimum Investment Rating</u>	<u>Maximum Investment In One Issuer</u>
Registered State Bonds, Notes, Warrants, California only	None	None	20%
U. S. Treasury Obligations	None	None	None
U.S. Agency Securities	None	None	None
Bankers Acceptances	40%	None	20%
Commercial Paper	15%	A1/P1	20%
Certificates of Deposit	30%	None	20%
Asset Backed Securities	20%	AA	20%
Medium - Term Notes	30%	A	20%

**SEQUOIA HEALTHCARE DISTRICT
NOTES TO FINANCIAL STATEMENTS**

NOTE 2 - CASH AND INVESTMENTS (Continued)

D. Interest Rate Risk

Interest rate risk is the risk that changes in market interest rates will adversely affect the fair value of an investment. Normally, the longer the maturity of an investment, the greater the sensitivity of its fair value to changes in market interest rates. The District generally manages its interest rate risk by purchasing a combination of shorter term and longer term investments and by timing cash flows from maturities so that a portion of the portfolio is maturing or coming close to maturity evenly over time as necessary to provide the cash flow and liquidity needed for operations.

Information about the sensitivity of the fair values of the District's investments (including investments held by bond trustees) to market interest rate fluctuations is provided by the following table that shows the distribution of the District's investments by maturity or earliest call date:

Investment Type	12 Months or less	13 to 24 Months	25 to 60 Months	More than 60 Months	Total
U.S. Treasuries	\$2,700,027	\$1,512,306	\$14,379,827	\$5,253,830	\$23,845,990
U.S. Agencies	1,497,930		4,860,246	8,099,111	14,457,287
Municipal Bonds	994,800			772,131	1,766,931
AssetBacked Securities			1,401,321		1,401,321
Medium-Term Notes	3,535,236	6,177,608	5,381,992	3,531,244	18,626,080
Total Investments	<u>\$8,727,993</u>	<u>\$7,689,914</u>	<u>\$26,023,386</u>	<u>\$17,656,316</u>	<u>\$60,097,609</u>

E. 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 actual rating as of June 30, 2006 for each investment type as provided by Standard and Poor's:

Investment Type	AAA	AA/AA-	A+	A	Total
U.S. Treasuries	\$23,845,990				\$23,845,990
U.S. Agencies	14,457,287				14,457,287
Municipal Bonds	1,766,931				1,766,931
Asset Backed Securities	1,401,321				1,401,321
Medium-Term Notes		\$3,319,790	\$6,751,828	\$8,554,462	18,626,080
Totals	<u>\$41,471,529</u>	<u>\$3,319,790</u>	<u>\$6,751,828</u>	<u>\$8,554,462</u>	60,097,609
Not rated:					
Cash in Banks					4,946,442
Total Investments					<u>\$65,044,051</u>

**SEQUOIA HEALTHCARE DISTRICT
NOTES TO FINANCIAL STATEMENTS**

NOTE 3 – COMMITMENTS

The District has approved conditional grants, not yet paid, for various projects. Conditional grants are only recognized when the conditions on which they depend are substantially met. The following grants have been approved but not yet recognized.

The District, through membership of Sequoia Health Services, has approved funding \$25 million of the \$130 million needed for construction of Sequoia Hospital. The payments are to be made over the course of the construction.

The Samaritan House Free Medical Clinic of Redwood City is to receive a grant of \$500,000 annually.

The San Mateo County Children's Health Initiative is to receive a maximum of \$1,350,000 annually. The annual payments will be made through the fiscal year 2006-2007.

The District has approved a contract with San Francisco State University to pay a maximum of \$1,000,000 each year based on the enrollment of students in the Sequoia Hospital/SFSU Baccalaureate Nursing Program at Canada College. The District will pay \$25,000 per enrollee for up to forty enrollees per year. The payment shall be made in July of each year for the students admitted for class beginning in August of the same year. The last payment of this commitment shall occur in July 2013.

NOTE 4 – CAPITAL ASSETS

Activity in capital assets for the year ended June 30, 2006 are summarized below for the year ended June 30:

	Balance at June 30, 2005	Additions	Retirements	Balance at June 30, 2006
Land	\$2,638,927			\$2,638,927
Building & Improvements	14,206,850	\$85,269	\$2,917	14,289,202
Machinery & Equipment	6,212	2,961		9,173
Total	16,851,989	88,230	2,917	16,937,302
Less: Accumulated Depreciation	(9,104,463)	(757,594)		(9,862,057)
Capital Assets - Net	<u>\$7,747,526</u>			<u>\$7,075,245</u>

NOTE 5 – UNRESTRICTED FUND BALANCE, DESIGNATED BY THE BOARD

Designated for Preservation of Corpus

In October, 1996, the District Board of Directors designated \$30,000,000 for preservation of corpus, arising from the transfer of assets to SHS, with the understanding that the entire amount will remain intact. In addition, the board designated that each year a factor of 3% will be added to the corpus to keep pace with inflation. For the year ended June 30, 2006, \$1,131,791 was added to the corpus for inflation. The ending balance on June 30, 2006 was \$39,989,963.

**SEQUOIA HEALTHCARE DISTRICT
NOTES TO FINANCIAL STATEMENTS**

NOTE 5 – UNRESTRICTED FUND BALANCE, DESIGNATED BY THE BOARD (Continued)

Designated for Depreciation

In October 1997, the District Board authorized the Depreciation Fund. Monthly additions are made in an amount equal to depreciation expense. The reserve is set aside for repairs and replacement of capital assets.

NOTE 6 – RELATED PARTY TRANSACTIONS

During 2006, the District made payments to Sequoia Health Services. The payments, totaling \$123,268, were reimbursements for off-site medical office building maintenance, administrative assistance and healthcare insurance.

NOTE 7 – LEASE AGREEMENTS

The District leases office building space to physicians and medical groups under noncancelable operating lease agreements. The income from these leases is reported as rental income in the statement of revenue, expenses, and changes in net assets. The District owns and leases space at two properties: 2900 Whipple Avenue which has 13 tenants and 525 Veterans Boulevard which has one tenant. The cost and net book value of the two properties is included in land, land improvements and buildings in Notes 4 above. Lease agreement expirations range through December 31, 2007, and most have options to renew with adjustments indexed for inflation.

The future minimum lease payments to be received for the years ended June 30 are as follows:

	<u>Amount</u>
2007	\$1,166,795
2008	<u>183,199</u>
Total	<u>\$1,349,994</u>

NOTE 8 – PENSION PLAN

Prior to October 1, 1996, the District maintained two pension plans, a defined contribution plan and a defined benefit plan. The defined contribution plan was formed under Internal Revenue Service code section 457(b) and is titled the Master Deferred Compensation Plan. The defined benefit plan is titled the Sequoia Healthcare District Employee Pension Plan.

The Master Deferred Compensation Plan allowed covered employees to contribute a portion of their pre-tax earnings to the plan. These contributions, called deferrals and earnings on them that remain in the plan, are not taxable to the participants until they are withdrawn. Deferrals ceased as of September 30, 1996. The assets of the plan are invested in group annuity contracts held by and in the name of a trust established for this purpose and mutual funds, which are subject to stock market risks associated with price changes.

**SEQUOIA HEALTHCARE DISTRICT
NOTES TO FINANCIAL STATEMENTS**

NOTE 8 – PENSION PLAN (Continued)

The Sequoia Healthcare District Employee Pension Plan, adopted on January 1, 1959, as amended is a defined benefit plan. The plan was last amended on August 19, 1998. The employer made contributions to the plan for the benefit of covered employees, the participants. Effective October 1, 1996 all benefit accruals under the plan were suspended indefinitely, provided however that vesting services credit will continue to accrue for participants who continue to be employed. Benefits are distributed to participants when they retire in accordance with the terms of the plan, based on certain actuarial computations. As stated in Note 1, the liability for this plan was assumed by Sequoia Health Services. The plan cannot be transferred to Sequoia Health Services. The District remains contingently liable for funding of the plan in the event of default by Sequoia Health Services. Based on the advice of the plan actuary, the Pension Plan Committee determined that the plan should be funded in the amount of \$3,026,000 for calendar year 2005. The District has funded the \$3,026,000 additional contribution to the plan and Sequoia Health Services has reimbursed this amount to the District.

NOTE 9 – EMPLOYEES' RETIREMENT SYSTEM

As established by Federal law, all public sector employees who are not members of a retirement system such as the state Public Employee Retirement System must be covered by social security or an alternate plan. The District has elected to use Social Security to cover its one employee. Statutory rates are paid by the employee and the District.