

SONOMA VALLEY HEALTH CARE DISTRICT

ANNUAL FINANCIAL REPORT

JUNE 30, 2009 and 2008

THOMAS L. CAMP

Certified Public Accountant

**SONOMA VALLEY HEALTH CARE DISTRICT
ANNUAL FINANCIAL REPORT
JUNE 30, 2009 and 2008**

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Sonoma Valley Health Care District

Management's Discussion and Analysis

Years Ended June 30, 2009 and 2008

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, 2009 and 2008. It should be read in conjunction with the accompanying financial statements and footnotes of the Hospital.

Financial Highlights

- The Hospital's net assets increased in 2009 by approximately \$955,000 or 21% and decreased in 2008 by approximately \$3,079,000 or 40%.
- Cash, cash equivalents and total investments increased in 2009 by approximately \$7,545,000 or 200% and decreased in 2008 by approximately \$1,604,000 or 30%.
- Net patient accounts receivable increased in 2009 by approximately \$208,000 or 5% and decreased in 2008 by approximately \$800,000 or 16%.
- The Hospital reported operating losses in both 2009 (\$1,529,000) and 2008 (\$3,387,000). The operating loss in 2009 decreased by approximately \$1,857,000 or 55% less than the operating loss reported in 2008. The operating loss in 2008 increased by \$1,454,000 or 75% over the operating loss reported in 2007.
- Net nonoperating revenues decreased by approximately \$113,000 or 4% in 2009 compared to 2008 and increased by approximately \$1,231,000 or 92% in 2008 compared to 2007.

Using This Annual Report

The Hospital's financial statements consist of three statements—a balance sheet; a statement of operations 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 Sheet and Statement of Operations and Changes in Net Assets

The balance sheet and the statement of operations and changes in net assets report information about the Hospital's resources and its activities. One of the most important questions asked about the Hospital's finances is, "Is the Hospital as a whole better or worse off as a result of the year's activities?" The balance sheet and the statement 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. 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. You can think of the Hospital's net assets – the difference between assets and liabilities – as one way to measure the Hospital's financial health, or financial position. Over time, increases or decreases in the Hospital's net assets are one indicator of whether its financial health is improving or deteriorating. You will need to consider other nonfinancial factors, however, such as changes in the Hospital's patient base and measures of the quality of service it provides to the community, as well as local economic factors to assess the overall health of the Hospital.

The Statement of Cash Flows

The final required statement is the statement of cash flows. The statement 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 sheet. The Hospital's net assets increased by \$955,000 or 21% in 2009 and decreased by \$3,079,000 or 40% in 2008 over 2007, as shown in Table 1.

The increases in net assets in 2009 are largely the result of increased patient volume and an increase in the Medicare case mix index, which increased our payments from that program. In 2009, inpatient and skilled nursing volume increased by seven percent and ten percent, respectively, which increased net revenue by approximately \$1,400,000. The Medicare case mix was almost four percent higher than in 2008 and accounted for an additional \$350,000 increase. However, these increases to net patient revenue were partially offset by a shift of net revenue to capitation resulting from a contract change in late 2008. Capitation revenues increased by 81% in 2009 due to a capitation arrangement being effective for a full year in 2009 compared to only three months in 2008. Considering both capitation and net patient revenues, reimbursement related to patient services increased by \$1,707,000 in 2009, or 4%.

The decreases in net assets in 2008 are largely the result of charging off losses on the impairment of capital assets, as discussed in Note 6 to the Financial Statements. In 2008 the loss on impairment accounted for 88% of the decline in net assets. These capital assets were comprised of architectural and engineering consulting costs, option payments for land acquisition, legal

advice and other costs related to various plans to address the Hospital's need to bring its current facility into compliance with certain seismic safety standards. In 2008, the entire balance of \$2,720,414 in assets was charged off because the Board abandoned its plan to eventually construct a replacement facility on six acres of land adjacent to the existing facility. This decision followed the defeat, in March 2008, of a general obligation bond measure that would have financed the planning necessary for the proposed replacement.

Table 1: Assets, Liabilities and Net Assets

| | <u>2009</u> | <u>2008</u> | <u>2007</u> |
|---|----------------------|----------------------|----------------------|
| Assets | | | |
| Current assets: | | | |
| Cash and cash equivalents | \$ 721,542 | \$ 352,141 | \$ 349,210 |
| Investments | 2,549,252 | 2,661,563 | 2,431,501 |
| Patient accounts receivable, net | 4,489,234 | 4,281,190 | 5,081,181 |
| Other receivables | 3,989,309 | 3,557,535 | 3,396,477 |
| Estimated third-party settlements | 833,747 | 462,588 | 735,484 |
| Supplies | 650,358 | 601,535 | 596,420 |
| Prepaid expenses and other current assets | 217,739 | 176,298 | 275,909 |
| Total current assets | <u>13,451,181</u> | <u>12,092,850</u> | <u>12,866,182</u> |
| Investments | 8,059,384 | 771,929 | 2,609,043 |
| Capital assets, net | 7,105,588 | 6,493,676 | 6,911,908 |
| Other assets | 263,558 | 417,804 | 533,066 |
| Total assets | <u>\$ 28,879,711</u> | <u>\$ 19,776,259</u> | <u>\$ 22,920,199</u> |
| Liabilities and Net Assets | | | |
| Current liabilities: | | | |
| Accounts payable and accrued expenses | \$ 5,397,180 | \$ 5,325,069 | \$ 4,179,042 |
| Estimated third-party settlements | - | 65,650 | - |
| Deferred property tax and other revenues | 3,886,724 | 3,101,172 | 3,127,326 |
| Estimated self-insurance costs | 107,000 | 94,000 | 85,000 |
| Current maturities of long-term debt | 510,787 | 2,384,442 | 1,433,696 |
| Total current liabilities | <u>9,901,691</u> | <u>10,970,333</u> | <u>8,825,064</u> |
| Estimated self-insurance costs | 416,000 | 378,000 | 327,000 |
| Long term debt, less current maturities | <u>13,059,569</u> | <u>3,880,144</u> | <u>6,141,112</u> |
| Total liabilities | <u>23,377,260</u> | <u>15,228,477</u> | <u>15,293,176</u> |
| Net Assets | | | |
| Invested in capital assets, net of related debt | 2,399,254 | 1,246,740 | 494,455 |
| Restricted: | | | |
| Expendable for debt service | 64,086 | 478,271 | 287,823 |
| Expendable for capital assets | 201,239 | 812,500 | 545,500 |
| Expendable for specific operating activities | 28,504 | 40,114 | 5,051 |
| | <u>293,829</u> | <u>1,330,885</u> | <u>838,374</u> |
| Unrestricted | <u>2,809,368</u> | <u>1,970,157</u> | <u>6,294,194</u> |
| Total net assets | <u>5,502,451</u> | <u>4,547,782</u> | <u>7,627,023</u> |
| Total liabilities and net assets | <u>\$ 28,879,711</u> | <u>\$ 19,776,259</u> | <u>\$ 22,920,199</u> |

In 2009, non-current investments increased by \$7,287,000 or 944% as compared to 2008. The reason for the increase relates to the unspent but earmarked general obligation bond proceeds which will be used to pay for a portion of the costs of renovating and retrofitting the District's existing hospital facility, and to purchase equipment as outlined in *Note 11* to the financial statements.

In 2008, net patient accounts receivable decreased by \$800,000 or 16% as compared to 2007. The reason for the decrease was the elimination of the billing and collections delays associated with the new computer software required to accommodate Medicare's new universal billing form and national numbering system for all providers which went into effect in May 2008. The nearly two million dollar decline in current investments is related to the Hospital's financing of a new piece of medical equipment – a replacement CT machine. The proceeds from this financing were received in 2007 and placed in an investment account, because the Hospital did not receive and pay for the equipment and related installation costs until 2008.

Operating Results and Changes in the Hospital's Net Assets

In 2009 and 2008, the Hospital's operating loss decreased by \$1,857,000 or 55% and increased by \$1,454,000 or 75%, as shown on the next page, in Table 2.

Table 2: Operating Results and Changes in Net Assets

| | <u>2009</u> | <u>2008</u> | <u>2007</u> |
|--|---------------------|---------------------|--------------------|
| Operating Revenues | | | |
| Net patient service revenue | \$ 37,868,643 | \$ 37,355,553 | \$ 36,875,200 |
| Capitation revenues | 3,036,583 | 1,681,697 | 1,332,375 |
| Other revenues | 210,121 | 365,986 | 199,131 |
| Total operating revenues | <u>41,115,347</u> | <u>39,403,236</u> | <u>38,406,706</u> |
| Operating Expenses | | | |
| Salaries and wages | 23,184,601 | 22,454,003 | 22,194,764 |
| Employee benefits | 4,443,235 | 4,106,475 | 4,134,552 |
| Medical fees | 1,882,600 | 1,495,545 | 1,191,683 |
| Purchased services | 4,580,887 | 6,269,603 | 4,504,903 |
| Supplies | 5,080,371 | 5,128,662 | 5,143,719 |
| Utilities | 737,521 | 754,077 | 715,602 |
| Insurance | 298,510 | 413,282 | 446,870 |
| Depreciation | 1,525,397 | 1,242,559 | 1,101,048 |
| Other | 911,428 | 925,558 | 905,802 |
| Total operating expenses | <u>42,644,550</u> | <u>42,789,764</u> | <u>40,338,943</u> |
| Operating Loss | <u>(1,529,203)</u> | <u>(3,386,528)</u> | <u>(1,932,237)</u> |
| Nonoperating Revenues | | | |
| Property taxes | 2,905,445 | 2,765,368 | 2,047,533 |
| Investment income | 54,737 | 205,438 | 275,971 |
| Interest expense | (372,180) | (405,621) | (365,048) |
| Noncapital grants and gifts | 158,377 | 320,065 | 89,974 |
| Other | (291,763) | (318,086) | (712,671) |
| Total nonoperating revenues | <u>2,454,616</u> | <u>2,567,164</u> | <u>1,335,759</u> |
| Loss before capital grants and gifts and loss on impairment of capital assets | 925,413 | (819,364) | (596,478) |
| Capital grants and gifts | 219,256 | 460,537 | 565,500 |
| Transfer to Community Foundation Sonoma County | (190,000) | - | - |
| Loss on impairment of capital assets | - | (2,720,414) | (402,837) |
| Increase (decrease) in net assets | 954,669 | (3,079,241) | \$ (433,815) |
| Net assets at beginning of year | <u>4,547,782</u> | <u>7,627,023</u> | <u>8,060,838</u> |
| Net assets at end of year | <u>\$ 5,502,451</u> | <u>\$ 4,547,782</u> | <u>7,627,023</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 2009 decreased by \$1,857,000 or 55% as compared to 2008 and increased by \$1,454,000 or 75% in 2008 as compared to 2007. The major components of those increases in operating loss are:

- Total operating revenues increased by \$1,712,000 or 3%. Net patient service revenue increased by \$513,000 or 1% in 2009 as compared to 2008 and increased by \$480,000 or 1% in 2008 compared to 2007. The increase in 2009 was primarily due to increased volume and a 4% higher Medicare case mix, generating approximately \$1,750,000 additional net revenue. These increases were partially offset by a shift of net revenue to capitation resulting from a contract change in late 2008. Capitation revenues correspondingly increased in 2009 by \$1,355,000 (81%) due to a capitation arrangement being effective for a full year in 2009 compared to only three months in 2008 from prior year. Other revenues decreased by \$156,000 or 43% in 2009 as compared to 2008 and increased by \$167,000 or 84% in 2008 compared to 2007. The decrease in 2009 is due to lower insurance recoveries.

The increase in 2008 was significantly impacted by a \$900,000 increase in the provision for uncollectable accounts, from \$1,275,000 in 2007 to \$2,175,000 in 2008. This increase is related to current economic conditions, which have both caused more individuals to choose high deductible health insurance plans and made it more difficult to collect the deductible component of the bill from those patients.

- Salaries, wages and benefits increased in 2009 by \$1,067,000 or 4% in and slightly increased in 2008 by \$231,000 or 1% compared to 2007. In 2009, salaries and wages, including benefits increase was primarily related to the salary adjustments granted in July 2008.
- Medical fees increased in 2009 by \$387,000 or 26% compared to 2008 and increased by \$304,000 or 25% in 2008 compared to 2007. In 2009, medical fees increased due to the new anesthesiologist services contract which began in the last half of 2009. In 2008, the increase was due to increased physician services in both the hospitalist and occupational health programs.
- Purchased services decreased in 2009 by \$1,689,000 or 27% compared to 2008 and increased by \$1,765,000 or 39% in 2008 compared to 2007. Nearly \$900,000 of this variance stemmed from eliminating costs associated with treating our risk contract beneficiaries at other facilities. As of December 31, 2008, we successfully negotiated a fee-for-service contract with a capitated payer, eliminating this financial risk entirely. Consulting services which increased significantly in 2008 from 2007 were reduced or eliminated in 2009, because the amount spent in 2008 was expected to contribute to increased patient volumes and future cost savings.

The increase in the operating loss in 2008 was primarily due to increased purchased services. In 2008 purchased services increased by \$1,765,000 in 2008, or 39%. This was a larger change than the increase in the operating loss between 2007 and 2008, so obviously these costs contributed significantly to the decline in our operating results. A substantial portion of these costs was spent on consulting efforts that should contribute to future cost savings and are not expected to recur. Over \$900,000 of the variance relates to consulting for assistance in reworking our hospitalist program, establishing nurse staffing guidelines and monitoring tools, improving our information systems networking capacity and preparing for our tri-annual accreditation (which we successfully passed). These costs will not be repeated, and they leave behind systems and procedures that provide ongoing value. Nearly \$400,000 of the variance stemmed from expenses incurred in treating our risk contract beneficiaries at other facilities. We will no longer bear this cost after December 31, 2008, because we have successfully negotiated a fee-for-service contract with the payer, eliminating this financial risk entirely. Finally, over \$200,000 of the variance resulted from additional repairs and maintenance costs on the hospital's aging utility infrastructure. As discussed in the following section, the Board placed a general obligation bond measure on the November 2008 ballot and a substantial portion of the proceeds will address these issues.

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 parcel taxes remained relatively constant in 2009, they increased by \$718,000 in 2008 (35%) because the electorate approved an increase in the annual rate from \$130 to \$195 per parcel for five years beginning July 2007. Interest expense remained relatively unchanged in 2009, 2008 and 2007. Investment income and noncapital grants and gifts changed significantly over the same three-year period. Noncapital grants and gifts decreased by \$162,000 (51%) in 2009 and increased by \$230,000 (256%) in 2008. Investment income decreased by \$151,000 (73%) and \$71,000 (26%), in 2009 and 2008, respectively.

Capital Grants and Gifts

The Hospital received gifts of \$219,000 from a foundation and various individuals to purchase capital assets in 2009 and \$460,500 in 2008, a decrease of \$241,000 and \$105,000, from 2008 and 2007, respectively.

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.

Capital Assets

At the end of 2009 and 2008, the Hospital had \$7,106,000 and \$6,494,000, respectively, invested in capital assets, net of accumulated depreciation, as detailed in *Note 6* to the financial statements. In 2009 and 2008, the Hospital purchased new equipment and made capital improvements costing \$1,636,000 and \$3,411,000, respectively.

The majority of the 2008 improvements related to the installation of a new CT machine. Additionally, the Hospital incurred costs of \$719,557 and \$983,158 related to the Hospital replacement project, which has subsequently been abandoned, therefore impairing the assets which have been written off as a special item (see discussion in *Note 6*).

Debt

At June 30, 2009 and 2008, the Hospital had \$13,570,000 and \$6,265,000, respectively, in bonds and equipment notes payable outstanding as detailed in *Note 11* to the financial statements. In 2009 the Hospital issued \$12,000,000 in general obligation bonds and paid off the remaining \$4,770,000 of revenue bonds as outlined in *Note 11*.

Future Plans

As discussed in *Notes 11 and 17* to the financial statements, the Hospital issued \$12 million in general obligation bonds in April 2009. This followed the Board's decision, in August 2008, to address the community's concerns regarding its prior expansion plans by putting before the electorate a proposal to approve up to \$35 million in general obligation bonds for the renovation project described below. The community responded by overwhelmingly approving the measure in November 2008.

\$4 million of the April bond proceeds were used in refunding the Hospital's existing revenue bonds. Because operations will no longer bear the burden of servicing this debt, cash flow through fiscal year 2014 will improve by an aggregate of \$5,279,000.

The project, which substantially reduces the uncertainty under which the Hospital was operating by allowing it to meet current seismic standards through at least 2030, is comprised of several components. It will use up to \$8 million of current and up to \$23 million of future bond proceeds to construct a new central utility plan, improve the utility infrastructure, make all necessary seismic upgrades to existing facilities, purchase additional medical equipment and install information systems wiring.

During the first phase of the project, extending through mid-2011, the Hospital will prepare a master plan, complete the detailed planning for the project, acquire some equipment, install the information systems wiring and begin construction. The Hospital expects to complete plans for the project and submit them to the Office of Statewide Health Planning and Development of the State of California ("OSHPD") by March 2010 and secure OSHPD's approval by June 2011. The Hospital has already engaged an architect and project manager to facilitate the project.

The Hospital expects to issue the remaining \$23 million in general obligation bonds by mid-2011 in order to finance the second and final phase of the project. During this phase, which the Hospital expects to complete in 2014, the Hospital will complete all construction and improvements and finish purchasing the equipment budgeted in the project. Total project costs are estimated to be at least \$31 million and will be financed by bond proceeds, interest earned on temporarily invested bond proceeds and operations.

The Hospital has convened a Citizens Bond Oversight Committee (“CBOC”) to ensure that all bond proceeds are spent in accordance with the ballot measure passed in November 2008. The CBOC is comprised of local citizens and is independent of management. It reviews all expenditures financed by bond proceeds and reports its findings directly to the District Board.

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.

INDEPENDENT AUDITOR'S REPORT

Board of Directors
Sonoma Valley Health Care District

I have audited the accompanying balance sheets of Sonoma Valley Health Care District as of June 30, 2009 and 2008, and the related statements of operations and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the District's management. My responsibility is to express an opinion on these financial statements based on my audits.

I conducted my audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that I plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the District's internal control over financial reporting. Accordingly, I express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. I believe that my audits provide a reasonable basis for my opinion.

In my 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, 2009 and 2008, and the changes in its financial position and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Management's discussion and analysis on pages 1 through 9 is not a required part of the basic financial statements, but is supplementary information required by the Governmental Accounting Standards Board. I 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, I did not audit the information and express no opinion on it.



September 22, 2009

SONOMA VALLEY HEALTH CARE DISTRICT
BALANCE SHEETS
Years Ended June 30, 2009 and 2008

| | <u>2009</u> | <u>2008</u> |
|--|--------------------------------|--------------------------------|
| <u>ASSETS</u> | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 721,542 | \$ 352,141 |
| Investments | 2,549,252 | 2,661,563 |
| Patient accounts receivable, net of allowance for uncollectible accounts | 4,489,234 | 4,281,190 |
| Other receivables | 3,989,309 | 3,557,535 |
| Estimated third-party settlements | 833,747 | 462,588 |
| Supplies | 650,358 | 601,535 |
| Prepaid expenses and other current assets | <u>217,739</u> | <u>176,298</u> |
| Total current assets | 13,451,181 | 12,092,850 |
| Investments | 8,059,384 | 771,929 |
| Capital assets, net | 7,105,588 | 6,493,676 |
| Other assets | <u>263,558</u> | <u>417,804</u> |
| Total assets | <u>\$28,879,711</u> | <u>\$19,776,259</u> |
| <u>LIABILITIES AND NET ASSETS</u> | | |
| Current liabilities: | | |
| Accounts payable and accrued expenses | \$ 5,397,180 | \$ 5,325,069 |
| Estimated third-party settlements | -0- | 65,650 |
| Deferred property taxes and other revenues | 3,886,724 | 3,101,172 |
| Estimated self-insurance costs | 107,000 | 94,000 |
| Current maturities of long-term debt | <u>510,787</u> | <u>2,384,442</u> |
| Total current liabilities | 9,901,691 | 10,970,333 |
| Estimated self-insurance costs | 416,000 | 378,000 |
| Long term debt, less current maturities | <u>13,059,569</u> | <u>3,880,144</u> |
| Total liabilities | 23,377,260 | 15,228,477 |
| Net assets: | | |
| Invested in capital assets, net of related debt | 2,399,254 | 1,246,740 |
| Restricted: | | |
| Expendable for debt service | 64,086 | 478,271 |
| Expendable for capital assets | 201,239 | 812,500 |
| Expendable for specific operating activities | <u>28,504</u> | <u>40,114</u> |
| | 293,829 | 1,330,885 |
| Unrestricted | <u>2,809,368</u> | <u>1,970,157</u> |
| Total net assets | <u>5,502,451</u> | <u>4,547,782</u> |
| Total liabilities and net assets | <u>\$28,879,711</u> | <u>\$19,776,259</u> |

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

SONOMA VALLEY HEALTH CARE DISTRICT
STATEMENTS OF OPERATIONS AND CHANGES IN NET ASSETS
Years Ended June 30, 2009 and 2008

| | <u>2009</u> | <u>2008</u> |
|--|----------------------------|----------------------------|
| Operating revenues: | | |
| Net patient service revenues, net of provision for uncollectible accounts; 2009 - \$2,131,244 and 2008 - \$2,174,807 | \$37,868,643 | \$37,355,553 |
| Capitation revenues | 3,036,583 | 1,681,697 |
| Other revenues | <u>210,121</u> | <u>365,986</u> |
| Total operating revenues | 41,115,347 | 39,403,236 |
| Operating expenses: | | |
| Salaries and wages | 23,184,601 | 22,454,003 |
| Employee benefits | 4,443,235 | 4,106,475 |
| Medical fees | 1,882,600 | 1,495,545 |
| Purchased services | 4,580,887 | 6,269,603 |
| Supplies | 5,080,371 | 5,128,662 |
| Utilities | 737,521 | 754,077 |
| Insurance | 298,510 | 413,282 |
| Depreciation | 1,525,397 | 1,242,559 |
| Other | <u>911,428</u> | <u>925,558</u> |
| Total operating expenses | <u>42,644,550</u> | <u>42,789,764</u> |
| Operating loss | (1,529,203) | (3,386,528) |
| Nonoperating revenues: | | |
| Property taxes | 2,905,445 | 2,765,368 |
| Investment income | 54,737 | 205,438 |
| Interest expense | (372,180) | (405,621) |
| Noncapital grants and gifts | 158,377 | 320,065 |
| Other | <u>(291,763)</u> | <u>(318,086)</u> |
| Total nonoperating revenues | <u>2,454,616</u> | <u>2,567,164</u> |
| Income (loss) before capital grants and gifts, transfer and loss on impairment of capital assets | 925,413 | (819,364) |
| Capital grants and gifts | 219,256 | 460,537 |
| Transfer to Community Foundation Sonoma County | (190,000) | -0- |
| Loss on impairment of capital assets | <u>-0-</u> | <u>(2,720,414)</u> |
| Increase (decrease) in net assets | 954,669 | (3,079,241) |
| Net assets at beginning of year | <u>4,547,782</u> | <u>7,627,023</u> |
| Net assets at end of year | <u>\$ 5,502,451</u> | <u>\$ 4,547,782</u> |

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

SONOMA VALLEY HEALTH CARE DISTRICT
STATEMENTS OF CASH FLOWS
Years Ended June 30, 2009 and 2008

| | <u>2009</u> | <u>2008</u> |
|---|----------------------------|--------------------------|
| Operating activities: | | |
| Receipts from patients and third-party payors | \$40,288,265 | \$40,499,633 |
| Other receipts, net | 568,170 | 438,361 |
| Payments to employees for services | (27,348,408) | (26,351,977) |
| Payments to physicians, suppliers and contractors | <u>(13,999,770)</u> | <u>(14,202,748)</u> |
| Net cash provided by (used in) operating activities | (491,743) | 383,269 |
| Non-capital financing activities: | | |
| Parcel taxes supporting operations | 2,881,036 | 2,889,384 |
| Noncapital grants and gifts | <u>158,377</u> | <u>320,065</u> |
| Net cash provided by non-capital financing activities | 3,039,413 | 3,209,449 |
| Capital and related financing activities: | | |
| Capital grants and gifts | 219,256 | 193,537 |
| Proceeds from disposition of capital assets | 6,032 | 4,885 |
| Proceeds from issuance of long-term debt | 12,480,000 | -0- |
| Principal paid on long-term debt | (5,273,258) | (1,460,221) |
| Interest paid on long-term debt | (292,981) | (334,712) |
| Purchases of capital assets | (1,636,364) | (3,410,727) |
| Loan costs paid from bond proceeds | <u>(152,069)</u> | <u>-0-</u> |
| Net cash used in capital and related financing activities | 5,350,616 | (5,007,238) |
| Investing activities: | | |
| Interest and dividends on investments | 119,833 | 220,244 |
| Investment of bond proceeds | (8,007,536) | -0- |
| Physician income guarantee payments | (254,793) | (424,378) |
| Payment to Community Foundation Sonoma County | (190,000) | -0- |
| Repayment of physician line of credit | 13,497 | 14,533 |
| Net change in other investments | <u>615,128</u> | <u>(56,699)</u> |
| Net cash provided by (used in) investing activities | (7,703,871) | (246,300) |
| Net (decrease) increase in cash and cash equivalents | 194,415 | (1,660,820) |
| Cash and cash equivalents at beginning of year | <u>963,682</u> | <u>2,624,502</u> |
| Cash and cash equivalents at end of year | <u>\$ 1,158,097</u> | <u>\$ 963,682</u> |
| Reconciliation of cash and cash equivalents to the balance sheets: | | |
| Cash carried in current assets | \$ 721,542 | \$ 352,141 |
| Cash equivalents carried in investments | <u>436,555</u> | <u>611,541</u> |
| | <u>\$ 1,158,097</u> | <u>\$ 963,682</u> |

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

SONOMA VALLEY HEALTH CARE DISTRICT
NOTES TO FINANCIAL STATEMENTS
Years Ended June 30, 2009 and 2008

NOTE 1. DESCRIPTION OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Reporting Entity and Nature of Operations

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 is governed by an elected Board of Directors and is considered the primary government for financial reporting purposes.

The District owns and operates Sonoma Valley Hospital (the Hospital). The Hospital is located in Sonoma, California, and is licensed for 56 general acute care beds and 27 skilled nursing beds. It also provides 24-hour basic emergency care, outpatient diagnostic and therapeutic services, and operates a home health agency. The Hospital derives a significant portion of its revenues from third-party payors, including Medicare, Medi-Cal and commercial insurance organizations.

NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The financial statements of the District 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 expenses and noncapital contributions are included in nonoperating revenues and expenses.

The District 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 District 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 and Evaluation of Subsequent Events

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 amount of revenues and expenses during the reporting period. Actual results could differ from those estimates. Management of the District has evaluated events or transactions occurring after June 30, 2009 through September 22, 2009, the date the financial statements are issued.

SONOMA VALLEY HEALTH CARE DISTRICT
NOTES TO FINANCIAL STATEMENTS
Years Ended June 30, 2009 and 2008

NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Cash Equivalents

For purposes of the statements of cash flows, the District 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, 2009 and 2008, cash equivalents consisted of money market mutual funds held by the trustee for debt service. The mutual funds generally invest in highly liquid U.S. government and agency obligations with limited market risk. At times, these investments may be in excess of the Federal Deposit Insurance Corporation (FDIC) insurance limit.

Investments and Investment Income

Investments in U.S. Treasury, agency and instrumentality obligations with remaining maturities 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. Management reviews all investments to identify those with declines in value that would be considered other than temporary. When identified, such investment declines are accounted for as realized losses.

Patient Accounts Receivable

Patient accounts receivable for services provided to patients covered under the Medicare and Medicaid (Medi-Cal in California) programs, privately sponsored managed care programs for which payment is made based on terms defined under formal contracts, and other payors (including self-pay) are recorded at their estimated realizable values based on contractual billing rates or the Hospital's standard billing rates for non-contract payors. A provision for uncollectible accounts is provided based on management's evaluation of the collectibility of current accounts and historical trends. Finance charges or interest is not accrued for past due accounts.

Management believes there are no significant credit risks associated with receivables from government programs. Receivables from managed care programs and others are from various payors who are subject to differing economic conditions. They do not represent any concentrated credit risk to the District. Management continually monitors and adjusts the estimated allowances for contractual adjustments and uncollectible accounts.

Supplies

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

SONOMA VALLEY HEALTH CARE DISTRICT
NOTES TO FINANCIAL STATEMENTS
Years Ended June 30, 2009 and 2008

NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Capital Assets

Capital assets are recorded at cost (which includes interest capitalized during construction) when acquired or at 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. The following estimated useful lives are used by the Hospital:

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

The District periodically reviews its capital assets for value impairment. Management has determined that no capital assets are significantly impaired.

Deferred Financing Costs

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

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.

SONOMA VALLEY HEALTH CARE DISTRICT
NOTES TO FINANCIAL STATEMENTS
Years Ended June 30, 2009 and 2008

NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Classification of Net Assets

Net assets of the District are classified into three categories. *Invested in capital assets, net of related debt*, consists of capital assets, net of accumulated depreciation and reduced by the outstanding balances of any borrowings that are attributable to the acquisition, construction, or improvement of those assets. *Restricted net assets* consists of net assets with limits on their use that are externally imposed by creditors (such as through debt covenants), grantors, contributors or by laws or regulations of other governments or constraints imposed by law through constitutional provisions or enabling legislation. *Unrestricted net assets* consist of net assets that do not meet the definition of “restricted” or “invested in capital assets, net of related debt.”

Net Patient Service Revenues

The Hospital has agreements with third-party payors 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 payors, 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.

Capitation Revenues

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 two of 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. Effective January 1, 2009, the Hospital is no longer responsible for the cost of services provided to subscribing participants by other hospitals.

Tax Revenues

Taxes for District operations and for debt service payments related to District General Obligation Bonds are levied annually on the taxable property within the District. The District recognizes property taxes receivable when the enforceable legal claim arises (January 1) and recognizes revenues over the period for which the taxes are levied (July 1 to June 30). Tax revenues are nonexchange transactions that are reported as nonoperating revenues.

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. In March 2007, Sonoma Valley Health Care District voters extended the special tax at an annual rate of up to \$195 per parcel for an additional five years. The purpose of the special parcel tax is to ensure continued local access to emergency room and acute hospital care and other medical services for residents of the District and for visitors to the area.

**SONOMA VALLEY HEALTH CARE DISTRICT
NOTES TO FINANCIAL STATEMENTS
Years Ended June 30, 2009 and 2008**

NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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 for noncapital purposes are received, regardless of restrictions, they are classified as noncapital grants and gifts and are included as nonoperating revenues in the statement of operations and changes in net assets. Support that is restricted for acquiring or improving capital assets is reported as capital grants and gifts in the statement of operations and changes in net assets. The amount is not reported in nonoperating revenues. Financial support from the community is recorded in the year that the support is received. Expenses directly associated with soliciting gifts and grants are reported as operating expenses in the statement of operations and changes in net assets.

Community Benefits

The Hospital provides care without charge or at amounts less than its established rate 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 revenues and are, therefore, not reported as net patient service revenues.

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.

NOTE 3. DEPOSITS, INVESTMENTS AND INVESTMENT INCOME

Summary of Carrying Values

The carrying values of deposits and investments at June 30, 2009 and 2008, are included in the balance sheets as follows:

| | <u>2009</u> | <u>2008</u> |
|--|----------------------------|----------------------------|
| Carrying values: | | |
| Deposits | \$ 822,639 | \$ 352,141 |
| Investments | <u>10,512,803</u> | <u>3,433,492</u> |
| | <u>\$11,335,442</u> | <u>\$ 3,785,633</u> |
| Included in the following balance sheet captions: | | |
| Cash and cash equivalents | \$ 721,542 | \$ 352,141 |
| Short-term investments | 2,549,252 | 2,661,563 |
| Noncurrent investments | <u>8,059,384</u> | <u>771,929</u> |
| | <u>\$11,330,178</u> | <u>\$ 3,785,633</u> |

SONOMA VALLEY HEALTH CARE DISTRICT
NOTES TO FINANCIAL STATEMENTS
Years Ended June 30, 2009 and 2008

NOTE 3. DEPOSITS, INVESTMENTS AND INVESTMENT INCOME (Continued)

Bank Deposits

Bank deposits exposed to custodial credit risk at June 30, 2009 and 2008, amounted to \$692,001 and \$367,539, respectively. None of the District's deposits with financial institutions in excess of federal depository insurance limits are held in uncollateralized accounts.

Custodial credit risk for deposits is the risk that, in the event of the failure of a depository financial institution, the District will not be able to recover its deposits or will not be able to recover collateral securities that are in the possession of an outside party. The California Government Code and the District's investment policy do not contain legal or policy requirements that would limit the exposure to custodial credit risk for deposits, other than the following provision for deposits: 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% of the total amount deposited by the public agencies. California law also allows financial institutions to secure District deposits by pledging first trust deed mortgage notes having a value of 150% of the secured public deposits.

Investments

Under the California Government Code, the District 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 District 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.

SONOMA VALLEY HEALTH CARE DISTRICT
NOTES TO FINANCIAL STATEMENTS
Years Ended June 30, 2009 and 2008

NOTE 3. DEPOSITS, INVESTMENTS AND INVESTMENT INCOME (Continued)

At June 30, 2009 and 2008, the District's investments (including investments held by bond trustee) and maturities are as follows:

| | 2009 | | |
|--|---|----------------------------|--------------------------|
| | Investment Maturities (in Years) | | |
| | Fair Value | Less than 1 | 1 – 5 |
| External investment pool (LAIF) | \$10,052,315 | \$10,052,315 | \$ -0- |
| Money market mutual funds and bank deposits | 436,555 | 436,555 | -0- |
| Interest in irrevocable trust | <u>119,766</u> | <u>-0-</u> | <u>119,766</u> |
| | <u>\$10,608,636</u> | <u>\$10,488,870</u> | <u>\$ 119,766</u> |
| | 2008 | | |
| | Investment Maturities (in Years) | | |
| | Fair Value | Less than 1 | 1 – 5 |
| U.S. Treasury obligations | \$ 25,971 | \$ -0- | \$ 25,971 |
| U.S. Agencies securities | 602,906 | -0- | 602,906 |
| External investment pool (LAIF) | 2,193,074 | 2,193,074 | -0- |
| Money market mutual funds | <u>611,541</u> | <u>611,541</u> | <u>-0-</u> |
| | <u>\$ 3,433,492</u> | <u>\$ 2,804,615</u> | <u>\$ 628,877</u> |

Except for the investment of unexpended funds borrowed for construction, the District's investment policy limits the first \$5,000,000 of investments to the LAIF. Once investments exceed \$5,000,000, the policy (California Government Code) 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 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** – 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. 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, 2009 and 2008, the District'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.

SONOMA VALLEY HEALTH CARE DISTRICT
NOTES TO FINANCIAL STATEMENTS
Years Ended June 30, 2009 and 2008

NOTE 3. DEPOSITS, INVESTMENTS AND INVESTMENT INCOME (Continued)

- **Custodial Credit Risk** – For an investment, custodial credit risk is the risk that, in the event of the failure of the counterparty, the District will not be able to recover the value of its investment or collateral securities that are in the possession of an outside party. The District’s investments in U.S. agency securities, LAIF, and money market mutual funds are held by the broker or by the bank’s trust department in other than the District’s name.
- **Concentration of Credit Risk** – This risk relates to the risk of loss attributed to the magnitude of the District’s investment in a single issuer. The District had the following investments in a single issuer in excess of 5% of total investments as of June 30, 2009 and 2008:

| | 2009 | | 2008 | |
|------|---------------|-------|--------------|-------|
| | | | | |
| LAIF | \$ 10,052,315 | 94.8% | \$ 2,193,074 | 63.9% |

- **Foreign Currency Risk** – This risk relates to adverse affects on the fair value of an investment from changes in exchange rates. The District had no investments denominated in foreign currency at June 30, 2009 and 2008.

Investment Income

Investment income for the years ended June 30, 2009 and 2008, consisted of:

| | <u>2009</u> | <u>2008</u> |
|---|-------------------------|--------------------------|
| Interest, dividends and realized net gains | \$ 141,805 | \$ 199,108 |
| Net increase (decrease)in fair value of investments | <u>(42,277)</u> | <u>6,330</u> |
| | 99,528 | 205,438 |
| Less amount capitalized | <u>(44,791)</u> | <u>-0-</u> |
| Net investment income | <u>\$ 54,737</u> | <u>\$ 205,438</u> |

SONOMA VALLEY HEALTH CARE DISTRICT
NOTES TO FINANCIAL STATEMENTS
Years Ended June 30, 2009 and 2008

NOTE 4. PATIENT ACCOUNTS RECEIVABLE

The Hospital grants credit without collateral to its patients, most of whom are District residents and are insured under third-party payor agreements. Patient accounts receivable at June 30, 2009 and 2008, consist of:

| | <u>2009</u> | <u>2008</u> |
|---|----------------------------|----------------------------|
| Medicare | \$ 1,305,125 | \$ 1,125,908 |
| Medi-Cal | 706,128 | 717,871 |
| Other third-party payors | 2,328,043 | 1,887,041 |
| Patients | <u>1,728,938</u> | <u>1,700,370</u> |
| | 6,068,234 | 5,431,190 |
| Less allowance for uncollectible accounts | <u>(1,579,000)</u> | <u>(1,500,000)</u> |
| Total patient accounts receivable | <u>\$ 4,489,234</u> | <u>\$ 3,931,190</u> |

NOTE 5. OTHER RECEIVABLES

Other receivables for the years ended June 30, 2009 and 2008, are as follows:

| | <u>2009</u> | <u>2008</u> |
|--|----------------------------|----------------------------|
| Property tax revenues: | | |
| Special parcel tax | \$ 3,056,722 | \$ 3,082,313 |
| Tax for general obligation bond debt service payments | <u>807,660</u> | <u>-0-</u> |
| | 3,864,382 | 3,082,313 |
| Accrued investment income | 37,939 | 23,818 |
| Due from Sonoma Valley Hospital Foundation | 15,017 | 5,176 |
| Current portion of physician line of credit | 14,186 | 13,496 |
| Capital grant from The Sonoma Community Development Agency | -0- | 267,000 |
| Insurance and stop-loss recoveries | -0- | 137,678 |
| Other | <u>57,785</u> | <u>28,054</u> |
| Total other receivables | <u>\$ 3,989,309</u> | <u>\$ 3,557,535</u> |

**SONOMA VALLEY HEALTH CARE DISTRICT
NOTES TO FINANCIAL STATEMENTS
Years Ended June 30, 2009 and 2008**

NOTE 6. CAPITAL ASSETS (Continued)

Loss on Impairment of Capital Assets

In August 2008, the District's Board of Directors abandoned a plan to acquire land and construct a new Hospital and authorized a November 2008 ballot measure to issue \$35 million in general obligation bonds, the proceeds of which will be used to construct a new central utility plant, upgrade existing buildings, and improve the related infrastructure, all on the current site, and to retire the existing revenue bonds. The District electorate approved the measure and the District issued \$12 million of general obligation bonds on April 1, 2009 (see Note 11 and Note 17).

Through June 30, 2008, the District had incurred \$2,720,414 in capitalized costs associated with the plan abandoned by the Board. Because these costs have no utilitarian value to the District, they were charged off at June 30, 2008, as a loss on impairment of capital assets. The loss is reported in the statement of operations and changes in net assets for the year ended June 30, 2008, as a special item because management believes the transactions or other events are within its control, are significant, and are either unusual in nature or infrequent in occurrence.

NOTE 7. DESIGNATED NET ASSETS

Unrestricted net assets at June 30, 2009 and 2008, include the following amounts designated by the District's Board of Directors. 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.

| | <u>2009</u> | <u>2008</u> |
|--|--------------------------|--------------------------|
| Designated for capital expenditures | \$ 467,177 | \$ 462,218 |
| Designated for the provision of charity care to uninsured patients | <u>185,509</u> | <u>465,811</u> |
| Total designated net assets | <u>\$ 652,686</u> | <u>\$ 928,029</u> |

On August 27, 2008, after discussions with the Foundation (Note 16) and a local donor, the Board of Directors determined that \$190,000 of its designated funds should be transferred to the Community Foundation Sonoma County (CFSC). These funds were previously donated to the Foundation and passed through to the District for the provision of charity care to uninsured patients. CFSC will deposit the funds in the Gary and Marcia Nelson Emergency Care Endowment Fund for Sonoma Valley, a permanent endowment to provide quality emergency healthcare support for Sonoma Valley. Specifically, the fund will support emergency room services at the Hospital through grants approved by CFSC's Board of Directors so long as the Hospital continues to provide those services to Sonoma Valley residents.

SONOMA VALLEY HEALTH CARE DISTRICT
NOTES TO FINANCIAL STATEMENTS
Years Ended June 30, 2009 and 2008

NOTE 8. OTHER ASSETS

Other assets consist of the following at June 30, 2009 and 2008:

| | <u>2009</u> | <u>2008</u> |
|---|--------------------------|--------------------------|
| Unamortized bond issue costs | \$ 148,531 | \$ 288,591 |
| Noncurrent amount of physician line of credit | <u>115,027</u> | <u>129,213</u> |
| Total other assets | <u>\$ 263,558</u> | <u>\$ 417,804</u> |

NOTE 9. ACCOUNTS PAYABLE AND ACCRUED EXPENSES

Accounts payable and accrued expenses included in current liabilities at June 30, 2009 and 2008, consist of:

| | <u>2009</u> | <u>2008</u> |
|---|----------------------------|----------------------------|
| Payable to suppliers, contractors and others | \$ 1,822,460 | \$ 2,028,520 |
| Payable to employees (including payroll taxes and benefits) | 2,881,348 | 2,652,920 |
| Reserve for probable recovery of overpayments by third-party payors | 380,000 | 350,000 |
| Accrued interest | 271,372 | 43,748 |
| Estimated costs of claims incurred but not reported under capitation contracts | <u>42,000</u> | <u>249,881</u> |
| Total accounts payable and accrued expenses | <u>\$ 5,397,180</u> | <u>\$ 5,325,069</u> |

NOTE 10. WORKERS' COMPENSATION CLAIMS

The Hospital is self-insured for workers' compensation claims of its employees up to \$750,000, with commercial stop-loss insurance coverage purchased for claims in excess of these amounts through December 31, 2008. Beginning January 1, 2009, the District is at risk for all costs of its workers' compensation claims. 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.

The Hospital's accrued workers' compensation claims liability activity during 2009 and 2008, is as follows:

| | <u>2009</u> | <u>2008</u> |
|---|--------------------------|--------------------------|
| Balance at beginning of year | \$ 472,000 | \$ 412,000 |
| Current year claims incurred and changes in estimates for claims incurred in prior years | 172,000 | 209,000 |
| Claims and expenses paid | <u>(121,000)</u> | <u>(149,000)</u> |
| Balance at end of year | <u>\$ 523,000</u> | <u>\$ 472,000</u> |

SONOMA VALLEY HEALTH CARE DISTRICT
NOTES TO FINANCIAL STATEMENTS
Years Ended June 30, 2009 and 2008

NOTE 11. LONG-TERM DEBT

The following is a summary of the District's long-term debt transactions for the years ended June 30, 2009 and 2008:

| | <u>2009</u> | | | |
|--|-------------------------------------|-----------------------------|---|----------------------------------|
| | <u>Beginning</u> <u>Balances</u> | <u>Additions</u> | <u>Payments/</u> <u>Amortization</u> | <u>Ending</u> <u>Balances</u> |
| Revenue bonds payable | \$ 4,770,000 | \$ -0- | \$ (4,770,000) | \$ -0- |
| General obligation bonds payable: | | | | |
| Principal | -0- | 12,000,000 | -0- | 12,000,000 |
| Original issue premium | -0- | 480,000 | (11,167) | 468,833 |
| Deferred loss on early retirement of revenue bonds | -0- | (233,749) | 11,692 | (222,057) |
| | <u>-0-</u> | <u>12,246,251</u> | <u>525</u> | <u>12,246,776</u> |
| Equipment notes payable | <u>1,494,586</u> | <u>332,253</u> | <u>(503,259)</u> | <u>1,323,580</u> |
| Total long-term debt | <u>\$ 6,264,586</u> | <u>\$ 12,578,504</u> | <u>\$ (5,272,734)</u> | <u>\$ 13,570,356</u> |
| | | | | |
| | <u>2008</u> | | | |
| | <u>Beginning</u> <u>Balances</u> | <u>Additions</u> | <u>Payments/</u> <u>Amortization</u> | <u>Ending</u> <u>Balances</u> |
| Revenue bonds payable | \$ 5,715,000 | \$ -0- | \$ (945,000) | \$ 4,770,000 |
| Equipment notes payable | <u>1,859,808</u> | <u>149,999</u> | <u>(515,221)</u> | <u>1,494,586</u> |
| Total long-term debt | <u>\$ 7,574,808</u> | <u>\$ 149,999</u> | <u>\$ (1,460,221)</u> | <u>\$ 6,264,586</u> |

General Obligation Bonds Payable

Upon voter approval in November 2008 (see Note 17), the District issued \$12,000,000 principal amount of general obligation bonds (Sonoma Valley Health Care District General Obligation Bonds, Election of 2008, Series A 2009). Bond proceeds are to be used to pay for a portion of the costs of renovating and retrofitting the District's existing hospital facility, to purchase equipment, to refund outstanding indebtedness, to pay costs of issuance and to pay bond interest due August 1, 2009. Interest on the Bonds is payable semiannually at rates ranging from 5.375% to 8.75% with principal payments due annually beginning August 1, 2013.

Bonds maturing on or before August 1, 2014, are not subject to redemption prior to their respective stated maturity dates. Bonds maturing on or after August 1, 2015, may be redeemed prior to maturity at the District's option at redemption prices equal to the par amount of Bonds redeemed. The Bonds are general obligations of the District payable from ad valorem taxes. In the event the District fails to provide sufficient funds for payment of principal and interest when due, a commercial insurance company has guaranteed to pay that portion of principal and interest for which funds are not available.

**SONOMA VALLEY HEALTH CARE DISTRICT
NOTES TO FINANCIAL STATEMENTS
Years Ended June 30, 2009 and 2008**

NOTE 11. LONG-TERM DEBT (Continued)

On April 1, 2009, the District, using General Obligation Bond proceeds, refunded all then outstanding Revenue Bonds. The refunding resulted in an accounting loss of \$234,000. This loss has been deferred and is reported as a deduction from the newly issued General Obligation Bonds and will be charged to expense through the year 2014. The District refunded its Revenue Bonds in order to extend its debt service payments through 2029 and to eliminate certain restrictive debt covenants. The refunding transaction increased total debt service payments by \$3,434,000 and resulted in an economic loss of \$291,000.

Equipment Notes Payable

The equipment notes payable require monthly payments of principal and interest ranging from \$46,790 through November 2010, \$42,110 through October 2011, and \$5,879 through maturity in November 2013, at rates ranging from 4.32% to 9.0%. The agreements are secured by capital equipment acquired with proceeds of the loans.

Under one of the equipment notes, the District is required 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 at least 30 days cash on hand. The District has complied with these covenants as of June 30, 2009.

Debt Service Requirements

Debt service requirements for long-term debt are as follows at June 30, 2009:

| <u>Year Ending June 30,</u> | <u>General Obligation Bonds</u> | | <u>Equipment Contracts</u> | |
|-----------------------------|---------------------------------|-----------------------------|----------------------------|-------------------------|
| | <u>Principal</u> | <u>Interest</u> | <u>Principal</u> | <u>Interest</u> |
| 2010 | -0- | \$ 769,200 | \$ 510,800 | \$ 53,400 |
| 2011 | -0- | 769,200 | 503,000 | 28,500 |
| 2012 | -0- | 769,200 | 211,300 | 9,300 |
| 2013 | -0- | 769,200 | 73,100 | 3,800 |
| 2014 | \$ 25,000 | 767,200 | 25,400 | 400 |
| 2015 – 2019 | 1,115,000 | 3,608,200 | | |
| 2020 – 2024 | 3,050,000 | 2,679,700 | | |
| 2025 – 2029 | 6,090,000 | 1,252,300 | | |
| 2030 | 1,720,000 | 7,900 | | |
| Total debt service | <u>\$ 12,000,000</u> | <u>\$ 11,392,100</u> | <u>\$ 1,323,600</u> | <u>\$ 95,400</u> |

SONOMA VALLEY HEALTH CARE DISTRICT
NOTES TO FINANCIAL STATEMENTS
Years Ended June 30, 2009 and 2008

NOTE 11. LONG-TERM DEBT (Continued)

Interest costs incurred during the years ended June 30, 2009 and 2008, are summarized as follows:

| | <u>2009</u> | <u>2008</u> |
|---|--------------------------|--------------------------|
| Interest cost: | | |
| Paid | \$ 292,981 | \$ 334,712 |
| Accrued | <u>227,624</u> | <u>70,909</u> |
| Total incurred | <u>520,605</u> | <u>405,621</u> |
| Amortization of deferred financing costs, original issue premium and deferred loss on early retirement of revenue bonds | 27,393 | -0- |
| Interest capitalized | <u>(175,818)</u> | <u>-0-</u> |
| Total interest expense | <u>\$ 372,180</u> | <u>\$ 405,621</u> |

NOTE 12. MEDICAL MALPRACTICE COVERAGE AND CLAIMS

The Hospital has joined together with other providers of health care services to form Beta Healthcare Group, 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 Beta. The Pool's governing agreements 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 probably ultimate costs of the incidents. Based upon the Hospital's claims experiences, no such accrual has been made. It is reasonably possible that this estimate could change materially in the near term.

NOTE 13. NET PATIENT SERVICE REVENUES

The Hospital has agreements with third-party payors that provide for payments to the Hospital at amounts different from its established rates. Medicare and Medi-Cal settlements are estimated and recorded in the financial statements in the year services are provided. Laws and regulations governing the Medicare and Medi-Cal programs are complex and subject to interpretation. The Hospital believes that it is in compliance with all applicable laws and regulations and is not aware of any pending or threatened investigations involving allegations of potential wrongdoing. While no such regulatory inquiries have been made, compliance with such laws and regulations can be subject to future government review and interpretation as well as significant regulatory action including fines, penalties and exclusion from the Medicare and Medi-Cal programs. Changes in Medicare, Medi-Cal or other programs or the reduction of program funding could have an adverse impact on future net patient service revenues. A summary of the payment arrangements with major third-party payors follows.

**SONOMA VALLEY HEALTH CARE DISTRICT
NOTES TO FINANCIAL STATEMENTS
Years Ended June 30, 2009 and 2008**

NOTE 13. NET PATIENT SERVICE REVENUES (Continued)

Medicare: Payments for most services rendered to Medicare program beneficiaries are based on prospectively determined rates. Inpatient acute rates vary according to a patient diagnostic classification system and skilled nursing care and outpatient services are paid at rates based upon resource utilization or specific procedures performed. Medicare settlements are estimated and recorded in the financial statements in the year in which they occur. The estimated settlements recorded at June 30, 2009, could differ from actual settlements based on the results of cost report audits. At June 30, 2009, cost reports through June 30, 2007, have been audited or otherwise final settled.

Medi-Cal: Payments for inpatient services rendered to Medi-Cal patients are based on allowable costs while outpatient payment is based on pre-determined charge screens. The Hospital is paid for Medi-Cal services at tentative rates with final settlements determined after submission of annual cost reports by the Hospital and audits thereof by Medi-Cal representatives. The Hospital's Medi-Cal cost reports have been audited or otherwise settled through June 30, 2007.

Others: Payments for services rendered to other than Medicare and Medi-Cal patients are based on established rates or agreements with certain commercial insurance companies, health maintenance organizations and preferred provider organizations which provide for various discounts from established rates.

Net patient service revenues for the years ended June 30, 2009 and 2008 are as follows:

| | <u>2009</u> | <u>2008</u> |
|---|-----------------------------|-----------------------------|
| Patient service revenues at established charge rates: | | |
| Services provided to Medicare patients | \$ 71,729,518 | \$ 65,793,560 |
| Services provided to Medi-Cal patients | 16,243,688 | 15,305,130 |
| Services provided to other patients | <u>55,454,407</u> | <u>54,476,328</u> |
| Gross patient service revenues | 143,427,613 | 135,575,018 |
| Less contractual adjustments and provision for uncollectible accounts | <u>(105,558,970)</u> | <u>(98,219,465)</u> |
| Net patient service revenues | <u>\$ 37,868,643</u> | <u>\$ 37,355,553</u> |

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 District's Board of Directors. The plan provides retirement benefits to plan members and death benefits to beneficiaries of plan members. Benefit provisions are contained in the plan document and are established and can be amended by action of the District's governing body. Contribution rates for plan members and the Hospital, expressed as a percentage of covered payroll, are 11.8% and 3.4% for 2009 and 11.6% and 3.1% for 2008, respectively. Contributions made by plan members and accrued by the Hospital aggregated approximately \$1,691,000 and \$480,000 during 2009 and \$1,702,000 and \$456,000 during 2008, respectively.

**SONOMA VALLEY HEALTH CARE DISTRICT
NOTES TO FINANCIAL STATEMENTS
Years Ended June 30, 2009 and 2008**

NOTE 15. STATEMENTS OF CASH FLOWS

| | <u>2009</u> | <u>2008</u> |
|---|--------------------------------|------------------------------|
| Reconciliation of operating loss to net cash used in operating activities: | | |
| Operating loss | \$(1,529,203) | \$(3,386,528) |
| Depreciation | 1,525,397 | 1,242,559 |
| Provision for uncollectible accounts | 2,134,244 | 2,174,806 |
| Accrued self-insurance costs | 51,000 | 60,000 |
| Loss on sales of capital assets | 17,469 | 11,100 |
| Changes in operating assets and liabilities: | | |
| Patient accounts and other receivables | (1,938,439) | (1,058,732) |
| Estimated amounts due from and to third-party payors | (436,809) | 338,546 |
| Accounts payable and accrued expenses | (221,272) | 801,884 |
| Other assets and liabilities | <u>(94,130)</u> | <u>199,634</u> |
| Net cash provided by (used in) operating activities | <u>\$ (491,743)</u> | <u>\$ 383,269</u> |

Noncash capital and related financing activities

During the years ended June 30, 2009 and 2008, the District acquired equipment valued at \$332,253 and \$149,999, respectively, by entering into equipment contracts payable.

NOTE 16. TRANSACTIONS WITH SONOMA VALLEY HOSPITAL FOUNDATION

Sonoma Valley Hospital Foundation, Inc. (Foundation) is authorized by the District 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 recorded contributions from the Foundation of \$228,449 in 2009 and \$430,535 in 2008. At June 30, 2009 and 2008, the Foundation's unaudited cash basis financial statements reported net assets of \$265,000 and \$475,000, respectively. The Foundation is not considered a component unit of the District because management believes the resources of the Foundation are not significant to the District.

**SONOMA VALLEY HEALTH CARE DISTRICT
NOTES TO FINANCIAL STATEMENTS
Years Ended June 30, 2009 and 2008**

NOTE 17. COMMITMENTS

Operating Leases

The District leases certain facilities and equipment under long-term, non-cancelable operating lease agreements. Total rental expense for all operating leases amounted to \$443,183 and \$419,841 in 2009 and 2008, respectively. Following is a schedule by year of future minimum lease payments under operating leases that have initial or remaining terms in excess of one year:

| <u>Year Ending June 30,</u> | <u>Amount</u> |
|--|--------------------------|
| 2010 | \$ 186,400 |
| 2011 | 108,800 |
| 2012 | 86,300 |
| 2013 | <u>60,600</u> |
| | <u>\$ 442,100</u> |

On September 1, 2009, the District entered into a four-year lease of and option to purchase two parcels of unimproved property near the Hospital. Under the lease agreement, the property may be used for parking, as a construction staging area and any other legally permitted use related to the Hospital's business. Basic rent is \$14,583 per month plus taxes. Upon exercise of the option to purchase the property, the purchase price will be \$4.2 million through August 31, 2010, and will increase by \$100,000 each year thereafter.

Renovation and Earthquake Retrofit Project

On November 4, 2008, the District electorate approved the authorization to issue a total of \$35 million in general obligation bonds. The District issued \$12 million of these bonds April 1, 2009 (see Note 11), using \$4 million of the proceeds to refund all of the then outstanding Revenue Bonds. \$8 million of the proceeds and the proceeds from all future bonds authorized by the election will be used to construct a new central utility plant, improve the utility infrastructure, make all necessary seismic upgrades to existing facilities and purchase additional medical equipment and install information systems wiring (the "Project").

During the first phase of the Project, extending through mid-2011, the District will prepare a master plan, complete the detailed planning for the Project, acquire some equipment, install the information systems wiring and begin construction. The District expects to complete plans for the Project and submit them to the Office of Statewide Health Planning and Development of the State of California ("OSHPD") by March 2010 and receive approval from OSHPD by June 2011.

The District expects to issue the remaining \$23 million in general obligation bonds by mid-2011 in order to finance the second and final phase of the Project. During this phase, which the District expects to complete in 2014, the District will complete all construction and improvement aspects of the Project and finish purchasing the equipment budgeted in the Project. Total project costs are estimated to be at least \$31 million and will be financed by bond proceeds, interest earned on temporarily invested bond proceeds and operations. Through June 30, 2009, the District has incurred \$344,124 in project costs, which are included in construction work in progress on the balance sheet and has made commitments for planning and project management in the amount of \$1,766,000.

**SONOMA VALLEY HEALTH CARE DISTRICT
NOTES TO FINANCIAL STATEMENTS
Years Ended June 30, 2009 and 2008**

NOTE 18. UNCOMPENSATED CARE AND COMMUNITY SUPPORT

Uncompensated Care

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. 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 the provision for uncollectible accounts is reflected in net patient service revenues.

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. Finally, some undetermined portion of the 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>2009</u> | <u>2008</u> |
|--|-----------------------------|-----------------------------|
| Community benefits (charity care) allowances | \$ 454,000 | \$ 621,000 |
| State Medi-Cal and other public aid programs | 12,441,000 | 12,057,000 |
| Provision for uncollectible accounts | <u>2,131,000</u> | <u>2,175,000</u> |
| Total | <u>\$ 15,026,000</u> | <u>\$ 14,853,000</u> |

The Hospital's estimated costs of providing uncompensated care and community benefits to the poor and the broader community for 2009 and 2008, are:

| | <u>2009</u> | <u>2008</u> |
|---|----------------------------|----------------------------|
| Uncompensated costs of community benefits and uncollectible accounts | \$ 646,000 | \$ 640,000 |
| Medi-Cal and other public aid programs | <u>1,013,000</u> | <u>1,587,000</u> |
| | 1,659,000 | 2,227,000 |
| Benefits for the broader community | <u>3,248,000</u> | <u>4,199,000</u> |
| Total estimated community benefit costs | <u>\$ 4,907,000</u> | <u>\$ 6,426,000</u> |

Benefits for the broader community include the unpaid costs of providing service to the elderly, providing health screenings and other health-related services, training health professionals, educating the community with various seminars and classes and the costs associated with providing free clinics and other community service programs.

**SONOMA VALLEY HEALTH CARE DISTRICT
 NOTES TO FINANCIAL STATEMENTS
 Years Ended June 30, 2009 and 2008**

NOTE 18. UNCOMPENSATED CARE AND COMMUNITY SUPPORT (Continued)

Community Support

The Hospital also commits significant time and resources to endeavors and critical services that 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 recruitment of physicians, health screening and assessments, prenatal education and care, community educational services, and various support groups.

During 2009 and 2008, the Hospital recorded the following amounts related to community support:

| | <u>2009</u> | <u>2008</u> |
|---|--------------------------|--------------------------|
| Noncapital gifts and grants included in nonoperating revenues | \$ 158,377 | \$ 320,065 |
| Capital gifts and grants from: | | |
| Sonoma Valley Hospital Foundation | 171,515 | 173,381 |
| Others | <u>47,741</u> | <u>287,156</u> |
| | <u>219,256</u> | <u>460,537</u> |
| Total community support | <u>\$ 377,633</u> | <u>\$ 780,602</u> |
| Fundraising expenses included in operating expenses | <u>\$ 17,026</u> | <u>\$ 183,614</u> |