

PENINSULA HEALTH CARE DISTRICT

Financial Statements

June 30, 2006

PENINSULA HEALTH CARE DISTRICT

TABLE OF CONTENTS JUNE 30, 2006

	<u>Page Number</u>
I. Independent Auditors' Report	1
II. Management's Discussion and Analysis	2-6
II. Basic Financial Statements	
Government-Wide Financial Statements	
Statement of Net Assets	7
Statement of Activities	8
Fund Financial Statements	
Governmental Fund – Balance Sheet	9
Governmental Fund - Statement of Revenues, Expenditures and Changes in Fund Balance	10
Statement of Net Assets – Proprietary Fund	11
Statement of Revenues, Expenditures and Changes in Fund Net Assets - Proprietary Fund	12
Statement of Cash Flows – Proprietary Fund	13
Notes to Financial Statements	14-24
III. Required Supplementary Information	
General Fund - Budgetary Comparison Schedule	25

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, 2006, 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 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, 2006, 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.

The required supplementary information, such as management's discussion and analysis on pages 2 through 6 and budgetary comparison information on page 26, are not a required part of the basic financial statements, but are supplementary information required by the accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it

Vavrinek, Trine, Day & Co., LLP

Vavrinek, Trine, Day & Co., LLP
Palo Alto, California

August 17, 2006

PENINSULA HEALTH CARE DISTRICT

MANAGEMENT'S DISCUSSION AND ANALYSIS JUNE 30, 2006

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, 2006. This information is presented in conjunction with the audited financial statements that follow this section.

FINANCIAL HIGHLIGHTS

- The District's current assets increased by \$3.7 million
- The District's net capital assets decreased by \$2.6 million
- The District's current liabilities decreased by \$1.1 million
- The District's fund balance increased by \$2.2 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, 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.

PENINSULA HEALTH CARE DISTRICT

MANAGEMENT'S DISCUSSION AND ANALYSIS JUNE 30, 2006

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.

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, 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.

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, 2006

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>2005-2006</u>	<u>2004-2005</u>	<u>Dollar Change</u>	<u>Percent Change</u>
Current Assets	\$ 25,079,960	\$ 21,340,321	\$ 3,739,639	17.52%
Capital Assets	19,465,688	22,099,232	(2,633,544)	-11.92%
Total Assets	<u>\$ 44,545,648</u>	<u>\$ 43,439,553</u>	<u>\$ 1,106,095</u>	5.61%
Current Liabilities	\$ 9,724	\$ 1,082,226	\$ (1,072,502)	-99.10%
Total Liabilities	<u>\$ 9,724</u>	<u>\$ 1,082,226</u>	<u>\$ (1,072,502)</u>	-99.10%
Invested in Capital Assets	\$ 19,465,688	\$ 22,099,233	\$ (2,633,545)	-11.92%
Unrestricted	25,070,236	20,258,094	4,812,142	23.75%
Total Net Assets	<u>\$ 44,535,924</u>	<u>\$ 42,357,327</u>	<u>\$ 2,178,597</u>	11.84%

Total net assets increased by \$2.2 million. The increase reflects an increase in total assets of \$1.1 million and a net reduction in current liabilities of 1.1 million. Cash increased \$3.6 million and reflects the District's commitment to increase its cash reserves for future capital needs.

PENINSULA HEALTH CARE DISTRICT

MANAGEMENT'S DISCUSSION AND ANALYSIS JUNE 30, 2006

REVIEW OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS

	<u>2005-2006</u>	<u>2004-2005</u>	<u>Dollar Change</u>	<u>Percent Change</u>
Revenues				
Tax Revenue	\$ 3,669,899	\$ 3,234,792	\$ 435,107	13.45%
Lease Income	1,547,619	1,785,714	(238,095)	-13.33%
Interest Income	800,598	523,572	277,026	52.91%
Gains and Losses	-	3,000	(3,000)	-100.00%
Other Revenue	22,600	17,687	4,913	27.78%
Total Revenue	<u>6,040,716</u>	<u>5,564,765</u>	<u>475,951</u>	8.55%
Expenditures				
Administration	30,823	31,618	(795)	-2.51%
Communications	90,552	90,322	230	0.25%
Consulting	3,143	26,010	(22,867)	-87.92%
Depreciation	1,889,498	1,621,334	268,164	16.54%
Grants	1,534,811	1,452,913	81,898	5.64%
Legal Fees	109,693	219,073	(109,380)	-49.93%
Promotions	58,454	73,417	(14,963)	-20.38%
Other	145,145	294,537	(149,392)	-50.72%
Total Expenditures	<u>3,862,119</u>	<u>3,809,224</u>	<u>52,895</u>	1.39%
Change in Net Assets	2,178,597	1,755,541	423,056	24.10%
Net Assets beginning of Year	<u>42,357,327</u>	<u>40,601,786</u>	<u>1,755,541</u>	4.32%
Net Assets End of Year	<u>\$ 44,535,924</u>	<u>\$ 42,357,327</u>	<u>\$ 2,178,597</u>	5.14%

Gross tax revenues increased by approximately \$435,000 due largely to the amendment of SB568 that reversed the Education Revenue Augmentation Fund (ERAF) shift that applied in the prior year. Favorable interest rates continued throughout the year and added \$277,000 to interest income. The decrease in lease income of approximately \$238,000 reflects the change from \$1.785 million annual rent in rent credit allowances under the old lease to \$1.5 million annual rent in cash which became effective September 1, 2005 under the new lease agreement reached between the Peninsula Health Care District and Mills-Peninsula Health Services. Although total expenses were relatively flat, depreciation expense increased \$268,000, but was offset by decreases in legal fees of \$109,000 and other expenses of \$149,000. The decreases in legal and other expenses were expected as the prior year included several non-recurring items. The District's net assets increased by \$2.1 million.

PENINSULA HEALTH CARE DISTRICT

MANAGEMENT'S DISCUSSION AND ANALYSIS JUNE 30, 2006

CAPITAL ASSETS

	<u>2005-2006</u>	<u>2004-2005</u>	Dollar <u>Change</u>	Percent <u>Change</u>
Land and Improvements	\$ 731,046	\$ 731,046	\$ -	0.00%
Building and Improvements	57,415,515	57,415,515	-	0.00%
Equipment	<u>21,450,367</u>	<u>21,816,119</u>	<u>(365,752)</u>	-1.68%
Subtotal	<u>79,596,928</u>	<u>79,962,680</u>	<u>(365,752)</u>	-0.46%
Less Accumulated Depreciation	<u>60,131,240</u>	<u>57,863,448</u>	<u>2,267,792</u>	3.92%
Capital Assets - Net of Depreciation	<u>\$ 19,465,688</u>	<u>\$ 22,099,232</u>	<u>\$ (2,633,544)</u>	-11.92%

The change of \$2.6 million resulted from depreciation and the reduction of the carrying cost of equipment.

ECONOMIC AND OTHER FACTORS

The District must rebuild its hospital by 2013 to be in compliance with State mandated seismic regulations. Accordingly the District has negotiated a new agreement with Mills-Peninsula Health Services for the construction of a new hospital on District owned land and a new long-term lease. Approved by the District Board in September, 2005 and executed in October, 2005 the agreement was approved by the District voters in August, 2006. It is expected that final closing will occur in the near future. Should Mills-Peninsula Health Services fail to perform under the new agreement, there are various buy-out provisions for the District. For this reason it is incumbent upon the District to accumulate a reserve fund for future capital needs and the District has resolved to do so.

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 HEALTH CARE DISTRICT

STATEMENT OF NET ASSETS JUNE 30, 2006

	<u>Governmental Activities</u>	<u>Business-Type Activities</u>	<u>Total</u>
Current Assets			
Cash and Cash Equivalents	\$ 24,222,159	\$ 584,351	\$ 24,806,510
Interest Receivable	255,000	-	255,000
Prepaid Expense	18,450	-	18,450
Total Current Assets	<u>24,495,609</u>	<u>584,351</u>	<u>25,079,960</u>
Property, Plant, and Equipment - Net	-	19,465,688	19,465,688
Total Assets	<u>24,495,609</u>	<u>20,050,039</u>	<u>44,545,648</u>
Current Liabilities			
Accounts Payable	7,310	2,414	9,724
Total Current Liabilities	<u>7,310</u>	<u>2,414</u>	<u>9,724</u>
Net Assets			
Invested in Capital Assets	-	19,465,688	19,465,688
Unrestricted	24,488,299	581,937	25,070,236
Total Net Assets	<u>\$ 24,488,299</u>	<u>\$ 20,047,625</u>	<u>\$ 44,535,924</u>

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

PENINSULA HEALTH CARE DISTRICT

**STATEMENT OF ACTIVITIES
YEAR ENDING JUNE 30, 2006**

<u>Functions/Programs</u>	<u>Expenses</u>	<u>Program Revenue</u>		
		<u>Charges for Services and Sales</u>	<u>Operating Grants and Contributions</u>	<u>Capital Grants and Contributions</u>
Governmental Activities:				
Community Grants	\$ 1,534,811	\$ -	\$ -	\$ -
General Administration:				
Administration Fees	30,823	-	-	-
Communication	90,552	-	-	-
Consulting	3,143	-	-	-
Legal Fees	53,804	-	-	-
Promotions	58,454	-	-	-
Other	145,145	-	-	-
Total Governmental Activities	1,916,732	-	-	-
Business Type Activities:				
Leasing	-	1,547,619	-	-
Depreciation	1,889,498	-	-	-
Legal	55,889	-	-	-
Total Business Activities	1,945,387	1,547,619	-	-
Total Primary Government	\$ 3,862,119	\$ 1,547,619	\$ -	\$ -

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

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

Changes in Net Assets

Governmental Activities	Business Type Activities	Total
\$ (1,534,811)	\$ -	\$ (1,534,811)
(30,823)	-	(30,823)
(90,552)	-	(90,552)
(3,143)	-	(3,143)
(53,804)	-	(53,804)
(58,454)	-	(58,454)
(145,145)	-	(145,145)
<u>(1,916,732)</u>	<u>-</u>	<u>(1,916,732)</u>
-	1,547,619	1,547,619
-	(1,889,498)	(1,889,498)
-	(55,889)	(55,889)
<u>-</u>	<u>(397,768)</u>	<u>(397,768)</u>
<u>(1,916,732)</u>	<u>(397,768)</u>	<u>(2,314,500)</u>
3,669,899	-	3,669,899
800,598	-	800,598
22,600	-	22,600
1,247,013	(1,247,013)	-
<u>5,740,110</u>	<u>(1,247,013)</u>	<u>4,493,097</u>
3,823,378	(1,644,781)	2,178,597
20,664,921	21,692,406	42,357,327
<u>\$ 24,488,299</u>	<u>\$ 20,047,625</u>	<u>\$ 44,535,924</u>

PENINSULA HEALTH CARE DISTRICT

**GOVERNMENTAL FUND
BALANCE SHEET
JUNE 30, 2006**

	<u>General Fund</u>
Current Assets	
Cash and Cash Equivalents	\$ 24,222,159
Interest Receivable	255,000
Prepaid Expense	18,450
Total Assets	<u>\$ 24,495,609</u>
Current Liabilities	
Accounts Payable	<u>\$ 7,310</u>
Total Liabilities	<u>7,310</u>
Fund Balance	
Designated for Future Capital Needs	23,588,299
Unreserved/Undesignated	900,000
Total Fund Balance	<u>24,488,299</u>
Total Liabilities and Fund Balance	<u>\$ 24,495,609</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, 2006**

	<u>General Fund</u>
Revenues	
Tax Revenue	\$ 3,669,899
Interest Income	800,598
Other Revenue	22,600
Total Revenues	<u>4,493,097</u>
Expenditures	
Administration Fees	30,823
Communications	90,552
Consulting	3,143
Grants	1,534,811
Legal Fees	53,804
Promotions	58,454
Other	145,145
Total Expenditures	<u>1,916,732</u>
Excess of Revenue Over Expenditures	2,576,365
Transfers In	<u>1,247,013</u>
Net Change in Fund Balance	3,823,378
Fund Balance - Beginning of Year	<u>20,664,921</u>
Fund Balance - End of Year	<u><u>\$ 24,488,299</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, 2006**

	<u>Business-Type Activities</u>
	<u>Enterprise Fund</u>
	<u>Leasing</u>
Current Assets	
Cash and Cash Equivalents	\$ 584,351
Total Current Assets	<u>584,351</u>
Property, Plant, and Equipment - Net	<u>19,465,688</u>
Total Assets	<u>20,050,039</u>
Current Liabilities	
Accounts Payable	<u>2,414</u>
Total Liabilities	<u>2,414</u>
Fund Balance	
Invested in Capital Assets	19,465,688
Unrestricted	<u>581,937</u>
Total Fund Balance	<u>\$ 20,047,625</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, 2006**

	<u>Business-Type Activities</u> <u>Enterprise Fund</u> <u>Leasing</u>
Operating Revenues	
Leasing Income	\$ 1,547,619
Total Operating Revenues	<u>1,547,619</u>
Operating Expenses	
Depreciation	1,889,498
Legal Fees	55,889
Total Operating Expenditures	<u>1,945,387</u>
Operating Income	(397,768)
Transfers Out	<u>(1,247,013)</u>
Change in Net Assets	(1,644,781)
Net Assets - Beginning of Year	<u>21,692,406</u>
Net Assets - End of Year	<u>\$ 20,047,625</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, 2006**

	<u>Business-Type Activities</u> <u>Proprietary Fund</u>
Cash Flows from Operating Activities:	
Leasing Revenues	\$ 1,250,000
Legal Fees	(63,945)
Net Cash Provided by Operating Activities	<u>1,186,055</u>
Cash Flows from Noncapital Financing Activities	
Transfers to the General Fund	(1,247,013)
Net Cash Used in Noncapital Financing Activities	<u>(1,247,013)</u>
Net Decrease in Cash and Cash Equivalents	(60,958)
Cash and Cash Equivalents - Beginning of Year	<u>645,309</u>
Cash and Cash Equivalents - End of Year	<u>\$ 584,351</u>
Reconciliation of Net Income to Net Cash Provided by Operating Activities	
Loss from Operations	\$ (397,768)
Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities	
Depreciation	1,889,498
Decrease in Deferred Revenue	(1,041,667)
Amount of Deferred Revenue Reduced from Asset Transfer	744,046
Decrease in Accounts Payable	(8,054)
Net Cash Used by Operating Activities	<u>\$ 1,186,055</u>

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

PENINSULA HEALTH CARE DISTRICT

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2006

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. 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.

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 only enterprise fund of the District accounts for the financial transactions related to the leasing operations of the District.

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.

PENINSULA HEALTH CARE DISTRICT

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2006

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

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

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

Governmental Funds All governmental funds are accounted for using the flow of current financial resources measurement focus and the modified accrual basis of accounting. With this measurement focus, only current assets and current liabilities generally are included on the balance sheet. The statement of revenues, expenditures, and changes in fund balance reports on the sources (revenues and other financing sources) and uses (expenditures and other financing uses) of current financial resources. This approach differs from the manner in which the governmental activities of the government-wide financial statements are prepared. Governmental fund financial statements, therefore, include reconciliations with brief explanations to better identify the relationship between the government-wide financial statements, prepared using the economic resources measurement focus and the accrual basis of accounting, and the governmental fund financial statements, prepared using the flow of current financial resources measurement focus and the modified accrual basis of accounting.

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.

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

PENINSULA HEALTH CARE DISTRICT

NOTES TO FINANCIAL STATEMENTS JUNE 30, 2006

Investments

Investments held at June 30, 2006, 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.

When purchased, such assets are recorded as expenditures in the governmental funds and capitalized in the government-wide statement of net assets. The valuation basis for capital assets is historical cost, or where historical cost is not available, estimated historical cost based on replacement cost.

Capital assets in the proprietary funds are capitalized in the fund in which they are utilized. The valuation basis for proprietary fund capital assets is the same as those used for the capital assets of governmental funds.

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.

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.

PENINSULA HEALTH CARE DISTRICT

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2006

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 61% 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 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.

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.

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..

New Accounting Pronouncements

In November 2003, GASB issued GASBS No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*. This Statement establishes guidance for accounting and reporting for impairment of capital assets and for insurance recoveries, whether associated with an impaired capital asset or not. This Statement is effective for periods beginning after December 31, 2004, or during the 2005-06 fiscal year. The District has adopted this Statement and it had no impact on the financial statements.

In July 2004, GASB issued GASBS No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*. This Statement will require local governmental employers who provide other postemployment benefits (OPEB) as part of the total compensation offered to employees to recognize the expense and related liabilities (assets) in the government-wide financial statements of net assets and activities. This Statement establishes standards for the measurement, recognition, and display of OPEB expense/expenditures and related liabilities (assets), note disclosures, and, if applicable, required supplementary information (RSI) in the financial reports of State and local governmental employers.

Current financial reporting practices for OPEB generally are based on pay-as-you-go financing approaches. They fail to measure or recognize the cost of OPEB during the periods when employees render the services or to provide relevant information about OPEB obligations and the extent to which progress is being made in funding those obligations.

PENINSULA HEALTH CARE DISTRICT

NOTES TO FINANCIAL STATEMENTS JUNE 30, 2006

This Statement generally provides for prospective implementation - that is, that employers set the beginning net OPEB obligation at zero as of the beginning of the initial year. The District will be required to implement the provisions of this Statement for the fiscal year ended June 30, 2009. The District currently does not offer post employment benefits.

In December 2004, GASB issued GASBS No. 46, Net Assets Restricted by Enabling Legislation. This Statement clarifies that a legally enforceable enabling legislation restriction is one that a party external to a government—such as citizens, public interest groups, or the judiciary—can compel a government to honor. The Statement states that the legal enforceability of an enabling legislation restriction should be reevaluated if any of the resources raised by the enabling legislation are used for a purpose not specified by the enabling legislation or if a government has other cause for reconsideration. Although the determination that a particular restriction is not legally enforceable may cause a government to review the enforceability of other restrictions, it should not necessarily lead a government to the same conclusion for all enabling legislation restrictions.

This Statement also specifies the accounting and financial reporting requirements if new enabling legislation replaces existing enabling legislation or if legal enforceability is reevaluated. Finally, this Statement requires governments to disclose the portion of total net assets that is restricted by enabling legislation. The requirements of this Statement are effective for financial statements for periods beginning after June 15, 2005. The District has adopted this Statement and it had no impact on the financial statements.

NOTE 2 – DEPOSITS AND INVESTMENTS

Summary of Deposits and Investments

Deposits and investments as of June 30, 2006, are classified in the accompanying financial statements as follows:

Governmental Activities	\$ 24,222,159
Business-Type Activities	584,351
Total Deposits and Investments	<u>\$ 24,806,510</u>

Deposits and investments as of June 30, 2006, consist of the following:

	Fair Value	Amortized Cost Basis
Cash on Hand and in Banks	\$ 584,351	\$ 584,351
Investment in Local Agency Investment Fund	9,625,849	9,643,344
Investment in San Mateo County Pool	14,413,004	14,578,815
Total Deposits and Investments	<u>\$ 24,623,204</u>	<u>\$ 24,806,510</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;

PENINSULA HEALTH CARE DISTRICT

**NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2006**

medium term corporate notes; shares of beneficial interest issued by diversified management companies, certificates of participation, obligations with first priority security; and collateralized mortgage obligations.

Investment in County Treasury - The 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 fair value provided by the County Treasurer for the entire portfolio (in relation to the amortized cost of that portfolio). 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 fair value of 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 fair value provided by LAIF for the entire LAIF portfolio (in relation to the amortized cost of that portfolio). The balance available for withdrawal is based on the accounting records maintained by LAIF, which is recorded on the amortized cost basis.

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

PENINSULA HEALTH CARE DISTRICT

**NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2006**

Interest Rate Risk

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

Segmented Time Distribution

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

Investment Type	Fair Value	Weighted Average Maturity in Years
San Mateo County Pool	\$ 14,413,004	1.4
State Investment Pool	9,625,849	0.4
Total	\$ 24,038,853	

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.

Investment Type	Fair Value	Minimum Legal Rating	Unrated
San Mateo County Pool	\$ 14,413,004	N/A	\$ 14,413,004
State Investment Pool	9,625,849	N/A	9,625,849
Total	\$ 24,038,853		\$ 24,038,853

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

PENINSULA HEALTH CARE DISTRICT

NOTES TO FINANCIAL STATEMENTS JUNE 30, 2006

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, 2006, the District's bank balance of \$628,943 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.

NOTE 3 – CAPITAL ASSETS

Activity in capital assets for the year ended June 30, 2006 was as follows:

Capital Assets	Beginning	Additions	Retirements	Ending
Land and Land Improvements	\$ 731,046	\$ -	\$ -	\$ 731,046
Buildings and Improvements	57,415,515	-	-	57,415,515
Equipment	21,816,119	-	365,752	21,450,367
	<u>79,962,680</u>	<u>-</u>	<u>365,752</u>	<u>79,596,928</u>
Accumulated Depreciation				
Land Improvements	721,850	8,190	-	730,040
Buildings and Improvements	38,923,216	1,259,841	-	40,183,057
Equipment	18,218,382	1,015,359	15,598	19,218,143
	<u>57,863,448</u>	<u>2,283,390</u>	<u>15,598</u>	<u>60,131,240</u>
Capital Assets - Net	<u>\$ 22,099,232</u>	<u>\$ (2,283,390)</u>	<u>\$ 350,154</u>	<u>\$ 19,465,688</u>

The State of California adopted strict seismic standards for acute care hospitals under Senate Bill 1953 which will require substantial modification to the existing hospital. Under current law, if the existing hospital fails to achieve compliance with the seismic standards by January 1, 2013 the hospital would be required to cease operations.

Based on independent engineering studies the District has determined that compliance is more efficiently and economically achieved by construction of a new facility rather than reconstruction of the existing hospital. The District and the Hospital have signed a set of agreements (the "Definitive Agreements"), which shall become effective upon the Closing under the Pre-Closing Agreement (See Notes 6 and 9 below), for the existing hospital to be demolished and a new hospital to be built and operated by MPHS on land owned by the District and leased to MPHS.

PENINSULA HEALTH CARE DISTRICT

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2006

In the opinion of counsel for the District, should a new hospital not be constructed or modifications to the current hospital not be completed by 2013, the likelihood of the State not providing extension of the 2013 date is not probable. Accordingly, because of the agreement for building a new hospital has not been finalized and the date that the hospital building and improvements would no longer be utilized is not certain, useful lives of Buildings and Improvements have not been adjusted to December 31, 2012. The remaining net book value of Buildings and Improvements affected by Senate Bill 1953 as of January 1, 2013 would be \$9,869,103. Annual depreciation expense would be increased for the year ended June 30, 2006 by \$1,315,880 to fully depreciate those assets.

The District will reevaluate depreciable lives during the following year when the status of the expected agreement with MPHS for construction of a new hospital is finalized.

The agreements between MPHS and the District contain certain covenants restricting the use of District property for the provision of health services.

NOTE 4 – PROPERTY PURCHASE AND LEASE COMMITMENTS

Prior to 1986 the District was the lessee of a building near the Hospital. The District sublet the building to an affiliate of Mills-Peninsula Health Services under terms identical to those required under the primary lease. In 1986 the District assigned the building lease to MPHS. Although the District and MPHS have operated since 1986 as if the assignment was effective and MPHS has paid all rents due under the lease directly to the building owner, documentation of consent of the assignment of the building owner has not been located. Should the lease assignment be determined not to be effective, the District may be obliged under the original lease to make the required payments should MPHS not meet its obligations. The future minimum lease payments required under assigned lease, which expires in 2013 are:

Year Ending June 30:	
2007	\$ 113,848
2008	113,848
2009	123,335
2010	123,335
2011	132,824
Thereafter	<u>265,649</u>
Total	<u>\$ 872,839</u>

The District may also have an option to purchase this building and the building's owner may have the right to require the District to purchase the building. The purchase price, defined by the original agreement, is approximately \$828,800 at June 30, 2006.

The District counsel is seeking clarification of the status of the lease assignment and option rights.

PENINSULA HEALTH CARE DISTRICT

NOTES TO FINANCIAL STATEMENTS JUNE 30, 2006

NOTE 5 - FUND BALANCES

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

	General Fund	Total
	<u> </u>	<u> </u>
Unreserved		
Designated		
Future capital needs	\$ 23,588,299	\$ 23,588,299
Total Designated	<u>23,588,299</u>	<u>23,588,299</u>
Undesignated	900,000	900,000
Total Unreserved	<u>24,488,299</u>	<u>24,488,299</u>
Total	<u><u>\$ 24,488,299</u></u>	<u><u>\$ 24,488,299</u></u>

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.

NOTE 6 – 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. This lease was modified by a Restructured Relationship Pre-Closing Agreement in October 2005 (the "Pre-Closing Agreement"), which is an agreement that binds the District and MPHS until the Closing thereunder, at which time the definitive agreements shall become effective and which provide for MPHS to demolish the existing facility as discussed in Note 3. Annual rent payments of \$1,785,714 were reduced to \$1,500,000 in September 2005. The total rent payments received under these agreements was \$1,547,619 for the year ended June 30, 2006. The modified lease terms will be effective through the date of the Closing under the Pre-Closing Agreement. After the Closing, a new lease agreement that is one of the Definitive Agreements, the Construction Ground Lease, will further modify the existing lease and govern the parties' lease relationship going forward. The lessee is obligated for all operating, maintenance and other costs of the facility.

The lessee was entitled under the original lease to apply the cost of certain 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. Effective October 2005, under the modifications to the lease, the rent payments were required to be in cash.

PENINSULA HEALTH CARE DISTRICT

NOTES TO FINANCIAL STATEMENTS JUNE 30, 2006

NOTE 7 – RESTRICTED GRANTS AND LOANS

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

In order to encourage the pursuit of nursing careers and graduate nurses to locate within the jurisdiction of the District, grants of up to \$2,000 are made to selected nursing students enrolled in two-year nursing programs. If the student completes the program and then completes two post graduate years in a nursing position within specified communities, the District forgives the loan in full. Grants of up to \$5,000 are made to selected nursing students enrolled in four-year nursing programs at local universities or colleges. If the student completes the four-year program and then completes four post graduate years in a nursing position within specified communities, the District forgives the loan in full.

These payments are recorded as grants. 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, 2006 there are no amounts recorded as unpaid loans from these transactions.

As of June 30, 2006 the District has determined that nine grants were in default amounting to \$46,500. During the year the District recovered \$13,400 and has established payment plans. Because of the uncertainty of recovering the amounts owed, the District has fully reserved the receivable and will report recoveries when received. The amount of reserves will be reevaluated after the District is able to establish a collection history.

NOTE 8 - LITIGATION

In June 1997, the District initiated litigation in the San Mateo County Superior Court 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. Under the Pre-Closing Agreement, the District will dismiss this litigation at or before the Closing. See Note 9 Subsequent Event.

NOTE 9 – SUBSEQUENT EVENT

The Definitive Agreements referred to in Notes 3, 6 and 8 were subject to approval by San Mateo County voters in August 2006. In the opinion of District counsel, the Closing under the Pre-Closing Agreement, and the effective date of the Definitive Agreements, will occur by December 2006.

Required Supplementary Information

PENINSULA HEALTH CARE DISTRICT

**GENERAL FUND
BUDGETARY COMPARISON SCHEDULE
JUNE 30, 2006**

	<u>Budgetary Amounts</u> <u>Original and Final</u>	<u>Actual</u>	<u>Variance</u>
Revenues			
Tax Revenue	\$ 3,200,000	\$ 3,669,899	\$ 469,899
Interest Income	600,000	800,598	200,598
Total Revenues	<u>3,800,000</u>	<u>4,470,497</u>	<u>670,497</u>
Expenditures			
Administration Fees	-	30,823	(30,823)
Communications	125,000	90,552	34,448
Consulting	55,000	3,143	51,857
Grants	1,700,000	1,534,811	165,189
Legal Fees	110,000	53,804	56,196
Other	175,000	145,145	29,855
Promotions	200,000	58,454	141,546
Total Expenditures	<u>2,365,000</u>	<u>1,916,732</u>	<u>448,268</u>
Excess Revenue Over Expenditures	1,435,000	2,553,765	1,118,765
Transfer From Other Funds	<u>1,435,000</u>	<u>1,247,013</u>	<u>(187,987)</u>
Excess of Revenue Over Expenditures and Transfers From Other Funds	2,870,000	3,800,778	930,778
Fund Balance - Beginning of Year	<u>20,664,921</u>	<u>20,664,921</u>	<u>-</u>
Fund Balance - End of Year	<u>\$ 23,534,921</u>	<u>\$ 24,465,699</u>	<u>\$ 930,778</u>