

# **Sonoma Valley Health Care District**

Accountants' Report and Financial Statements

June 30, 2006 and 2005

# Sonoma Valley Health Care District

June 30, 2006 and 2005

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## Independent Accountants' Report on Financial Statements

Board of Directors  
Sonoma Valley Health Care District  
Sonoma, California

We have audited the accompanying balance sheets of SONOMA VALLEY HEALTH CARE DISTRICT (the Hospital) as of June 30, 2006 and 2005, and the related statements of revenues, expenses and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the Hospital's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. 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 of SONOMA VALLEY HEALTH CARE DISTRICT as of June 30, 2006 and 2005, and its changes in financial position and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The accompanying management's discussion and analysis as listed in the table of contents is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. 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.

/s/ **BKD, LLP**

September 21, 2006

# **Sonoma Valley Health Care District**

## **Management's Discussion and Analysis**

### **Years Ended June 30, 2006 and 2005**

#### ***Introduction***

This management's discussion and analysis of the financial performance of Sonoma Valley Health Care District (the Hospital) provides an overview of the Hospital's financial activities for the years ended June 30, 2006 and 2005. It should be read in conjunction with the accompanying financial statements of the Hospital.

#### ***Financial Highlights***

- Cash and investments decreased in 2006 by approximately \$1,167,000 (20%) and decreased in 2005 by approximately \$476,000 (7%).
- The Hospital's net assets increased in each of the past two years with a \$1,446,000 or 22%, increase in 2006 and \$1,189,000 or 22%, increase in 2005.
- The Hospital reported operating losses in both 2006 (\$1,515,000) and 2005 (\$1,216,000). The operating loss in 2006 increased by approximately \$300,000 or 25% over the operating loss reported in 2005. The operating loss in 2005 increased by approximately \$476,000 or 64% over the operating loss reported in 2004.
- Net nonoperating revenues increased by approximately \$782,000 or 36% in 2006 compared to 2005, and by \$698,000 or 48% in 2005 compared to 2004.

#### ***Using This Annual Report***

The Hospital's financial statements consist of three statements—a balance sheet; a statement of revenues, expenses and changes in net assets; and a statement of cash flows. These statements provide information about the activities of the Hospital, including resources held by the Hospital but restricted for specific purposes by creditors, contributors, grantors or enabling legislation. The Hospital is accounted for as a business-type activity and presents its financial statements using the economic resources measurement focus and the accrual basis of accounting.

#### ***The Balance Sheets and Statements of Revenues, Expenses and Changes in Net Assets***

One of the most important questions asked about any hospital's finances is "Is the Hospital as a whole better or worse off as a result of the year's activities?" The balance sheets and the statements of revenues, expenses and changes in net assets report information about the Hospital's resources and its activities in a way that helps answer this question. These statements include all restricted and unrestricted assets and all liabilities using the accrual basis of accounting. Using the accrual basis of accounting means that all of the current year's revenues and expenses are taken into account regardless of when cash is received or paid.

These two statements report the Hospital's net assets and changes in them. The Hospital's total net assets—the difference between assets and liabilities—is one measure of the Hospital's financial health or financial position. Over time, increases or decreases in the Hospital's net assets are an indicator of whether its financial health is improving or deteriorating. Other nonfinancial factors, such as changes in the Hospital's patient base, changes in legislation and regulations, measures of the quantity and quality of services provided to its patients and local economic factors should also be considered to assess the overall financial health of the Hospital.

### **The Statements of Cash Flows**

The statements of cash flows reports cash receipts, cash payments and net changes in cash and cash equivalents resulting from four defined types of activities. It provides answers to such questions as where did cash come from, what was cash used for and what was the change in cash and cash equivalents during the reporting period.

### **The Hospital's Net Assets**

The Hospital's net assets are the difference between its assets and liabilities reported in the balance sheets. The Hospital's net assets increased by \$1,446,000 (22%) in 2006 over 2005 and by \$1,189,000 (22%) in 2005 over 2004, as shown in Table 1.

**Table 1: Assets, Liabilities and Net Assets**

|   | <b>2006</b>          | <b>2005</b>          | <b>2004</b>          |
|---|----------------------|----------------------|----------------------|
| <b>Assets</b>                                   |                      |                      |                      |
| Short-term investments                          | \$ 3,453,294         | \$ 4,614,994         | \$ 5,308,982         |
| Patient accounts receivable, net                | 4,594,116            | 5,111,506            | 3,793,246            |
| Other current assets                            | 4,425,672            | 3,750,523            | 3,896,540            |
| Capital assets, net                             | 6,436,905            | 5,535,893            | 4,744,371            |
| Other noncurrent assets                         | <u>1,277,960</u>     | <u>1,366,579</u>     | <u>1,404,476</u>     |
| Total assets                                    | <u>\$ 20,187,947</u> | <u>\$ 20,379,495</u> | <u>\$ 19,147,615</u> |
| <b>Liabilities</b>                              |                      |                      |                      |
| Long-term debt (including current portion)      | \$ 6,330,000         | \$ 7,044,874         | \$ 7,790,022         |
| Other current and noncurrent liabilities        | <u>5,797,109</u>     | <u>6,719,378</u>     | <u>5,931,548</u>     |
| Total liabilities                               | <u>12,127,109</u>    | <u>13,764,252</u>    | <u>13,721,570</u>    |
| <b>Net Assets</b>                               |                      |                      |                      |
| Invested in capital assets, net of related debt | 1,268,760            | (263,957)            | (1,740,932)          |
| Restricted expendable                           | 196,684              | 252,752              | 220,798              |
| Unrestricted                                    | <u>6,595,394</u>     | <u>6,626,448</u>     | <u>6,946,179</u>     |
| Total net assets                                | <u>8,060,838</u>     | <u>6,615,243</u>     | <u>5,426,045</u>     |
| Total liabilities and net assets                | <u>\$ 20,187,947</u> | <u>\$ 20,379,495</u> | <u>\$ 19,147,615</u> |

In 2006, patient accounts receivable declined by \$517,390 (10%) as the Hospital was able to address the billing and collection staff shortages experienced during 2005. Other current assets increased by \$675,149 (18%) primarily because of increased working capital needs associated with physician recruiting efforts and the hospitalist program. Other liabilities declined by \$922,269 (14%) because vendor payments were made timelier during fiscal 2006. Finally, capital assets increased by \$901,012 (16%) primarily due to projects associated with planning a new hospital replacement facility. The asset and liability changes noted above required the use of cash and, as a result, short-term investments declined by \$1,161,700 (25%).

A significant change in the Hospital's assets in 2005 is the increase in patient accounts receivable. Although net patient service revenues increased in 2005 by only 6%, net patient accounts receivable increased by \$1,318,260 (35%) or 12.6 days of revenue at June 30, 2005 vs. June 30, 2004. The increase results primarily from delays in filing claims with third-party payers caused by difficulty in securing adequate staffing throughout the year. In addition, the state Medicaid program and certain commercial insurance providers have become slower in making payments on behalf of covered individuals in 2005. This trend reflects the tight budgetary constraints the state is experiencing and attempts by commercial insurance providers to conserve cash and control costs by challenging claims more strenuously.

### **Operating Results and Changes in the Hospital's Net Assets**

In 2006 and 2005, the Hospital's operating loss increased by \$299,383 or 25% and \$476,440 or 64%, respectively, as shown in Table 2.

**Table 2: Operating Results and Changes in Net Assets**

|  | <b>2006</b>         | <b>2005</b>         | <b>2004</b>       |
|--|---------------------|---------------------|-------------------|
| <b>Operating Revenues</b>                                    |                     |                     |                   |
| Net patient service revenue                                  | \$ 35,410,400       | \$ 32,149,477       | \$ 30,469,469     |
| Premium revenues   | 1,196,640           | 1,181,267           | 772,605           |
| Other operating revenues                                     | <u>181,860</u>      | <u>101,990</u>      | <u>213,600</u>    |
| Total operating revenues                                     | <u>36,788,900</u>   | <u>33,432,734</u>   | <u>31,455,674</u> |
| <b>Operating Expenses</b>                                    |                     |                     |                   |
| Salaries and wages and employee benefits                     | 23,745,928          | 20,602,942          | 18,429,635        |
| Purchased services and professional fees                     | 6,258,153           | 6,417,706           | 6,090,114         |
| Depreciation   | 1,252,099           | 1,325,951           | 1,312,669         |
| Other operating expenses                                     | <u>7,048,124</u>    | <u>6,302,156</u>    | <u>6,362,837</u>  |
| Total operating expenses                                     | <u>38,304,304</u>   | <u>34,648,755</u>   | <u>32,195,255</u> |
| <b>Operating Loss</b>  | <u>(1,515,404)</u>  | <u>(1,216,021)</u>  | <u>(739,581)</u>  |
| <b>Nonoperating Revenues (Expenses)</b>                      |                     |                     |                   |
| Property taxes   | 2,026,913           | 2,000,803           | 1,991,224         |
| Investment income  | 144,622             | 154,717             | 46,849            |
| Noncapital grants and gifts                                  | 1,895,375           | 561,395             | 115,659           |
| Interest expense   | (295,385)           | (313,227)           | (575,173)         |
| Other  | <u>(828,527)</u>    | <u>(242,390)</u>    | <u>(115,614)</u>  |
| <b>Total Nonoperating Revenues (Expenses)</b>                | <u>2,942,998</u>    | <u>2,161,298</u>    | <u>1,462,945</u>  |
| <b>Excess of Revenues Over Expenses Before Capital Gifts</b> | 1,427,594           | 945,277             | 723,364           |
| <b>Capital Gifts</b>   | <u>18,001</u>       | <u>243,921</u>      | <u>173,541</u>    |
| <b>Increase in Net Assets</b>                                | <u>\$ 1,445,595</u> | <u>\$ 1,189,198</u> | <u>\$ 896,905</u> |

## ***Operating Losses***

The first component of the overall change in the Hospital's net assets is its operating income or loss—generally, the difference between net patient service and other operating revenues and the expenses incurred to perform those services. In each of the past three years, the Hospital has reported an operating loss. This is consistent with the Hospital's recent operating history as the Hospital was formed and is operated primarily to serve residents of Sonoma Valley, regardless of their ability to pay. The Hospital levies property taxes to provide sufficient resources to enable the facility to serve lower income and other residents.

The operating loss for 2006 increased by \$299,383 or 25% as compared to 2005. Although operating revenues grew by \$3,358,000 (10%) in 2006, they did not keep pace with operating expenses which grew by \$3,656,000 (11%). The operating loss for 2005 increased by \$476,440 or 64% as compared to 2004.

Net patient service revenue increased by \$3,260,000 (10%) in 2006 compared to 2005. This increase was largely attributable to the Hospital's ability to renegotiate certain significant managed care contracts at improved reimbursement rates and the Hospital's receiving approval for additional payments from Medicare due to a geographic reclassification request. The increase of \$1,680,000 (6%) in net patient service revenue in 2005 was primarily caused by a change in patient volume in 2005 and a revision of the Hospital's charge master.

Employee salaries and wages and benefits accounted for 86% and 88% of the increase in operating expenses in 2006 and 2005, respectively. In a continuing effort to improve staff recruitment and retention, the Hospital increased health benefits substantially during 2006. In addition, new state-mandated staffing ratios required the use of additional employees during 2006. During 2005, the Hospital instituted significant increases in clinical salary levels at the beginning of the year, particularly for nurses. These increases were designed to improve the Hospital's ability to recruit and retain nurses and other health care professionals who have been in short supply in the United States for a number of years. Most of the remaining increase in operating expenses in both 2006 and 2005 was in the area of medical professional fees. The Hospital, in response to local market conditions, increased the amount paid to staff physicians who provided coverage to the emergency room.

## ***Nonoperating Revenues and Expenses***

Nonoperating revenues and expenses consist of property taxes levied by the Hospital, investment income, interest expense and noncapital grants and gifts. While the property tax revenue, investment income and interest expense remained relatively constant in 2006 as compared to 2005, noncapital grants and gifts grew substantially from \$561,395 in 2005 to \$1,895,375 in 2006, a more than two-fold increase. This arose from the Hospital's 2005 decision to hire an executive who would devote his full-time efforts to fund-raising and a significant gift from an estate in 2006 of approximately \$1,170,000. Property tax revenue remained consistent in 2005 as compared to 2004, interest expense decreased by approximately \$226,000 due to refinancing the outstanding bonds payable in April 2004 and investment income increased by approximately \$107,000 due to improved market conditions.

## ***Capital Grants and Gifts***

The Hospital received gifts of \$18,001 from a foundation and various individuals to purchase capital assets in 2006 and \$243,921 in 2005, a decrease of \$225,920 or 93% from 2005 and an increase of \$70,380 or 41% from 2005 to 2004. Substantially all of these gifts have been expended and are reflected in unrestricted net assets as of June 30, 2006 and 2005.

## ***The Hospital's Cash Flows***

Changes in the Hospital's cash flows are consistent with changes in operating losses and nonoperating revenues and expenses, discussed earlier, with one exception. Cash provided by operating activities decreased slightly more than the change in the operating loss in 2005 due to the increase in the Hospital's patient accounts receivable discussed above.

## ***Capital Asset and Debt Administration***

### **Capital Assets**

At the end of 2006 and 2005, the Hospital had \$6,436,905 and \$5,535,893, respectively, invested in capital assets, net of accumulated depreciation, as detailed in *Note 7* to the financial statements. In 2006 and 2005, the Hospital purchased new equipment and made capital improvements costing \$1,367,842 and \$1,558,873, respectively. Additionally, the Hospital incurred costs of \$785,608 and \$603,828 related to the hospital replacement project in 2006 and 2005. All of this activity was financed internally. In 2005, the Hospital began expending funds to build a replacement facility, as discussed in *Note 16*. As of June 30, 2006, \$1,420,536 had been spent for this purpose.

### **Debt**

At June 30, 2006 and 2005, the Hospital had \$6,330,000 and \$7,044,874, respectively, in revenue bonds and capital lease obligations outstanding as detailed in *Note 11* to the financial statements. The Hospital issued no new debt in 2006 and 2005. The Hospital's formal debt issuances which consist of revenue bonds, at June 30, 2006 and 2005, are subject to limitations imposed by state law. There have been no changes in the Hospital's debt ratings in the past two years.

## ***Contacting the Hospital's Financial Management***

This financial report is designed to provide our patients, suppliers, taxpayers and creditors with a general overview of the Hospital's finances and to show the Hospital's accountability for the money it receives. Questions about this report and requests for additional financial information should be directed to the chief financial officer by telephoning (707) 935-5018.

**Sonoma Valley Health Care District**  
**Balance Sheets**  
**June 30, 2006 and 2005**

**Assets**

|  | <b>2006</b>   | <b>2005</b>   |
|--|---------------|---------------|
| <b>Current Assets</b>  |               |               |
| Cash   | \$ 282,514    | \$ 270,070    |
| Short-term investments   | 3,453,294     | 4,614,994     |
| Restricted cash and investments – current  | 202,429       | 202,104       |
| Patient accounts receivable, net of allowance;<br>2006 – \$1,050,000, 2005 – \$730,000 | 4,594,116     | 5,111,506     |
| Property taxes receivable  | 2,110,426     | 2,110,319     |
| Other receivables  | 591,998       | 229,641       |
| Estimated amounts due from third-party payers  | 238,989       | —             |
| Supplies   | 580,055       | 642,850       |
| Prepaid expenses and other   | 419,261       | 295,539       |
| Total current assets   | 12,473,082    | 13,477,023    |
| <b>Noncurrent Cash and Investments</b>   |               |               |
| Held by trustee for debt service   | 1,043,881     | 1,061,586     |
| Less amount required to meet current obligations                                       | 202,429       | 202,104       |
|  | 841,452       | 859,482       |
| <b>Capital Assets, Net</b>   | 6,436,905     | 5,535,893     |
| <b>Other Assets</b>  |               |               |
| Deferred financing costs   | 436,508       | 507,097       |
| Total assets   | \$ 20,187,947 | \$ 20,379,495 |

## Liabilities and Net Assets

|   | <u>2006</u>          | <u>2005</u>          |
|---|----------------------|----------------------|
| <b>Current Liabilities</b>                      |                      |                      |
| Current maturities of long-term debt            | \$ 615,000           | \$ 714,874           |
| Accounts payable                                | 1,343,081            | 2,148,695            |
| Accrued compensation                            | 2,078,461            | 1,724,007            |
| Deferred revenue                                | 2,148,567            | 2,103,915            |
| Estimated amounts due to third-party payers     | —                    | 471,761              |
| Estimated self-insurance costs                  | <u>227,000</u>       | <u>271,000</u>       |
| Total current liabilities                       | 6,412,109            | 7,434,252            |
| <b>Long-term Debt</b>                           |                      |                      |
|   | <u>5,715,000</u>     | <u>6,330,000</u>     |
| Total liabilities                               | <u>12,127,109</u>    | <u>13,764,252</u>    |
| <b>Net Assets</b>                               |                      |                      |
| Invested in capital assets, net of related debt | 1,268,760            | (263,957)            |
| Restricted-expendable for debt service          | 196,684              | 252,752              |
| Unrestricted                                    | <u>6,595,394</u>     | <u>6,626,448</u>     |
| Total net assets                                | <u>8,060,838</u>     | <u>6,615,243</u>     |
| Total liabilities and net assets                | <u>\$ 20,187,947</u> | <u>\$ 20,379,495</u> |

**Sonoma Valley Health Care District**  
**Statements of Revenues, Expenses and Changes in Net Assets**  
**Years Ended June 30, 2006 and 2005**

|  | <b>2006</b>        | <b>2005</b>        |
|--|--------------------|--------------------|
| <b>Operating Revenues</b>  |                    |                    |
| Net patient service revenue, net of provision for uncollectible accounts; 2006 – \$1,247,163, 2005 – \$1,491,771 | \$ 35,410,400      | \$ 32,149,477      |
| Premium revenue  | 1,196,640          | 1,181,267          |
| Other  | 181,860            | 101,990            |
| Total operating revenues   | 36,788,900         | 33,432,734         |
| <b>Operating Expenses</b>  |                    |                    |
| Salaries and wages   | 20,331,540         | 17,797,516         |
| Employee benefits  | 3,414,388          | 2,805,426          |
| Medical fees   | 1,026,447          | 791,391            |
| Purchased services   | 5,231,706          | 5,626,315          |
| Supplies   | 4,959,269          | 4,650,822          |
| Utilities  | 780,681            | 710,664            |
| Insurance  | 385,813            | 247,038            |
| Depreciation   | 1,252,099          | 1,325,951          |
| Other  | 922,361            | 693,632            |
| Total operating expenses   | 38,304,304         | 34,648,755         |
| <b>Operating Loss</b>  | <b>(1,515,404)</b> | <b>(1,216,021)</b> |
| <b>Nonoperating Revenues (Expenses)</b>  |                    |                    |
| Property taxes   | 2,026,913          | 2,000,803          |
| Investment income  | 144,622            | 154,717            |
| Interest expense   | (295,385)          | (313,227)          |
| Noncapital grants and gifts  | 1,895,375          | 561,395            |
| Other  | (828,527)          | (242,390)          |
| Total nonoperating revenues (expenses)   | 2,942,998          | 2,161,298          |
| <b>Excess of Revenues Over Expenses Before Capital Gifts</b>   | 1,427,594          | 945,277            |
| <b>Capital Gifts</b>   | 18,001             | 243,921            |
| <b>Increase in Net Assets</b>  | 1,445,595          | 1,189,198          |
| <b>Net Assets, Beginning of Year</b>   | 6,615,243          | 5,426,045          |
| <b>Net Assets, End of Year</b>   | \$ 8,060,838       | \$ 6,615,243       |

**Sonoma Valley Health Care District**  
**Statements of Cash Flows**  
**Years Ended June 30, 2006 and 2005**

|  | <b>2006</b>        | <b>2005</b>        |
|--|--------------------|--------------------|
| <b>Operating Activities</b>  |                    |                    |
| Receipts from and on behalf of patients                                  | \$ 36,434,832      | \$ 32,561,135      |
| Payments to suppliers and contractors                                    | (14,585,742)       | (12,181,352)       |
| Payments to employees  | (23,435,474)       | (20,575,908)       |
| Other receipts (payments), net   | <u>186,234</u>     | <u>234,902</u>     |
| Net cash provided by (used in) operating activities                      | <u>(1,400,150)</u> | <u>38,777</u>      |
| <b>Noncapital Financing Activities</b>                                   |                    |                    |
| Property taxes supporting operations                                     | 2,050,306          | 1,993,906          |
| Noncapital grants and gifts  | <u>1,895,375</u>   | <u>561,395</u>     |
| Net cash provided by noncapital financing activities                     | <u>3,945,681</u>   | <u>2,555,301</u>   |
| <b>Capital and Related Financing Activities</b>                          |                    |                    |
| Capital grants and gifts   | 18,001             | 243,921            |
| Proceeds from disposition of capital assets                              | 25,000             | 3,415              |
| Principal paid on long-term debt   | (714,874)          | (745,148)          |
| Interest paid on long-term debt  | (298,410)          | (315,496)          |
| Purchase of capital assets   | (1,312,883)        | (1,516,221)        |
| Purchase of hospital replacement project capital assets                  | <u>(785,608)</u>   | <u>(603,828)</u>   |
| Net cash used in capital and related financing activities                | <u>(3,068,774)</u> | <u>(2,933,357)</u> |
| <b>Investing Activities</b>  |                    |                    |
| Interest and dividends on investments                                    | 143,255            | 141,147            |
| Net change in short-term investments                                     | 1,161,700          | 693,988            |
| Advances to medical practices, net                                       | (786,973)          | (277,469)          |
| Net change in investments held by trustee                                | <u>36,939</u>      | <u>141,349</u>     |
| Net cash provided by investing activities                                | <u>554,921</u>     | <u>699,015</u>     |
| <b>Increase in Cash and Cash Equivalents</b>                             | 31,678             | 359,736            |
| <b>Cash and Cash Equivalents, Beginning of Year</b>                      | <u>673,009</u>     | <u>313,273</u>     |
| <b>Cash and Cash Equivalents, End of Year</b>                            | <u>\$ 704,687</u>  | <u>\$ 673,009</u>  |
| <b>Reconciliation of Cash and Cash Equivalents to the Balance Sheets</b> |                    |                    |
| Cash in current assets   | \$ 282,514         | \$ 270,070         |
| Cash equivalents in noncurrent cash and investments                      | <u>422,173</u>     | <u>402,939</u>     |
|  | <u>\$ 704,687</u>  | <u>\$ 673,009</u>  |

|   | <b>2006</b>           | <b>2005</b>      |
|---|-----------------------|------------------|
| <b>Reconciliation of Net Operating Revenues (Expenses) to Net Cash Provided by (Used in) Operating Activities</b> |                       |                  |
| Operating loss  | \$ (1,515,404)        | \$ (1,216,021)   |
| Depreciation  | 1,252,099             | 1,325,951        |
| Amortization  | 70,589                | 72,653           |
| Accrued self-insurance costs  | (44,000)              | (106,000)        |
| Loss (gain) on sale of capital assets   | (24,661)              | 25,180           |
| Changes in operating assets and liabilities   |                       |                  |
| Patient and other receivables, net  | 156,400               | (1,078,899)      |
| Estimated amounts due from and to third-party payers  | (710,750)             | 566,300          |
| Accounts payable and accrued expenses   | (544,648)             | 448,047          |
| Other assets and liabilities  | <u>(39,775)</u>       | <u>1,566</u>     |
| Net cash provided by (used in) operating activities   | <u>\$ (1,400,150)</u> | <u>\$ 38,777</u> |
| <b>Supplemental Cash Flows Information</b>  |                       |                  |
| Capital assets acquisitions included in accounts payable  | \$ 80,979             | \$ 26,020        |

# **Sonoma Valley Health Care District**

## **Notes to Financial Statements**

### **June 30, 2006 and 2005**

#### **Note 1: Nature of Operations and Summary of Significant Accounting Policies**

##### ***Nature of Operations and Reporting Entity***

Sonoma Valley Health Care District (the District) is a political subdivision of the state of California organized under the State of California Local Health Care District Law as set forth in the Health and Safety Code of the State of California. The District owns and operates Sonoma Valley Hospital (Hospital).

The Hospital is an acute care hospital located in Sonoma, California. The Hospital primarily earns revenues by providing inpatient, outpatient and emergency care services to patients in the Sonoma County area. It also operates a home health agency in the same geographic area.

##### ***Basis of Accounting and Presentation***

The financial statements of the Hospital have been prepared on the accrual basis of accounting using the economic resources measurement focus. Revenues, expenses, gains, losses, assets and liabilities from exchange and exchange-like transactions are recognized when the exchange transaction takes place. Operating revenues and expenses include exchange transactions.

Property taxes, investment income, interest on capital assets-related debt and loan activity for medical practices are included in nonoperating revenues and expenses. The Hospital first applies restricted net assets when an expense or outlay is incurred for purposes for which both restricted and unrestricted net assets are available.

The Hospital prepares its financial statements as a business-type activity in conformity with applicable pronouncements of the Governmental Accounting Standards Board (GASB). Pursuant to GASB Statement No. 20, the Hospital has elected to apply the provisions of all relevant pronouncements of the Financial Accounting Standards Board (FASB) that were issued on or before November 30, 1989, and do not conflict with or contradict GASB pronouncements.

##### ***Use of Estimates***

The preparation of 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 reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

##### ***Cash Equivalents***

The Hospital considers all liquid investments, other than investments in external investment pools, with original maturities of three months or less to be cash equivalents. At June 30, 2006 and 2005, cash equivalents consisted of money market mutual funds held by the trustee for debt service.

# **Sonoma Valley Health Care District**

## **Notes to Financial Statements**

### **June 30, 2006 and 2005**

#### ***Special Parcel Tax***

In March 2002, Sonoma Valley Health Care District voters adopted a special tax on each taxable parcel of land within the District at an annual rate of up to \$130 per parcel for five years. The purpose of the special parcel tax is to ensure continued local access to emergency room care, acute hospital care and other medical services for residents of the District and for visitors to the area.

The Hospital received approximately 5.0% and 5.5% of its financial support from the special parcel tax in 2006 and 2005, respectively. These funds were used to support operations.

The special parcel taxes, or property taxes, are assessed in June and are received beginning in November and March of each year and become delinquent after December and April of that year. Revenue from the special parcel tax is recognized in the year for which the taxes are levied. The Hospital obtained a line of credit during 2006 that allows the Hospital to receive advances on the parcel tax in advance of their actual collections. At June 30, 2006, there was no outstanding balance on this line of credit.

#### ***Risk Management***

The Hospital is exposed to various risks of loss from torts; theft of, damage to and destruction of assets; business interruption; errors and omissions; employee injuries and illnesses; and natural disasters. Commercial insurance coverage is purchased for claims arising from such matters other than workers' compensation. Settled claims have not exceeded this commercial coverage in any of the three preceding years.

The Hospital is self-insured for a portion of its exposure to risk of loss from workers' compensation. Annual estimated provisions are accrued for the self-insured portion of workers' compensation claims and include an estimate of the ultimate costs for both reported claims and claims incurred but not reported.

#### ***Investments and Investment Income***

Investments in U.S. Treasury, agency and instrumentality obligations with a remaining maturity of one year or less at the time of acquisition are carried at amortized cost. All other investments are carried at fair value. Fair value is determined using quoted market prices.

Investment income includes dividend and interest income, realized gains and losses on investments carried at other than fair value and the net change for the year in the fair value of investments carried at fair value.

#### ***Patient Accounts Receivable***

The Hospital reports patient accounts receivable for services rendered at net realizable amounts from third-party payers, patients and others. The Hospital provides an allowance for uncollectible accounts based upon a review of outstanding receivables, historical collection information and existing economic conditions.

**Sonoma Valley Health Care District**  
**Notes to Financial Statements**  
**June 30, 2006 and 2005**

***Supplies***

Supply inventories are stated at the lower of cost, determined using the first-in, first-out method, or market.

***Capital Assets***

Capital assets are recorded at cost at the date of acquisition, or fair value at the date of donation if acquired by gift. Depreciation is computed using the straight-line method over the estimated useful life of each asset. Assets under capital lease obligations and leasehold improvements are depreciated over the shorter of the lease term or their respective estimated useful lives. The following estimated useful lives are being used by the Hospital:

|                                      |               |
|--------------------------------------|---------------|
| Land improvements                    | 10 – 20 years |
| Buildings and leasehold improvements | 20 – 40 years |
| Equipment                            | 2 – 10 years  |

***Deferred Financing Costs***

Deferred financing costs represent costs incurred in connection with the issuance of long-term debt. Such costs are being amortized over the term of the respective debt using the interest method.

***Compensated Absences***

Hospital policies permit most employees to accumulate paid time-off benefits that may be realized as paid time off or as a cash payment upon termination. Expense and the related liability are recognized as paid time-off benefits when earned. Compensated absence liabilities are computed using the regular pay and termination pay rates in effect at the balance sheet date plus an additional amount for compensation-related payments such as social security and Medicare taxes computed using rates in effect at that date.

***Net Assets***

Net assets of the Hospital are classified in three components. Net assets invested in capital assets, net of related debt, consist of capital assets net of accumulated depreciation and reduced by the outstanding balances of borrowings used to finance the purchase or construction of those assets. Restricted expendable net assets are noncapital assets that must be used for a particular purpose as specified by creditors, grantors or donors external to the Hospital, including amounts deposited with trustees as required by bond indentures, reduced by the outstanding balances of any related borrowings. Unrestricted net assets are remaining assets less remaining liabilities that do not meet the definition of invested in capital assets, net of related debt or restricted expendable.

# **Sonoma Valley Health Care District**

## **Notes to Financial Statements**

### **June 30, 2006 and 2005**

#### ***Net Patient Service Revenue***

The Hospital has agreements with third-party payers that provide for payments to the Hospital at amounts different from its established rates. Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payers and others for services rendered and includes estimated retroactive revenue adjustments and a provision for uncollectible accounts. Retroactive adjustments are considered in the recognition of revenue on an estimated basis in the period the related services are rendered and such estimated amounts are revised in future periods as adjustments become known.

#### ***Premium Revenue***

The Hospital, in association with Marin Independent Practice Association (MIPA) has agreements with various health maintenance organizations (HMOs) to provide medical services to subscribing participants. Under these agreements, the Hospital receives monthly capitation payments based on the number of each HMO's participants, regardless of the services actually performed by the Hospital. The Hospital is responsible for the cost of most services provided to subscribing participants by other hospitals. The Hospital has stop-loss agreements in effect to limit its losses on individual claims. In addition, the HMOs make fee-for-service payments to the Hospital for certain covered services based upon discounted fee schedules.

#### ***Community Benefits***

The Hospital provides care without charge or at amounts less than its established rates to patients meeting certain criteria under its charity care policy. Because the Hospital does not pursue collection of amounts determined to qualify under its charity care policy, these amounts are deducted from gross patient service revenue and are, therefore, not reported as net patient service revenue.

#### ***Income Taxes***

As an essential government function of the state of California, the Hospital is generally exempt from federal and state income taxes under Section 115 of the Internal Revenue Code and a similar provision of state law.

#### ***Reclassifications***

Certain reclassifications have been made to the 2005 financial statements to conform to the 2006 presentation. The reclassifications had no effect on the change in net assets.

#### **Note 2: Net Patient Service Revenue**

The Hospital has agreements with third-party payers that provide for payments to the Hospital at amounts different from its established rates. These payment arrangements include:

# Sonoma Valley Health Care District

## Notes to Financial Statements

### June 30, 2006 and 2005

- **Medicare** – Inpatient acute care services and substantially all outpatient services rendered to Medicare program beneficiaries are paid at prospectively determined rates per discharge. These rates vary according to a patient classification system that is based on clinical, diagnostic and other factors. Inpatient skilled nursing services are paid at prospectively determined per diem rates that are based on the patients' acuity. The Hospital is reimbursed for certain services at tentative rates with final settlement determined after submission of annual cost reports by the Hospital and audits thereof by the Medicare fiscal intermediary. The Hospital's Medicare cost reports have been audited by the Medicare fiscal intermediary through June 30, 2004.
- **Medi-Cal** – Inpatient services rendered to Medi-Cal program beneficiaries are reimbursed under a cost reimbursement methodology for certain services and at prospectively determined rates for outpatient and all other services. The Hospital is reimbursed for cost reimbursable services at tentative rates with final settlement determined after submission of annual cost reports by the Hospital and audits thereof by the Medi-Cal fiscal intermediary. The Hospital's Medi-Cal cost reports have been audited by the Medi-Cal fiscal intermediary through June 30, 2004.

Approximately 56% and 53% of net patient service revenue is from participation in the Medicare and state-sponsored Medi-Cal programs for the years ended June 30, 2006 and 2005, respectively. Laws and regulations governing the Medicare and Medi-Cal programs are complex and subject to interpretation and change. As a result, it is reasonably possible that recorded estimates will change materially in the near term.

The Hospital has also entered into payment agreements with certain commercial insurance carriers, health maintenance organizations and preferred provider organizations. The basis for payment to the Hospital under these agreements includes prospectively determined rates per discharge, discounts from established charges and prospectively determined daily rates.

### **Note 3: Deposits, Investments and Investment Income**

#### ***Deposits***

Custodial credit risk is the risk that in the event of a bank failure, a government's deposits may not be returned to it. The Hospital's deposit policy for custodial credit risk requires compliance with the provisions of state law.

State law requires collateralization of all deposits with federal depository insurance; bonds and other obligations of the U.S. Treasury, U.S. agencies or instrumentalities or the state of California; bonds of any city, county, school district or special road district of the state of California; bonds of any state; or a surety bond having an aggregate value at least equal to the amount of the deposits.

**Sonoma Valley Health Care District**  
**Notes to Financial Statements**  
**June 30, 2006 and 2005**

At June 30, 2006 and 2005, \$800,923 and \$214,471 of the Hospital's bank balances of \$900,923 and \$314,471, respectively, were exposed to custodial credit risk as follows:

|   | <b>2006</b> | <b>2005</b> |
|---|-------------|-------------|
| Uninsured and uncollateralized  | \$ —        | \$ —        |
| Uninsured and collateral held by pledging financial institution's trust department or agent in other than the Hospital's name | 800,923     | 214,471     |
|   | \$ 800,923  | \$ 214,471  |

**Investments**

The Hospital may legally invest in direct obligations of and other obligations guaranteed as to principal by the U.S. Treasury and U.S. agencies and instrumentalities and bank repurchase agreements. Additionally, the Hospital may invest in the state of California guaranteed Local Agency Investment Fund (LAIF). LAIF funds consist primarily of U.S. Treasury obligations, U.S. agencies obligations, certificates of deposit and corporate bonds.

At June 30, 2006 and 2005, the Hospital had the following investments and maturities:

| <b>Type</b>                     | <b>2006</b>       |                            |            |             |                     |
|---------------------------------|-------------------|----------------------------|------------|-------------|---------------------|
|                                 | <b>Fair Value</b> | <b>Maturities in Years</b> |            |             |                     |
|                                 |                   | <b>Less than 1</b>         | <b>1-5</b> | <b>6-10</b> | <b>More than 10</b> |
| U.S. Treasury obligations       | \$ 25,624         | \$ —                       | \$ 25,624  | \$ —        | \$ —                |
| U.S. agencies obligations       | 596,084           | —                          | 596,084    | —           | —                   |
| External investment pool (LAIF) | 3,453,294         | 3,453,294                  | —          | —           | —                   |
| Money market mutual funds       | 422,173           | 422,173                    | —          | —           | —                   |
|                                 | \$ 4,497,175      | \$ 3,875,467               | \$ 621,708 | \$ 0        | \$ 0                |

| <b>Type</b>                     | <b>2005</b>       |                            |            |             |                     |
|---------------------------------|-------------------|----------------------------|------------|-------------|---------------------|
|                                 | <b>Fair Value</b> | <b>Maturities in Years</b> |            |             |                     |
|                                 |                   | <b>Less than 1</b>         | <b>1-5</b> | <b>6-10</b> | <b>More than 10</b> |
| U.S. Treasury obligations       | \$ 27,163         | \$ —                       | \$ 27,163  | \$ —        | \$ —                |
| U.S. agencies obligations       | 631,484           | —                          | 631,484    | —           | —                   |
| External investment pool (LAIF) | 4,614,994         | 4,614,994                  | —          | —           | —                   |
| Money market mutual funds       | 402,939           | 402,939                    | —          | —           | —                   |
|                                 | \$ 5,676,580      | \$ 5,017,933               | \$ 658,647 | \$ 0        | \$ 0                |

**Sonoma Valley Health Care District**  
**Notes to Financial Statements**  
**June 30, 2006 and 2005**

The Hospital's investment policy limits the first \$5,000,000 of investments to the LAIF. Once investments exceed \$5,000,000, the policy limits investments to bonds and other obligations of the U.S. Treasury, U.S. agencies or instrumentalities or the state of California; bonds of any city, county, school district or special road district of the state of California; bonds of banks for cooperatives, federal land banks, federal intermediate credit banks, federal home loan banks, Federal Home Loan Bank, Tennessee Valley Authority and the National Mortgage Association; the LAIF or certificates of deposit.

The investment policy does not specifically address interest rate risk, credit risk, custodial credit risk, concentration of credit risk or foreign currency risk.

- **Interest Rate Risk** – The money market mutual funds are presented as an investment with a maturity of less than one year because they are redeemable in full immediately.
- **Credit Risk** – Credit risk is the risk that the issuer or other counterparty to an investment will not fulfill its obligations. At June 30, 2006 and 2005, the Hospital's investments in money market mutual funds were rated AAA by Standard and Poor's and Aaa by Moody's Investors Service and the Hospital's investments in LAIF were not rated.
- **Custodial Credit Risk** – For an investment, custodial credit risk is the risk that, in the event of the failure of the counterparty, the Hospital will not be able to recover the value of its investment or collateral securities that are in the possession of an outside party. The Hospital's investments in U.S. agency obligations, LAIF and money market mutual funds are held by the broker or by the bank's trust department in other than the Hospital's name.
- **Concentration of Credit Risk** – This risk relates to the risk of loss attributed to the magnitude of the Hospital's investment in a single issuer. The Hospital did not have any investment in a single issuer in excess of 5% as of June 30, 2006 or 2005.
- **Foreign Currency Risk** – This risk relates to adverse affects on the fair value of an investment from changes in exchange rates. The Hospital had no investments denominated in foreign currency at June 30, 2006 and 2005.

**Summary of Carrying Values**

The carrying values of deposits and investments shown above are included in the balance sheets as follows:

|  | <b>2006</b>         | <b>2005</b>         |
|--|---------------------|---------------------|
| Carrying value                                   |                     |                     |
| Deposits   | \$ 282,514          | \$ 270,070          |
| Investments                                      | <u>4,497,175</u>    | <u>5,676,580</u>    |
|  | <u>\$ 4,779,689</u> | <u>\$ 5,946,650</u> |
| Included in the following balance sheet captions |                     |                     |
| Cash   | \$ 282,514          | \$ 270,070          |
| Short-term investments                           | 3,453,294           | 4,614,994           |
| Noncurrent cash and investments                  | <u>1,043,881</u>    | <u>1,061,586</u>    |
|  | <u>\$ 4,779,689</u> | <u>\$ 5,946,650</u> |

**Sonoma Valley Health Care District**  
**Notes to Financial Statements**  
**June 30, 2006 and 2005**

**Investment Income**

Investment income for the years ended June 30, 2006 and 2005, consisted of:

|   | <b>2006</b>       | <b>2005</b>       |
|---|-------------------|-------------------|
| Interest and dividend income              | \$ 181,561        | \$ 159,720        |
| Net decrease in fair value of investments | <u>(36,939)</u>   | <u>(5,003)</u>    |
|   | <u>\$ 144,622</u> | <u>\$ 154,717</u> |

**Note 4: Patient Accounts Receivable**

The Hospital grants credit without collateral to its patients, many of whom are area residents and are insured under third-party payer agreements. Patient accounts receivable at June 30, 2006 and 2005, consisted of:

|   | <b>2006</b>         | <b>2005</b>         |
|---|---------------------|---------------------|
| Medicare                                  | \$ 1,121,095        | \$ 1,181,749        |
| Medi-Cal                                  | 713,838             | 860,811             |
| Other third-party payers                  | 2,191,708           | 2,487,459           |
| Patients                                  | <u>1,617,475</u>    | <u>1,311,487</u>    |
|   | 5,644,116           | 5,841,506           |
| Less allowance for uncollectible accounts | <u>1,050,000</u>    | <u>730,000</u>      |
|   | <u>\$ 4,594,116</u> | <u>\$ 5,111,506</u> |

**Note 5: Notes Receivable**

***Sonoma Valley Community Health Center***

Sonoma Valley Community Health Center, Inc. (SVCHC) is a nonprofit organization providing health care access to residents of Sonoma Valley. The District agreed to advance SVCHC up to \$225,000 for its working capital needs under an unsecured line of credit agreement. Advances under the line of credit agreement amounted to \$179,182 as of June 30, 2005. During fiscal year ending June 30, 2006, SVCHC paid back all advances under the line of credit.

***Valley of the Moon Medical Group***

Valley of the Moon Medical Group, Inc. (VMMG) is a locally organized independent practice association. VMMG's primary purpose is to secure and administer managed care health insurance contracts. The Hospital has historically partnered with VMMG on numerous managed care contracts, including jointly negotiating and administering these contracts. However, due to the bankruptcy of the Health Plan of the Redwoods in 2002, the majority of plan participants selected managed care contracts that paid VMMG on a capitated basis and paid the Hospital on a fee-for-service basis. Beginning December 1, 2002 through April 2006, the Hospital had agreed to pay for all of VMMG's managed care administrative costs in order to maintain the managed care contracts in the Sonoma Valley area. In April 2006, VMMG ceased operations.

# Sonoma Valley Health Care District

## Notes to Financial Statements

June 30, 2006 and 2005

The Hospital had previously extended an \$800,000 unsecured line of credit to VMMG. Due to VMMG ceasing operations, the Hospital does not anticipate any future payments on the outstanding advances under the line of credit. The amount due the Hospital from VMMG under the line of credit agreement at June 30, 2006 and 2005, was \$252,616 and \$201,255, respectively.

The net receivable due from SVCHC and VMMG are as follows:

|   | 2006           | 2005             |
|---|----------------|------------------|
| Sonoma Valley Community Health Center               | \$ —           | \$ 179,182       |
| Valley of the Moon Medical Group                    | <u>252,616</u> | <u>201,255</u>   |
|   | 252,616        | 380,437          |
| Less allowance for estimated uncollectible balances | <u>252,616</u> | <u>300,000</u>   |
|   | <u>\$ 0</u>    | <u>\$ 80,437</u> |

### Note 6: Related Party Transactions

Sonoma Valley Hospital Foundation, Inc. (Foundation) is authorized to solicit contributions on behalf of the Hospital. In the absence of donor restrictions, the Foundation has discretionary control over the amounts, timing and use of their distributions. The Hospital received \$285,000 and \$25,000 in noncapital gifts and \$0 and \$225,000 in capital gifts from the Foundation during 2006 and 2005, respectively. At June 30, 2006 and 2005, the Foundation's net assets totaled approximately \$62,500 and \$74,300, respectively.

### Note 7: Capital Assets

Capital assets activity for the years ended June 30, 2006 and 2005, were:

|                                      | 2006                 |                   |                  |             | Ending<br>Balance   |
|--------------------------------------|----------------------|-------------------|------------------|-------------|---------------------|
|                                      | Beginning<br>Balance | Additions         | Disposals        | Transfers   |                     |
| Land                                 | \$ 197,660           | \$ —              | \$ —             | \$ —        | \$ 197,660          |
| Land improvements                    | 731,370              | —                 | —                | —           | 731,370             |
| Buildings and leasehold improvements | 19,300,220           | 15,920            | —                | 131,383     | 19,447,523          |
| Equipment                            | 10,737,510           | 1,137,401         | (174,649)        | 51,113      | 11,751,375          |
| Construction in progress             | 23,986               | 214,521           | —                | (182,496)   | 56,011              |
|                                      | <u>30,990,746</u>    | <u>1,367,842</u>  | <u>(174,649)</u> | <u>0</u>    | <u>32,183,939</u>   |
| Hospital replacement project         | 634,928              | 785,608           | —                | —           | 1,420,536           |
|                                      | <u>31,625,674</u>    | <u>2,153,450</u>  | <u>(174,649)</u> | <u>0</u>    | <u>33,604,475</u>   |
| Less accumulated depreciation        |                      |                   |                  |             |                     |
| Land improvements                    | 725,015              | 1,385             | —                | —           | 726,400             |
| Buildings and leasehold improvements | 16,891,630           | 528,479           | —                | —           | 17,420,109          |
| Equipment                            | 8,473,136            | 722,235           | (174,310)        | —           | 9,021,061           |
|                                      | <u>26,089,781</u>    | <u>1,252,099</u>  | <u>(174,310)</u> | <u>0</u>    | <u>27,167,570</u>   |
| Capital assets, net                  | <u>\$ 5,535,893</u>  | <u>\$ 901,351</u> | <u>\$ (339)</u>  | <u>\$ 0</u> | <u>\$ 6,436,905</u> |

**Sonoma Valley Health Care District**  
**Notes to Financial Statements**  
**June 30, 2006 and 2005**

|   | 2005                 |                   |                    |                    | Ending<br>Balance   |
|---|----------------------|-------------------|--------------------|--------------------|---------------------|
|   | Beginning<br>Balance | Additions         | Disposals          | Transfers          |                     |
| Land                                    | \$ 197,660           | \$ —              | \$ —               | \$ —               | \$ 197,660          |
| Land improvements                       | 731,370              | —                 | —                  | —                  | 731,370             |
| Buildings and leasehold<br>improvements | 19,001,032           | 23,622            | (272,621)          | 548,187            | 19,300,220          |
| Equipment                               | 10,716,401           | 768,749           | (952,143)          | 204,503            | 10,737,510          |
| Construction in progress                | 26,808               | 766,502           | —                  | (769,324)          | 23,986              |
|   | <u>30,673,271</u>    | <u>1,558,873</u>  | <u>(1,224,764)</u> | <u>(16,634)</u>    | <u>30,990,746</u>   |
| Hospital replacement project            | 31,100               | 603,828           | —                  | —                  | 634,928             |
|   | <u>30,704,371</u>    | <u>2,162,701</u>  | <u>(1,224,764)</u> | <u>(16,634)</u>    | <u>31,625,674</u>   |
| Less accumulated depreciation           |                      |                   |                    |                    |                     |
| Land improvements                       | 723,000              | 2,015             | —                  | —                  | 725,015             |
| Buildings and leasehold<br>improvements | 16,472,483           | 691,089           | (271,942)          | —                  | 16,891,630          |
| Equipment                               | 8,764,517            | 632,847           | (924,228)          | —                  | 8,473,136           |
|   | <u>25,960,000</u>    | <u>1,325,951</u>  | <u>(1,196,170)</u> | <u>0</u>           | <u>26,089,781</u>   |
| Capital assets, net                     | <u>\$ 4,744,371</u>  | <u>\$ 836,750</u> | <u>\$ (28,594)</u> | <u>\$ (16,634)</u> | <u>\$ 5,535,893</u> |

**Note 8: Accounts Payable and Accrued Expenses**

Accounts payable and accrued expenses included in current liabilities at June 30, 2006 and 2005, consisted of:

|  | 2006                | 2005                |
|--|---------------------|---------------------|
| Payable to suppliers and contractors                           | \$ 1,343,081        | \$ 2,148,695        |
| Payable to employees (including payroll taxes and<br>benefits) | 2,078,461           | 1,724,007           |
| Other  | <u>227,000</u>      | <u>271,000</u>      |
|  | <u>\$ 3,648,542</u> | <u>\$ 4,143,702</u> |

**Sonoma Valley Health Care District**  
**Notes to Financial Statements**  
**June 30, 2006 and 2005**

**Note 9: Medical Malpractice Coverage and Claims**

The Hospital has joined together with other providers of health care services to form Program Beta, a public entity risk pool (Pool) currently operating as a common risk management and insurance program for its members. The Hospital purchases medical malpractice insurance from the Pool under a claims-made policy. The Hospital pays an annual premium to the Pool for its torts insurance coverage. The Hospital purchases excess liability insurance through a commercial insurer for amounts in excess of the coverage provided under Program Beta. The Pool's governing agreement specifies that the Pool will be self-sustaining through member premiums and will reinsure through commercial carriers for claims in excess of stop-loss amounts. Accounting principles generally accepted in the United States of America require a health care provider to accrue the expense of its share of malpractice claim costs, if any, for any reported and unreported incidents of potential improper professional service occurring during the year by estimating the probable ultimate costs of the incidents. Based upon the Hospital's claims experience, no such accrual has been made. It is reasonably possible that this estimate could change materially in the near term.

**Note 10: Workers' Compensation Claims**

Substantially all of the Hospital's employees are covered by the Hospital's self-insured workers' compensation plan. The Hospital is self-insured for workers' compensation claims of employees up to \$500,000 with commercial stop-loss insurance coverage purchased for claims in excess of that amount. A provision is accrued for self-insured workers' compensation claims including both claims reported and claims incurred but not yet reported. The Hospital utilizes an actuary to estimate the ultimate costs to settle such claims. Estimated future payments related to workers' compensation claims have been discounted at a rate of 4%. It is reasonably possible that the Hospital's estimate will change by a material amount in the near term.

Activity in the Hospital's accrued workers' compensation claims liability during 2006 and 2005, was approximately as follows:

|   | <b>2006</b> | <b>2005</b> |
|---|-------------|-------------|
| Balance, beginning of year  | \$ 271,000  | \$ 377,000  |
| Current year claims incurred and changes in estimates<br>for claims incurred in prior years | 29,000      | (37,000)    |
| Claims and expenses paid  | (73,000)    | (69,000)    |
| Balance, end of year  | \$ 227,000  | \$ 271,000  |

# Sonoma Valley Health Care District

## Notes to Financial Statements

June 30, 2006 and 2005

### Note 11: Long-term Obligations

The following is a summary of long-term obligation transactions for the Hospital for the years ended June 30, 2006 and 2005:

|                                    | 2006                 |                    |                     |                     |                    |
|------------------------------------|----------------------|--------------------|---------------------|---------------------|--------------------|
|                                    | Beginning<br>Balance | Additions          | Deductions          | Ending<br>Balance   | Current<br>Portion |
| <b>Long-term debt</b>              |                      |                    |                     |                     |                    |
| Revenue bonds payable              | \$ 6,935,000         | \$ —               | \$ (605,000)        | \$ 6,330,000        | \$ 615,000         |
| Capital lease obligation           | <u>109,874</u>       | <u>—</u>           | <u>(109,874)</u>    | <u>—</u>            | <u>—</u>           |
| Total long-term debt               | <u>7,044,874</u>     | <u>0</u>           | <u>(714,874)</u>    | <u>6,330,000</u>    | <u>615,000</u>     |
| <b>Other long-term liabilities</b> |                      |                    |                     |                     |                    |
| Workers' compensation claims       | <u>271,000</u>       | <u>29,000</u>      | <u>(73,000)</u>     | <u>227,000</u>      | <u>227,000</u>     |
| Total long-term obligations        | <u>\$ 7,315,874</u>  | <u>\$ 29,000</u>   | <u>\$ (787,874)</u> | <u>\$ 6,557,000</u> | <u>\$ 842,000</u>  |
| <br>                               |                      |                    |                     |                     |                    |
|                                    | 2005                 |                    |                     |                     |                    |
|                                    | Beginning<br>Balance | Additions          | Deductions          | Ending<br>Balance   | Current<br>Portion |
| <b>Long-term debt</b>              |                      |                    |                     |                     |                    |
| Revenue bonds payable              | \$ 7,540,000         | \$ —               | \$ (605,000)        | \$ 6,935,000        | \$ 605,000         |
| Capital lease obligation           | <u>250,022</u>       | <u>—</u>           | <u>(140,148)</u>    | <u>109,874</u>      | <u>109,874</u>     |
| Total long-term debt               | <u>7,790,022</u>     | <u>0</u>           | <u>(745,148)</u>    | <u>7,044,874</u>    | <u>714,874</u>     |
| <b>Other long-term liabilities</b> |                      |                    |                     |                     |                    |
| Workers' compensation claims       | <u>377,000</u>       | <u>(37,000)</u>    | <u>(69,000)</u>     | <u>271,000</u>      | <u>271,000</u>     |
| Total long-term obligations        | <u>\$ 8,167,022</u>  | <u>\$ (37,000)</u> | <u>\$ (814,148)</u> | <u>\$ 7,315,874</u> | <u>\$ 985,874</u>  |

**Sonoma Valley Health Care District**  
**Notes to Financial Statements**  
**June 30, 2006 and 2005**

**Revenue Bonds Payable**

The revenue bonds payable consist of Insured Refunding Revenue Bonds, Series 2004 (Series 2004 Bonds) in the original amount of \$7,540,000 dated April 1, 2004, which bear interest at 1.5% to 4.1%. The Bonds are payable in annual installments through March 31, 2014. The Hospital is required to make monthly deposits of approximately \$66,000 to the debt service fund held by the trustee. All of the Bonds still outstanding may be redeemed at the Hospital's option on or after April 1, 2007. The redemption price is 101% decreasing to 100% on or after April 1, 2009. The Bonds are secured by the net revenues and accounts receivable of the Hospital and the assets restricted under the bond indenture agreement and are collateralized by a deed of trust on substantially all of the Hospital's assets.

The Series 2004 Bonds were issued in order to advance refund \$7,500,000 of Series 1984B and Series 1987C Bonds. The Series 1984B and Series 1987C Bonds were paid off and retired on June 1, 2004.

The indenture agreement requires that certain funds be established with the trustee. Accordingly, these funds are included as assets held by trustee for debt service in the balance sheet. The indenture agreement also requires the Hospital to comply with certain restrictive covenants including minimum insurance coverage, maintaining a current ratio of at least 1.30 to 1.00 and an annual debt service coverage ratio of 1.10 to 1.00, restrictions on incurrence of additional debt and maintaining minimum days cash on hand ranging from 15 days in 2004 to 30 days in 2009 and thereafter.

The debt service requirements as of June 30, 2006, are as follows:

| <b>Year Ending June 30,</b> | <b>Total to be Paid</b> | <b>Principal</b>    | <b>Interest</b>   |
|-----------------------------|-------------------------|---------------------|-------------------|
| 2007                        | \$ 821,641              | \$ 615,000          | \$ 206,641        |
| 2008                        | 1,134,654               | 945,000             | 189,654           |
| 2009                        | 1,128,280               | 965,000             | 163,280           |
| 2010                        | 1,123,400               | 990,000             | 133,400           |
| 2011                        | 777,907                 | 675,000             | 102,907           |
| 2012 – 2014                 | <u>2,291,951</u>        | <u>2,140,000</u>    | <u>151,951</u>    |
|                             | <u>\$ 7,277,833</u>     | <u>\$ 6,330,000</u> | <u>\$ 947,833</u> |

**Capital Lease Obligation**

The Hospital was obligated under a lease for equipment that is accounted for as a capital lease during the years ended June 30, 2006 and 2005. Assets under the capital lease at June 30, 2006 and 2005, totaled \$662,200 and \$662,200, net of accumulated depreciation of \$662,200 and \$540,797, respectively. The Hospital paid off the capital lease during fiscal year 2006.

**Sonoma Valley Health Care District**  
**Notes to Financial Statements**  
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**Note 12: Restricted and Designated Net Assets**

At June 30, 2006 and 2005, restricted expendable net assets of \$196,684 and \$252,752, respectively, were available for debt service payments.

At June 30, 2006 and 2005, approximately \$983,000 and \$2,362,000, respectively, of unrestricted net assets has been designated by the Hospital's Board of Directors for capital acquisitions. Designated net assets remain under the control of the Board of Directors, which may at its discretion later use these net assets for other purposes.

**Note 13: Uncompensated Care**

The Hospital's policy is to provide service to all who require it, regardless of their ability to pay. As such, it provides substantial amounts of uncompensated care. When this care is provided to patients who lack financial resources (and therefore are deemed medically indigent), it is classified as community benefits. When it is provided to patients who have the means to pay but decline to do so, it is classified as provision for uncollectible accounts. Neither community benefits nor provision for uncollectible accounts is reflected in net patient service revenue.

Prior to September 2004, the Hospital rarely, if ever, identified those patients who were medically indigent. Accordingly, when these patients failed to pay, the care was classified as a provision for uncollectible accounts. In September 2004, the Hospital adopted a formal community benefits policy, developed under guidelines provided by the California Hospital Association, and began to identify those patients who are medically indigent. As a result, although the underlying policy of providing uncompensated care remained unchanged, the amount of community benefits actually recorded increased substantially in 2005.

In addition, the Hospital provides services to other medically indigent patients under certain government-reimbursed public aid programs. Such programs pay providers amounts that are less than established charges for the services provided to the recipients and frequently the payments are less than the cost of rendering the services provided. Finally, some undetermined portion of provision for uncollectible accounts represents care to indigent patients who the Hospital has been unable to identify.

Uncompensated charges relating to these services are as follows:

|  | <u>2006</u>          | <u>2005</u>          |
|--|----------------------|----------------------|
| Community benefits allowances                | \$ 816,000           | \$ 420,000           |
| State Medi-Cal and other public aid programs | 8,076,000            | 9,430,000            |
| Provision for uncollectible accounts         | <u>1,247,000</u>     | <u>1,492,000</u>     |
|  | <u>\$ 10,139,000</u> | <u>\$ 11,342,000</u> |

# **Sonoma Valley Health Care District**

## **Notes to Financial Statements**

### **June 30, 2006 and 2005**

In addition to uncompensated charges, the Hospital also commits significant time and resources to endeavors and critical services which meet otherwise unfilled community needs. Many of these activities are sponsored with the knowledge that they will not be self-supporting or financially viable. Such programs include health screening and assessments, prenatal education and care, community educational services and various support groups.

#### **Note 14: Pension Plan**

The Hospital contributes to a defined contribution pension plan covering substantially all employees. Pension expense is recorded for the amount of the Hospital's required contributions, determined in accordance with the terms of the plan. The plan is administered by the Hospital's Board of Directors. The plan provides retirement benefits to plan members and death benefits to the beneficiaries of plan members. Benefit provisions are contained in the plan document and were established and can be amended by action of the Hospital's governing body. Contribution rates for plan members and the Hospital expressed as a percentage of covered payroll were 8.7% and 2.9% for 2006 and 8.9% and 2.9% for 2005, respectively. Contributions actually made by plan members and the Hospital aggregated approximately \$1,236,000 and \$406,000 during 2006 and \$1,206,000 and \$396,000 during 2005, respectively.

#### **Note 15: Contingencies**

##### ***Litigation***

In the normal course of business, the Hospital is, from time to time, subject to allegations that may or do result in litigation. Some of these allegations are in areas not covered by the Hospital's self-insurance program (discussed elsewhere in these notes) or by commercial insurance; for example, allegations regarding employment practices or performance of contracts. The Hospital evaluates such allegations by conducting investigations to determine the validity of each potential claim. Based upon the advice of legal counsel, management records an estimate of the amount of ultimate expected loss, if any, for each. Events could occur that would cause the estimate of ultimate loss to differ materially in the near term.

#### **Note 16: Hospital Replacement Project**

Because the Hospital's current facility is operationally inefficient and does not meet certain seismic safety standards required by the state of California. Structural engineering and architectural consultants have advised the Hospital that it is impracticable to correct these deficiencies at its current site. Accordingly, the Board directed management to retain architects and a financial consultant to assist in planning for a replacement facility. Management is working with architects to develop the hospital replacement project design, but no final commitments have been made. Management expects the project will be financed primarily through general obligation bonds, private investment and philanthropy. Voter approval will be required to issue general obligation bonds.

**Sonoma Valley Health Care District**  
**Notes to Financial Statements**  
**June 30, 2006 and 2005**

**Note 17: Community Support**

The Hospital receives financial support from the community and charitable organizations in the form of grants and gifts for a variety of purposes. When gifts are received, regardless of restrictions for noncapital purposes, they are classified as noncapital grants and gifts in nonoperating revenue on the statement of revenues, expenses and changes in net assets. Support that is restricted for the purpose of acquiring or improving capital assets is recorded as capital gifts on the statement of revenues, expenses and changes in net assets and, therefore, not reflected in either operating or nonoperating revenue. Financial support from the community is recorded in the year that the support is received. The expenses directly associated with soliciting gifts and grants are reflected in operating expenses on the statement of revenues, expenses and changes in net assets.

During 2006 and 2005, the Hospital recorded the following amounts related to community support:

|  | <u>2006</u>         | <u>2005</u>       |
|--|---------------------|-------------------|
| Unrestricted noncapital gifts and grants included in nonoperating revenues | \$ 1,895,375        | \$ 561,395        |
| Capital gifts and grants from  |                     |                   |
| Sonoma Valley Hospital Foundation  | —                   | 225,000           |
| Others   | <u>18,001</u>       | <u>18,921</u>     |
| Total community support  | \$ <u>1,913,376</u> | \$ <u>805,316</u> |
| Fundraising expenses included in operating expenses                        | \$ <u>384,180</u>   | \$ <u>198,764</u> |