

Petaluma Health Care District

Petaluma, California

FINANCIAL STATEMENTS WITH INDEPENDENT AUDITORS' REPORT

June 30, 2017 and 2016



**K · C O E
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Petaluma Health Care District

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INDEPENDENT AUDITORS' REPORT

To the Board of Directors
Petaluma Health Care District
Petaluma, California

We have audited the accompanying financial statements of Petaluma Health Care District (the District), which comprise the statements of net position as of June 30, 2017 and 2016; the statements of revenues, expenses, and changes in net position, and cash flows; and the related notes to the financial statements, which collectively comprise the basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

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 and the State Controller's *Minimum Audit Requirements for California Special Districts*. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the District's preparation and fair presentation of the financial statements in order to design 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. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

INDEPENDENT AUDITORS' REPORT

(Continued)

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the District as of June 30, 2017 and 2016, and the respective changes in financial position and cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America as well as accounting systems prescribed by the State Controller's Office and state regulations governing special districts.

Other Matters

Required Supplementary Information The District has omitted management's discussion and analysis (MD&A) that accounting principles generally accepted in the United States of America require to be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of the financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. Our opinion on the basic financial statements is not affected by this missing information.

KCoe Isom, LLP

November 6, 2017
Chico, California

Petaluma Health Care District
STATEMENTS OF NET POSITION

June 30	2017	2016
ASSETS		
Current Assets		
Cash and cash equivalents	\$ 98,088	\$ 84,777
Accounts receivable - net of allowance of \$7,086 and \$13,806 in 2017 and 2016, respectively	20,846	26,400
Inventory	5,766	1,741
Prepaid expenses and deposits	89,050	73,097
Other receivables	236,982	5,281
Notes receivable	913,934	177,476
Total Current Assets	1,364,666	368,772
Investments	2,117,852	2,662,211
Notes Receivable - Net	-	1,396,117
Prepaid Affiliation Costs	-	10,599
Capital Assets - Net	4,358,360	4,930,524
TOTAL ASSETS	7,840,878	9,368,223
LIABILITIES		
Current Liabilities		
Accounts payable	119,310	198,638
Accrued liabilities:		
Payroll and vacation	120,619	104,439
Retiree health insurance	264,390	281,759
Rent deposits	5,000	5,000
Advances from grantors	48,549	43,235
Total Current Liabilities	557,868	633,071
Prepaid Lease Payments	-	229,195
TOTAL LIABILITIES	557,868	862,266
NET POSITION		
Net investment in capital assets	4,358,360	4,930,524
Unrestricted	2,924,650	3,575,433
TOTAL NET POSITION	\$ 7,283,010	\$ 8,505,957

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

Petaluma Health Care District

STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION

Years Ended June 30	2017	2016
Operating Revenues		
Program service fees	\$ 1,275,790	\$ 1,380,298
Rental income	607,715	524,427
Total Operating Revenues	1,883,505	1,904,725
Operating Expenses		
Salaries, wages, and benefits	1,215,024	1,195,464
Depreciation and amortization	642,315	662,538
Professional fees	215,393	111,060
Purchased services	716,893	787,354
Bad debt expense	5,550	21,950
Operating supplies	36,935	43,481
Office supplies	21,698	26,376
Insurance	25,206	19,068
Utilities	32,803	32,622
Repairs and maintenance	3,780	1,608
Rents and leases	61,968	71,527
Advertising and promotion	35,825	23,788
Community support	105,470	180,228
Meetings and training	7,793	9,764
Dues and subscriptions	10,585	11,196
Travel	12,598	17,608
Other	34,227	35,447
Total Operating Expenses	3,184,063	3,251,079
Operating Loss	(1,300,558)	(1,346,354)
Nonoperating Revenues (Expenses)		
Investment income	89,373	154,788
Gain (Loss) on sale of assets	(8,366)	1,484
Interest expense	(3,396)	(3,040)
Net Nonoperating Revenues (Expenses)	77,611	153,232
Change in Net Position	(1,222,947)	(1,193,122)
Net Position - Beginning of Year	8,505,957	9,699,079
Net Position - End of Year	\$ 7,283,010	\$ 8,505,957

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

Petaluma Health Care District

STATEMENTS OF CASH FLOWS

Years Ended June 30	2017	2016
CASH FLOWS FROM OPERATING ACTIVITIES		
Receipts for services and support	\$ 1,049,643	\$ 1,422,431
Receipt of grant awards	48,549	43,235
Rental receipts	378,520	105,651
Payments to suppliers and contractors	(1,420,480)	(1,346,501)
Payments to and on behalf of employees	(1,198,844)	(1,214,373)
Payments on behalf of retiree health insurance	(17,369)	(15,188)
Other payments	(48,785)	(21,950)
NET CASH USED IN OPERATING ACTIVITIES	(1,208,766)	(1,026,695)
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Purchase of capital assets	(59,552)	(125,920)
Change in line of credit	-	(60,000)
Interest paid	(3,396)	(3,040)
NET CASH USED IN CAPITAL AND RELATED FINANCIAL ACTIVITIES	(62,948)	(188,960)
CASH FLOWS FROM INVESTING ACTIVITIES		
Investment income received	75,363	92,227
Net sale of investments	550,000	950,000
Change in notes receivable	659,662	154,805
NET CASH PROVIDED BY INVESTING ACTIVITIES	1,285,025	1,197,032
Net Change in Cash and Cash Equivalents	13,311	(18,623)
Cash and Cash Equivalents - Beginning of Year	84,777	103,400
Cash and Cash Equivalents - End of Year	\$ 98,088	\$ 84,777
RECONCILIATION OF OPERATING LOSS TO NET CASH USED BY OPERATING ACTIVITIES		
Operating loss	\$ (1,300,558)	\$ (1,346,354)
Adjustments to reconcile operating loss to net cash used by operating activities:		
Depreciation and amortization	642,315	662,538
Prepaid lease payments recognized	(229,195)	(418,776)
Changes in:		
Accounts receivable and other receivables	(226,147)	42,133
Inventory	(4,025)	-
Prepaid expenses and deposits	(15,953)	3,348
Accounts payable	(79,328)	21,278
Accrued liabilities	(1,189)	(34,097)
Advances from grantors	5,314	43,235
NET CASH USED IN OPERATING ACTIVITIES	\$ (1,208,766)	\$ (1,026,695)

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

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The following is a summary of significant accounting policies followed in the preparation of the financial statements.

Nature of Operations Petaluma Health Care District (the District) was organized in 1946 and is governed by elected officials. The District's purpose is to improve the health and well-being of the local community through advocacy, partnerships and education, and to insure local access to health services in Petaluma, California, and the surrounding community.

Basis of Accounting The District applies the provisions of Governmental Accounting Standards Board (GASB) Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989, FASB and AICPA Pronouncements*. The statement incorporates into the GASB's authoritative literature certain accounting and financial reporting guidance that is included in the following pronouncements issued on or before November 30, 1989, which does not conflict with GASB pronouncements: 1) Financial Accounting Standards Board (FASB) Statements and Interpretations; 2) Accounting Principles Board (APB) Opinions; and 3) Accounting Research Bulletins (ARB) of the American Institute of Certified Public Accountants' Committee on Accounting Procedure.

The District also applies GASB Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*; and GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities*. These statements establish standards for reporting deferred outflows of resources, deferred inflows of resources, and net position for all state and local governments.

The District has adopted the financial reporting provisions of GASB Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*, but has elected not to present Management's Discussion and Analysis (MD&A) that GASB has determined is necessary to supplement, although not required to be part of, the basic financial statements.

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, as well as the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Cash and Cash Equivalents Cash and cash equivalents include cash on hand and demand deposits in a financial institution.

Investments Noncurrent investments are designated by the Board of Directors for future programs and expansion over which the Board retains control and may, at its discretion, subsequently use for other purposes.

In accordance with GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*, highly liquid investments with maturities of one year or less at the time of purchase are stated at amortized cost. All other investments are stated at fair value. Fair value is determined from quoted market prices. The District is restricted by state law and the Board's investment policy in the types of investments that can be made.

Petaluma Health Care District
NOTES TO THE FINANCIAL STATEMENTS
(Continued)

Permissible investments include the county treasury, the State Local Agency Investment Fund (LAIF), federally-insured deposits, and individual securities. Individual securities must be backed by the federal government or rated AAA, AA, or A by Standard & Poor's; or Aaa, Aa, or A by Moody's indices. In addition, maturities may not exceed five years, unless authorized by the District's investment policy. The proportion of investments in each of the permissible categories is restricted as defined in the *California Government Code* and further limited by the District's investment policy. The maximum maturity of funds invested is approximately ten years. The District's investment policy established safety of principal as the primary investment objective. The District's investment strategy is to realize a reasonable interest yield, and investment decisions are executed with the intent that they will be held to maturity.

The District realized a loss from sales of investments of \$8,366 for the year ended June 30, 2017, and a gain of \$1,484 for the year ended June 30, 2016. The calculation of realized gain or loss is independent of the calculation of the net change in the fair value of investments. Realized gains and losses on investments that had been held for more than one fiscal year and subsequently sold in the current year may have been recognized as an increase or decrease in the fair value of investments reported in the prior year. The unrealized loss on investments was \$20,962 and \$3,096 at June 30, 2017 and 2016, respectively. This amount includes all changes in fair value, including purchases and sales that occurred during the year.

Fair Value Measurements The District accounts for certain assets and liabilities in accordance with GASB Statement No. 72, *Fair Value Measurement and Application*. The District measures some assets for fair value on a recurring basis as described in note 2. The District may be required, from time to time, to measure certain assets and liabilities at fair value on a non-recurring basis. These include assets that are adjusted for the lower of cost or market, such as an inventory valuation.

The District classifies its fair value assets and liabilities into a hierarchy of three levels based on the markets in which they are traded and the reliability of the assumptions used to determine fair value. The asset or liability measurement level within the hierarchy is based on the lowest level of any assumption that is significant to the measurement.

Valuations within the hierarchy levels are based upon the following:

- Level 1:* Quoted market prices for identical instruments traded in active exchange markets.
- Level 2:* Quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable or can be corroborated by observable market data.
- Level 3:* Model-based techniques that use at least one significant assumption not observable in the market.

Inventory Inventory is stated at lower of cost or market and is accounted for on the first-in-first out basis.

Petaluma Health Care District
NOTES TO THE FINANCIAL STATEMENTS
(Continued)

Accounts Receivable Accounts receivable are carried at their estimated collectible amounts. Collectability is determined based on past credit history with customers and their current financial condition. The allowance for noncollection pertains to Lifeline customer receivables and amounts to \$7,086 and \$13,806 for June 30, 2017 and 2016, respectively.

Capital Assets Capital assets are defined by the District as having an initial cost of \$5,000 or more and an estimated useful life in excess of one year. All capital assets are recorded at cost. Depreciation is provided over the estimated useful life of each class of depreciable asset and is computed using the straight-line method. The range of estimated useful lives in years by type of asset is as follows:

Buildings	20-30
Site improvements	5-30
Equipment	5-20
Vehicles	5

Advances From Grantors Proceeds received from grant awards are passed through the District, therefore, no revenue or expense is recognized.

Operating Revenues and Expenses The statements of revenues, expenses, and changes in net position distinguish between operating and nonoperating revenues and expenses. Operating revenues result from exchange transactions generated from program service fees, which are primarily Lifeline service fees, and rental income. Nonexchange revenues, such as contributions received for purposes other than capital asset acquisition and investment income, are reported as nonoperating revenues. Operating expenses are all expenses incurred to provide operating income and other financing costs.

Net Position Net position is classified into two components. These components consist of: 1) net investment in capital assets, which consists of capital assets net of accumulated depreciation, reduced by the current balances of any outstanding borrowings used to finance the purchase or construction of those assets; and 2) unrestricted, which is the remaining equity that does not meet the other criteria.

Risk Management The District 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; natural disasters; and employee health, dental, and accident benefits. Commercial insurance coverage is purchased for claims arising from such matters. Settled claims have not exceeded this commercial coverage in any of the three preceding years. The District participates in two joint powers' agreements for comprehensive liability coverage and for workers' compensation coverage.

Advertising The District expenses advertising costs when incurred.

Petaluma Health Care District
NOTES TO THE FINANCIAL STATEMENTS
(Continued)

2. CASH AND INVESTMENTS

The following is a summary of cash and investments:

June 30	2017	2016
Cash on Hand	\$ 39	\$ 221
Deposits (1)	98,049	84,556
Subtotals	98,088	84,777
Investments That are Not Securities (2)		
Local Agency Investment Fund	776	775
Money market fund / Commercial paper	256,158	128,183
Subtotals	256,934	128,958
Investment Securities		
U.S. government securities	660,277	1,083,305
Municipal bonds	-	104,066
Corporate bonds	1,200,641	1,345,882
Subtotals	1,860,918	2,533,253
Total Cash and Investments	\$ 2,215,940	\$ 2,746,988

- (1) **Deposits** The carrying amount of deposits includes demand deposits in a financial institution.
- (2) **Investments That are Not Securities** A “security” is a transferable financial instrument that evidences ownership, whether in physical or book entry form. Investments that are not securities do not have custodial credit risk because they do not involve a transferable financial instrument. Thus, they are not subject to custodial credit risk.

Custodial Credit Risk – Deposits

Custodial credit risk is the risk that in the event of a bank failure, the District’s deposits may not be returned. The District has a collateralization agreement with the bank, which mitigates custodial credit risk. The cash balance in the bank at June 30, 2017, amounted to \$98,088. Deposits amounting to \$250,000 are covered by depository insurance and the balance, if any, is subject to the collateralization agreement.

Credit Risk – Investments

California Government Code, Section 53601, limits investments in commercial paper to “prime” quality of the highest ranking or of the highest letter and numerical rating as provided by nationally recognized statistical rating organizations (NRSRO) and limits investments in medium-term notes to a rating of A or better. Individual securities must be backed by the federal government or rated AAA, AA, or A by Standard & Poor’s; or Aaa, Aa, or A by Moody’s indices. The District’s investment policy does not place additional limits on its investment choices.

Petaluma Health Care District

NOTES TO THE FINANCIAL STATEMENTS

(Continued)

The District's investment portfolio includes individual securities plus shares held by investment pools. The investment pools are comprised of various tax-exempt bonds and corporate bonds, both foreign and domestic. As of June 30, 2017, the District owned various corporate bonds that are rated by Standard & Poor's to below an A rating. This investment rating is below the minimum rating required by the *California Government Code* and the District's investment policy.

Investments by investment type and ratings are as follows:

June 30, 2017	Fair Value / Amortized Cost	AA+, A+, A	AA-, A-	BB+, BBB+, BB-	Not Rated
Local Agency Investment Fund	\$ 776	\$ -	\$ -	\$ -	776
Money market fund	256,158	-	-	-	256,158
U.S. government securities	660,277	657,698	-	2,410	169
Corporate bonds	1,200,641	528,961	341,257	324,902	5,521
Totals	\$ 2,117,852	\$ 1,186,659	\$ 341,257	\$ 327,312	\$ 262,624

June 30, 2016	Fair Value / Amortized Cost	AA+, A+, A	AA-, A-	BB+, BBB+, BB-	Not Rated
Local Agency Investment Fund	\$ 775	\$ -	\$ -	\$ -	775
Money market fund	128,183	-	-	-	128,183
U.S. government securities	1,083,305	1,079,301	-	3,684	320
Municipal bonds	104,066	104,066	-	-	-
Corporate bonds	1,345,882	615,634	449,607	177,786	102,855
Totals	\$ 2,662,211	\$ 1,799,001	\$ 449,607	\$ 181,470	\$ 232,133

Petaluma Health Care District
NOTES TO THE FINANCIAL STATEMENTS
(Continued)

Concentration of Credit Risk – Investments

California Government Code, Section 53635, places the following concentration limits on the state investment pool and the county investment pool:

No more than 40% may be invested in eligible commercial paper; no more than 10% may be invested in the outstanding commercial paper of any single issuer; and no more than 10% of the outstanding commercial paper of any single issuer may be purchased.

California Government Code, Section 53601, places the following concentration limits on the District's investments:

No more than 5% may be invested in the securities of any one issuer, except the obligations of the U.S. government, U.S. government agencies, and U.S. government-sponsored enterprises; no more than 10% may be invested in any one mutual fund; no more than 25% may be invested in commercial paper; no more than 10% of the outstanding commercial paper of any single issuer may be purchased; no more than 30% may be invested in bankers' acceptances of any one commercial bank; no more than 30% may be invested in negotiable certificates of deposit; no more than 20% may be invested in repurchase agreements or reverse-repurchase agreements; and no more than 30% may be invested in medium-term notes.

Investments that exceeded 5% of the District's total investments are as follows:

June 30, 2017	Market Value	Percentage of Total Portfolio
U.S. government securities:		
U.S. Treasury note .75%	\$ 398,943	18.88%
U.S. Treasury note 1.625%	\$ 251,113	11.88%
Corporate bonds:		
Astrazeneca 1.95%	\$ 150,388	7.12%
Broadcom Corp. 5.53%	\$ 150,144	7.10%
General Electric Capital Corp. 1.6%	\$ 200,122	9.47%
Starbucks Corp. 2%	\$ 151,020	7.15%
Cisco Systems Inc. 2.125%	\$ 141,135	6.68%
Costco Wholesale Corp. 1.7%	\$ 149,645	7.08%
Wal-Mart Stores Inc. 1.95%	\$ 151,023	7.15%

Petaluma Health Care District
NOTES TO THE FINANCIAL STATEMENTS
(Continued)

June 30, 2016	Market Value	Percentage of Total Portfolio
U.S. government securities:		
Federal Home Loan Bank Bond 4.875%	\$ 259,393	9.77%
U.S. Treasury note .875%	\$ 150,347	5.66%
U.S. Treasury note .75%	\$ 401,065	15.11%
U.S. Treasury note 1.625%	\$ 256,670	9.67%
Corporate bonds:		
Astrazeneca 1.95%	\$ 152,490	5.74%
Broadcom Corp. 5.53%	\$ 146,715	5.53%
General Electric Capital Corp. 1.6%	\$ 201,784	7.60%
Starbucks Corp. 2%	\$ 153,329	5.77%
Cisco Systems Inc. 2.125%	\$ 143,788	5.42%
Costco Wholesale Corp. 1.7%	\$ 153,609	5.79%
Wal-Mart Stores Inc. 1.95%	\$ 154,089	5.80%

Petaluma Health Care District
NOTES TO THE FINANCIAL STATEMENTS
(Continued)

Interest Rate Risk – Investments

California Government Code, Section 53601, limits investments to maturities of five years unless the governing body has authorized the longer terms. The District has adopted a formal investment policy that limits investment maturities as a means of managing its exposure to fair value losses arising from changing interest rates.

Investments grouped by maturity date are as follows:

June 30, 2017	Less Than One Year	One to Five Years	Six to Ten Years	More Than Ten Years
Local Agency Investment Fund	\$ 776	\$ -	\$ -	-
Money market fund	256,158	-	-	-
U.S. government securities	398,944	261,333	-	-
Corporate bonds	203,937	996,704	-	-
Totals	\$ 859,815	\$ 1,258,037	\$ -	-

June 30, 2016	Less Than One Year	One to Five Years	Six to Ten Years	More Than Ten Years
Local Agency Investment Fund	\$ 775	\$ -	\$ -	-
Money market fund	128,183	-	-	-
U.S. government securities	409,739	673,566	-	-
Municipal bonds	-	104,066	-	-
Corporate bonds	100,158	1,245,724	-	-
Totals	\$ 638,855	\$ 2,023,356	\$ -	-

Petaluma Health Care District
NOTES TO THE FINANCIAL STATEMENTS
(Continued)

Fair Value Measurements

The District categorizes its fair value measurements within the fair value hierarchy established by generally accepted accounting principles. The hierarchy is based on the valuation inputs used to measure the fair value of the asset. Level 1 inputs are quoted prices in active markets for identical assets; level 2 inputs are significant other observable inputs; and level 3 inputs are significant unobservable inputs.

The District has the following recurring fair value measurements as of June 30, 2017:

- Local Agency Investment Fund of \$776 is valued using quoted prices for similar instruments in active markets and quoted prices for identical or similar instruments in markets that are not active (level 2 inputs).
- U.S. government securities of \$660,277 and money market funds of \$256,158 are valued using quoted market prices (level 1 inputs).
- Corporate bonds of \$1,200,641 are valued using a matrix pricing model (level 2 inputs).

3. NOTES RECEIVABLE

Included in notes receivable are two promissory notes secured by second deeds of trust amounting to \$913,934 and \$1,573,593 as of June 30, 2017 and 2016, respectively. The first note is payable in monthly installments at an annual rate of 6% and amortized over six years with an outstanding balance of \$-0- and \$504,768 as of June 30, 2017 and 2016, respectively. The second note is payable in monthly installments that began on July 1, 2013, at a rate of 5.75% per annum and amortized over a ten-year period with an outstanding balance of \$913,934 and \$1,068,825 as of June 30, 2017 and 2016, respectively.

Petaluma Health Care District
NOTES TO THE FINANCIAL STATEMENTS
(Continued)

4. CAPITAL ASSETS

Capital assets consisted of the following:

June 30, 2017	Beginning Balance	Additions	Deletions	Ending Balance
Land	\$ 962,310	\$ -	\$ -	\$ 962,310
Buildings and improvements	21,139,655	-	-	21,139,655
Furniture and equipment	1,443,661	59,552	-	1,503,213
Construction in progress	167,904	-	-	167,904
Subtotals	23,713,530	59,552	-	23,773,082
Less: Accumulated depreciation	18,783,006	631,716	-	19,414,722
Capital Assets - Net	\$ 4,930,524	\$ (572,164)	\$ -	\$ 4,358,360

June 30, 2016	Beginning Balance	Additions	Deletions	Ending Balance
Land	\$ 962,310	\$ -	\$ -	\$ 962,310
Buildings and improvements	21,139,655	-	-	21,139,655
Furniture and equipment	2,463,810	125,920	(1,146,069)	1,443,661
Construction in progress	167,904	-	-	167,904
Subtotals	24,733,679	125,920	(1,146,069)	23,713,530
Less: Accumulated depreciation	19,284,549	644,526	(1,146,069)	18,783,006
Capital Assets - Net	\$ 5,449,130	\$ (518,606)	\$ -	\$ 4,930,524

Depreciation expense for the years ended June 30, 2017 and 2016, was \$631,716 and \$644,526, respectively.

Petaluma Health Care District
NOTES TO THE FINANCIAL STATEMENTS
(Continued)

5. LEASE/AFFILIATION AGREEMENT

On November 4, 1996, the District signed an agreement with SRM Alliance Hospital Services, a California nonprofit public benefit corporation (Alliance), to lease Petaluma Valley Hospital, the facility housing the hospice program, and all of the personal property used in connection with those operations. The agreement also contained provisions to assign the District's interest in various leased equipment and real estate, third-party participation agreements, licenses, trademarks, and other intangible property, along with the transfer of ownership of inventory and patient medical records. The agreement commenced on January 19, 1997, for a period of 20 years.

In consideration for this agreement, Alliance agreed to pay cash, pay off certain debts, and become the primary obligor on other debts. The amount of lease payments attributed to real estate was recorded as an operating lease, the amount attributed to personal property was recorded as a sales-type lease, and the amount attributed to goodwill was recorded as a sale. The sales-type lease proceeds and sale of goodwill were recognized as income in 1997. The operating lease proceeds are deferred and amortized over the 20-year lease term. The allocation of lease proceeds was based on the related fair market values. Alliance also agreed to fund a District-sponsored free clinic for a minimum of \$15,000 annually.

The lease expired on January 20, 2017, and the District did not enter into another agreement with Alliance and is in the process of negotiating terms with Paladin Healthcare Management, the District's choice successor to operate the hospital. Alliance will continue to operate the hospital until a transfer date can be agreed upon. Currently, the expected transfer date is September 1, 2018.

The District has a rent receivable balance of \$232,456 as of June 30, 2017, due from Alliance. Alliance has stated that it will not pay such amount until: (1) the District has agreed to the terms of a Lease Surrender and Transfer Agreement relating to the surrender and transfer of the Petaluma Valley Hospital to the District, (2) the District accepts Alliance's offer relating to the parties' dispute over which party owns the Hospice Program, (3) the District accepts Alliance's offer relating to Alliance's cooperation with, and partial funding of, the District's or a new hospital operator's development of a new information technology and electronic health record system for the Petaluma Valley Hospital, and (4) the mutual agreement of the parties regarding all other disputes and open issues. The above items are expected to be settled and finalized by September 1, 2018.

Prepaid Affiliation Costs

Costs incurred for the lease/affiliation agreement were allocated between costs attributed to the operating lease, costs attributed to the sale of personal property, and goodwill in the same ratio as the proceeds allocated from the agreement. Costs attributed to the operating lease were capitalized and amortized over the life of the lease. Accumulated amortization amounted to \$360,344 and \$349,745 at June 30, 2017 and 2016, respectively. Prepaid affiliation costs were fully amortized as of June 30, 2017.

Petaluma Health Care District
 NOTES TO THE FINANCIAL STATEMENTS
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Prepaid Lease Payments

The operating lease payments are recognized as rental income over the term of the lease. The amount recognized as rental income in 2017 and 2016 amounted to \$229,195 and \$418,776, respectively; and accumulated revenue amortized from inception amounted to \$8,375,086 and \$8,145,868 at June 30, 2017 and 2016, respectively. Prepaid lease payments were fully amortized as of June 30, 2017.

6. LINE OF CREDIT

The District entered into a revolving line-of-credit agreement with Exchange Bank, which provides for advances up to \$500,000. Interest is payable on the outstanding advances at the rate of .25% over the prime rate as published in the *Wall Street Journal*, subject to a floor of 4.25%. The District had no outstanding balance on the revolving line of credit as of June 30, 2017 and 2016. The line of credit expires on March 1, 2018, and is secured by the District's investment account held at Exchange Bank.

7. COMPENSATED ABSENCES

The District's policy allows employees to accumulate vacation leave until the employee's total accrued days equal twice their annual allowance, not to exceed eight weeks. Upon retirement or separation from the District, the employee is entitled to full compensation for unused vacation. The amount due within one year could not be estimated.

Costs for compensated absences are accrued when earned by employees. Accumulated unpaid employee benefits are recognized as a liability in the statement of net position. A schedule of changes in compensated absences follows:

	Compensated Absences
Balance - July 1, 2015	\$ 71,863
Amount earned	91,651
Amount paid	(80,258)
Balance - June 30, 2016	83,256
Amount earned	81,658
Amount paid	(65,201)
Balance - June 30, 2017	\$ 99,713

Petaluma Health Care District
NOTES TO THE FINANCIAL STATEMENTS
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8. OPERATING LEASE AGREEMENTS

The District is the lessor of certain land and buildings under noncancelable operating leases. Future minimum rental receipts under the operating leases are as follows:

Years Ending June 30		
2018	\$	200,470
2019	\$	153,190
2020	\$	157,360
2021	\$	115,424
2022	\$	63,126

The District has operating leases for office space and office equipment, which expire in various months through June 2018. Rent expense amounted to \$61,968 and \$65,237 at June 30, 2017 and 2016, respectively.

9. PENSION PLANS

The District sponsors the Deferred Compensation Plan of Petaluma Health Care District, a defined contribution retirement plan under *Internal Revenue Code*, Section 457. All permanent employees are eligible to participate. Participants may contribute up to \$18,000, and an additional \$6,000 if the participant is over the age of 50. The District will match 50% of the participant's contribution to a maximum of 2.5% of their salary. Total participant and District contributions are immediately 100% vested.

The District also sponsors the Employees' Retirement Plan of Petaluma Health Care District, a defined contribution profit sharing plan under *Internal Revenue Code*, Section 401(a). All permanent employees 21 years of age or older are eligible to participate. Contributions from the District will be made at the discretion of the District and are immediately 100% vested. Contributions to the two plans amounted to \$72,104 and \$78,355 for 2017 and 2016, respectively.

10. RETIREE HEALTH INSURANCE

Plan Description

Under an amended policy adopted by the Board of Directors (Directors) in July 2000, retired directors who were in office on January 1, 1991, or retired directors who served in office through December 31, 2000, and who completed 12 years of service prior to retirement, were eligible to receive health benefits upon termination. The District pays the premiums for such retired directors and their eligible dependents. Such benefits extend after a director's term expires for the number of years equal to the number of years served by the director. The Board of Directors adopted a new policy in 2003 whereby the District will not provide medical benefits to directors who assumed office on or after January 1, 2001; or, to re-elected directors who assumed office on or after January 1, 2001. However, medical benefits will continue for those directors who are in office now for the rest of their term (ending this year or two years hence) and to former directors who are subject to the amended policy adopted in July 2000.

Funding Policy

The District's agreement with retirees is for monthly contributions for members who meet the eligibility criteria. The members receiving benefit contributions vary depending on the level of coverage selected.

Postemployment Benefit Cost and Net Obligation

The District's total unfunded liability was \$264,390 and \$281,759 as of June 30, 2017 and 2016, respectively.

Funded Status and Funding Progress

The District finances the obligation on a pay-as-you-go basis.

Actuarial Methods and Assumptions

Projections of benefits for financial reporting purposes are based on the plan, as understood by the District and plan members, and include the types of benefits provided at the time of each valuation and the historical pattern of sharing of benefits provided at the time of each valuation along with the historical pattern of sharing of benefits costs between the District and plan members at that point. The actuarial methods and assumptions used include techniques that are designed to reduce short-term volatility in actuarial accrued liabilities and the actuarial value of assets consistent with the long-term perspective of the calculations.

The District accrued an estimated liability for future costs of benefits provided under this policy based on an actuarial study conducted as of July 1, 2010. This study utilized an entry-age normal actuarial cost method with an interest rate assumption of 5% and a health inflation assumption ranging from 7% to 5% per year. As of June 30, 2017, two former board members were eligible and participating in the benefits.

A copy of the actuarial report is available by contacting the District's main office.

11. COMMITMENTS AND CONTINGENCIES

Joint Powers Agreements

The District participates in a joint venture under a joint powers agreement (JPA) with the Association of California Healthcare Districts, Inc. – ALPHA FUND (the Fund). The Fund arranges for and provides certain member health care entities with pooled workers' compensation self-insurance.

The District also participates in a joint venture under a joint powers agreement (JPA) with the Program BETA Risk Management Authority (the Program). The Program was formed for the purpose of operating a comprehensive liability self-insurance program for certain healthcare districts of the Association of California Healthcare Districts, Inc (ACHD). The Program operates as a separate JPA established as a public agency separate and distinct from ACHD. Each member hospital pays a premium commensurate with the level of coverage requested and shares surpluses and deficits proportionate to its participation in the Program. The Program provides coverage on a claims-made basis.

Revenue Bonds

Health Facility Revenue Bonds Series 1990A were advance funded in 1997. Funds were used to purchase securities that were deposited in an irrevocable trust with an escrow agent to provide for all future debt service payments (for the 1990A Series A Bonds). The 1990A Series A Bonds are considered defeased, and the related liability has been removed from the books. Total principal outstanding on the 1990A Series A Bonds as of June 30, 2017, was \$925,000.