Report of Independent Auditors and
Financial Statements with
Supplementary Information

Palm Drive Health Care District

Years Ended June 30, 2014 and 2013

MOSS-ADAMS LLP

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MANAGEMENT’S DISCUSSION AND ANALYSIS

Introduction – The management's discussion and analysis of the financial performance of Palm Drive Health Care District (the "District") provides an overview of the District's financial activities for the years ended June 30, 2014, 2013 and 2012, respectively. It should be read in conjunction with the accompanying financial statements and footnotes of the District.

Financial Highlights

Year Ended June 30, 2014

- Total assets decreased by approximately $5,910,000 from June 30, 2013.
- Total cash and cash equivalents increased by approximately $319,000 from June 30, 2013.
- Patient accounts receivable decreased by approximately $3,150,000 from June 30, 2013.
- Current assets decreased by approximately $4,229,000 from June 30, 2013, while current liabilities increased by approximately $3,503,000 during that same period.
- Long-term capital assets decreased by approximately $857,000 from June 30, 2013, while long-term debt decreased by approximately $884,000 during that same period.
- The increase in net deficit was approximately $8,936,000 for the year ended June 30, 2014.

Year Ended June 30, 2013

- Total assets increased by approximately $1,314,000 from June 30, 2012.
- Total cash and cash equivalents decreased by approximately $129,000 from fiscal year June 30, 2012.
- Patient accounts receivable decreased by approximately $147,000 from June 30, 2012. The net days in patient accounts receivable were 52.0 at June 30, 2013, as compared to 50.7 at June 30, 2012.
- Current assets increased by approximately $626,000 from June 30, 2012, while current liabilities increased by approximately $3,424,000 from June 30, 2012.
- Long-term capital assets increased by approximately $2,033,000 from fiscal year June 30, 2012, while long-term debt decreased by approximately $684,000 from June 30, 2012.
- The increase in net deficit was approximately $1,426,000 for the year ended June 30, 2013.

Year Ended June 30, 2012

- Total assets increased by approximately $457,000 from June 30, 2011.
- Total cash and cash equivalents decreased by approximately $668,000 from fiscal year June 30, 2011.
- Patient accounts receivable increased by approximately $377,000 from June 30, 2011. The net days in patient accounts receivable were 50.7 at June 30, 2012, as compared to 48.25 at June 30, 2011.
- Current assets decreased by approximately $259,000 from June 30, 2011, while current liabilities increased by approximately $626,000 from June 30, 2011.
- Long-term capital assets increased by approximately $819,000 from fiscal year June 30, 2011, while long-term debt increased by approximately $298,000 from June 30, 2011.
- The increase in net deficit was approximately $467,000 for the year ended June 30, 2012.

Overview of Palm Drive Health Care District's Financial Statements

This annual report consists of the audited financial statements and the notes to the financial statements which reflect the District's financial position and operating results for the years ended June 30, 2014 and 2013. The audited financial statements include the report of the independent auditors, statement of net position, statement of revenues, expenses, and changes in net position, and statement of cash flows. They also include notes to the financial statements.

- The statements of net position includes all of the District's assets and liabilities based on the accrual method of accounting for the year ended June 30, 2014 and 2013.

- The statements of revenues, expenses, and changes in net position present the operating activities of the District during the year ended June 30, 2014 and 2013.

- The statements of cash flows reports the net cash provided by operating activities as well as other sources and uses of cash from various District financial activities.

Cash and Cash Equivalents

For the fiscal year ended June 30, 2014, the District's cash and cash equivalents totaled approximately $710,000 compared to approximately $391,000 at June 30, 2013, and $520,000 at June 30, 2012. At June 30, 2014, days of operating cash on hand were approximately 7.9 as compared to 4.4 at June 30, 2013, and 6.2 at June 30, 2012. The District's goal is to maintain sufficient cash balances to pay all short-term liabilities and service the long-term debt deposit requirements. The majority of the District's cash is deposited with a local bank in various forms of cash and cash equivalent funds.

Current Assets and Liabilities

During fiscal year ended June 30, 2014, current assets decreased by approximately $4,229,000 with decreases in patient accounts receivable of approximately $3,150,000 and an increase in cash and cash equivalents of approximately $319,000. Current liabilities increased by approximately $3,503,000 due mainly to an increase of approximately $2,505,000 in accounts payable and $1,436,000 in third party settlements and a decrease of approximately $77,000 in accrued payroll and related liabilities.

During fiscal year ended June 30, 2013, current assets increased by approximately $626,000 with decreases in patient accounts receivable of approximately $147,000 and a decrease in cash and cash equivalents of approximately $129,000. Current liabilities increased by approximately $3,424,000 due mainly to an increase of approximately $2,455,000 in accounts payable and accrued expenses, an increase of approximately $168,000 in accrued payroll and related liabilities, and an increase in current portion of capital lease obligations of approximately $929,000.

During fiscal year ended June 30, 2012, current assets decreased by approximately $259,000 with increases in patient accounts receivable of approximately $377,000 and a decrease in cash and cash equivalents of approximately $668,000. Current liabilities increased by approximately $626,000 due mainly to an increase of approximately $513,000 in accounts payable and accrued expenses and an increase of approximately $77,000 in accrued payroll and related liabilities.

The current ratio at June 30, 2014, is 0.24 as compared to 0.76 at June 30, 2013, and 1.08 at June 30, 2012.

Capital Assets

During the fiscal year ended June 30, 2014, the District reinvested into the facility approximately $789,000 through the purchase of an upgraded electronic health information system, major moveable equipment, and building improvements as compared to the years ending June 30, 2013, and June 30, 2012, where the District reinvested into the facility approximately $2.0 million and $1.5 million, respectively. The purchases during fiscal year June 30, 2014, were funded mainly through a new capital lease, which is consistent with purchases made in fiscal year 2013, but contrasted by the 2012 purchases, which were funded through two new operating leases.

Long-Term Debt and District Tax Revenues

During the fiscal year ending June 30, 2014, the District entered into a capital lease for the upgrade of the information system and related equipment. The decrease in long term debt during fiscal year ending June 30, 2014, was approximately $884,000 as compared to an increase in long-term debt during fiscal year 2013 and 2012 of $684,000 and $290,000, respectively. During the year ended June 30, 2014, the total tax collections from the District were $4,085,234 as compared to $4,164,420 in 2013 and $4,045,120 in 2012. These collections service the debt obligations for three separate bond issues totaling $22,265,000 and $22,940,000 in principal as of June 30, 2014 and 2013, respectively.

Volumes

- Acute care patient days were 2,514 for the year ended June 30, 2014, as compared to 4,130 for the year ended June 30, 2013, and 4,358 for the year ended June 30, 2012.

- ER visits were 4,358 for the year ended June 30, 2014, as compared to 6,929 visits for the year ended June 30, 2013, and 7,467 visits for the year ended June 30, 2012.

Gross Patient Charges

The District charges all its patients equally based on its established pricing structure for the services rendered. The District may exercise its policy to increase pricing annually to coincide with the beginning of a new fiscal year.

Inpatient gross service charges were approximately $32,895,000 for the year ended June 30, 2014, as compared to $47,952,000 for the year ended June 30, 2013, and $42,662,000 for the year ended June 30, 2012. Outpatient gross service charges were approximately $45,117,000 for the year ended June 30, 2014, as compared to $45,642,000 for the year ended June 30, 2013, and $42,817,000 for the year ended June 30, 2012.

Deductions from Revenue

Deductions from revenue are a combination of contractual allowances and provisions for bad debts. Contractual allowances are computed deductions based on the difference between gross charges and the contractually agreed upon rates of reimbursement with third party government-based programs such as Medicare and Medi-Cal and other third party payers and HMO-based payers such as Blue Cross and Aetna.

Deductions from revenue (as a percentage of gross patient service charges) were 69.00% for fiscal year ending June 30, 2014, as compared to 70.59% for fiscal year ending June 30, 2013, and 67.31% for the fiscal year ending June 30, 2012. Total deductions from revenue were approximately $56,868,000 for fiscal year ending June 30, 2014, as compared to $66,105,000 for fiscal year ending June 30, 2013, and $57,536,000 for the fiscal year ending June 30, 2012.

Net Patient Service Revenues

Net patient service revenues are the resulting difference between gross patient charges and the deductions from revenue. Net patient service revenues were approximately $21,145,000 for year ended June 30, 2014, as compared to $27,488,000 for the year ended June 30, 2013, and $27,942,000 for the year ended June 30, 2012.

Operating Expenses

Total operating expenses were approximately $32,589,000 for year ended June 30, 2014, as compared to $33,261,000 for the year ended June 30, 2013, and $31,434,000 for the year ended June 30, 2012. The net decrease from fiscal year ended June 30, 2013, is approximately $672,000. The net increase from fiscal year ended June 30, 2012, is approximately $1,827,000. The significant changes were:

- Labor-related expenses (salaries and wages, employee benefits and contract labor) decreased from 2013 by approximately $2,805,000 due primarily to the hospital closing and the laying off of staff.

- Supplies expense decreased by approximately $1,954,000 due primarily to the hospital closing and the winding down of patient care activities.

- Contract labor, physician fees, and various other expenses increased by approximately $1,197,000 due primarily to the District's use of professionals familiar with closing the hospital and filing for bankruptcy.

Economic Factors

During the fiscal years ended June 30, 2014 and 2013, the District's operated the health care facility for the community at a deficit. With a decrease in volume and payment rates, combined with increasing costs to retain staff and increased competition, the District's challenges became too many and too great to overcome.

The District expects to continue as a going concern through its ability to levy a parcel tax, allowing it to continue to meet all of its regulatory covenants.

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REPORT OF INDEPENDENT AUDITORS

The Board of Directors
Palm Drive Health Care District

Report on Financial Statements

We have audited the accompanying financial statements of Palm Drive Health Care District (the "District"), which comprise the statements of net position as of June 30, 2014 and 2013, and the related statements of revenues, expenses, and changes in net position, and cash flows for the years then ended, and the related notes to the financial statements.

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.

Auditor's 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 standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States. 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 auditor's 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 entity'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 entity'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 obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the District as of June 30, 2014 and 2013, and the changes in its net position and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter Regarding Going Concern

The accompanying financial statements have been prepared assuming that the District will continue as a going concern. As discussed in Note 2 to the financial statements, the District has suffered recurring losses from operations, closed the hospital, filed for Chapter 9 bankruptcy, and has a net capital deficiency that raise substantial doubt about its ability to continue as a going concern. Management's plans in regard to these matters are also described in Note 2. The financial statements do not include any adjustments that might result from the outcome of this uncertainty. Our opinion is not modified with respect to this matter.

Emphasis of Matter Regarding the Adoption of a New Accounting Standard

As discussed in Note 3, the Government Accounting Standard Board ("GASB") issued Statement No. 65, *Items Previously Reported as Assets and Liabilities* ("GASB No. 65"), which is effective for financial statements for periods beginning after December 15, 2012. GASB No. 65 establishes accounting and financial reporting standards that reclassify, as deferred outflows of resources or deferred inflows of resources, certain items that were previously reported as assets and liabilities and recognizes, as outflows of resources or inflows of resources, certain items that were previously reported as assets and liabilities. It also provides other financial reporting guidance related to the impact of the financial statement elements deferred outflows of resources and deferred inflows of resources, such as changes in the determination of the major fund calculations and limiting the use of the term deferred in financial statement presentations. The District has adopted this statement for the fiscal year ended June 30, 2014, and as a result, the financial statements presented herein have been restated retrospectively.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 1 through 4 be presented to supplement the 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 financial reporting for placing the financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management regarding the methods of preparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Moss Adams LLP

San Francisco, California
January29, 2015

FINANCIAL STATEMENTS

	2014	(As Restated) 2013
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	$ 709,971	$ 390,598
Restricted trust funds available for current debt service	1,104,134	1,067,364
Patient accounts receivable, net of allowance for uncollectible accounts of $197,159 and $348,217 at the years ended June 30, 2014 and 2013, respectively	770,415	3,920,418
Property taxes receivable	147,184	214,909
Estimated third party payor settlements	313,500	848,818
Inventories	-	671,468
Prepaid expenses and deposits	66,040	226,644
Total current assets	3,111,244	7,340,219
NONCURRENT INVESTMENTS		
Funds held by county for bond debt service	331,830	304,926
Funds held by trustee under bond requirements	1,807,433	1,837,248
Designated by the board or agreements for specific purposes	2,453	218,631
	2,141,716	2,360,805
Related party notes receivable	10,172	614,648
Capital assets, net of accumulated depreciation	12,592,053	13,449,173
Total assets	$ 17,855,185	$ 23,764,845
LIABILITIES AND NET POSITION		
CURRENT LIABILITIES		
Accounts payable and accrued expenses	$ 8,260,225	$ 5,755,648
Accrued payroll and related liabilities	1,421,721	1,498,711
Estimated third party payor settlements	1,435,607	-
Unearned property tax revenues	607,291	560,811
Current portion of capital lease obligations	682,245	1,129,117
Current portion of bonds payable	715,000	675,000
Total current liabilities	13,122,089	9,619,287
Capital lease obligations, net of current portion	1,239,782	1,001,721
Bonds payable, net of current portion	21,550,000	22,265,000
Total liabilities	35,911,871	32,886,008
NET POSITION		
Restricted, by bond indenture agreements and other	3,243,397	3,359,637
Unrestricted (deficit)	(21,300,083)	(12,480,800)
Total net deficit	(18,056,686)	(9,121,163)
Total liabilities and net position	$ 17,855,185	$ 23,764,845

See accompanying notes.

	2014	(As Restated) 2013
OPERATING REVENUES		
Net patient service revenue, net of provision for bad debts of $2,323,562 and $2,182,667 for the years ended June 30, 2014 and 2013, respectively	$ 21,144,799	$ 27,487,982
Capitation revenue	8,025	37,734
Other operating revenue	114,548	1,542,197
Total operating revenues	21,267,372	29,067,913
OPERATING EXPENSES		
Salaries and wages	11,552,479	13,556,148
Employee benefits	3,432,392	4,233,796
Contract labor	412,235	378,901
Professional fees	3,152,743	3,246,744
Supplies	4,334,760	6,288,909
Purchased services	3,648,304	2,390,475
Utilities and phone	352,618	378,541
Repairs and maintenance	338,769	393,907
Rents and leases	290,459	341,752
Insurance	200,419	228,884
Depreciation	1,453,217	934,385
Impairment of information technology project	839,820	-
Incentive overpayment expense	1,154,510	-
Other operating expenses	1,426,043	888,125
Total operating expenses	32,588,768	33,260,567
OPERATING LOSS	(11,321,396)	(4,192,654)
NONOPERATING REVENUES AND (EXPENSES)		
District tax revenues	4,085,234	4,164,420
Investment income	116	236
Interest expense	(1,521,817)	(1,540,449)
Grants, contributions and other	(177,660)	200,348
Total nonoperating revenues	2,385,873	2,824,555
INCREASE IN DEFICIT	(8,935,523)	(1,368,099)
NET POSITION, beginning of the year, as restated	(9,121,163)	(7,753,064)
NET POSITION, end of the year	$ (18,056,686)	$ (9,121,163)

See accompanying notes.

PALM DRIVE HEALTH CARE DISTRICT
STATEMENTS OF CASH FLOWS
Years Ended June 30, 2014 and 2013 (As Restated)

	2014	(As Restated) 2013
CASH FLOWS USED IN OPERATING ACTIVITIES		
Cash received from patients and third-parties on behalf of patients	$ 24,302,827	$ 27,672,754
Cash received from operations, other than patient services	601,141	1,536,232
Cash payments to suppliers and contractors	(9,771,198)	(13,737,661)
Cash payments to employees and benefit programs	(15,061,861)	(17,622,060)
Net cash provided by (used in) operating activities	70,909	(2,150,735)
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
District tax revenues	2,044,719	2,080,818
Grants, contributions and other	(177,660)	200,348
Net cash from noncapital financing activities	1,867,059	2,281,166
CASH FLOWS USED IN CAPITAL AND RELATED FINANCING ACTIVITIES		
District tax revenues	2,040,515	2,083,602
Purchase of capital assets	(788,818)	(1,730,658)
Proceeds from issuance of loan	-	455,169
Principal payments on loan	-	(455,169)
Principal payments on capital lease obligations	(855,910)	(316,270)
Principal payments on bonds payable	(675,000)	(645,000)
Interest payments on debt borrowings	(1,521,817)	(1,540,449)
Net cash used in capital and related financing activities	(1,801,030)	(2,148,775)
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from sale of investments	182,319	1,888,842
Interest and dividends received from investments	116	236
Net cash from investing activities	182,435	1,889,078
NET CHANGE IN CASH AND CASH EQUIVALENTS	319,373	(129,266)
CASH AND CASH EQUIVALENTS, beginning of the year, as restated	390,598	519,864
CASH AND CASH EQUIVALENTS, end of the year	$ 709,971	$ 390,598

See accompanying notes.

	2014	(As Restated) 2013
RECONCILIATION OF OPERATING LOSS TO NET CASH FROM OPERATING ACTIVITIES		
Operating loss	$ (11,321,396)	$ (4,192,654)
Adjustments to reconcile operating loss to net cash used in operating activities:		
Depreciation	1,453,217	934,385
Provision for uncollectible accounts	2,323,562	2,182,667
Impairment of information technology project	839,820	-
Changes in operating assets and liabilities:		
Patient accounts receivable	826,441	(2,035,629)
Property taxes receivable	67,725	(58,726)
Inventories	671,468	28,326
Prepaid expenses and deposits	160,604	(9,948)
Related party notes receivable	604,476	(614,648)
Accounts payable and accrued expenses	2,504,577	2,454,863
Accrued payroll and related liabilities	(76,990)	167,884
Refundable advances	-	(60,414)
Estimated third party payor settlements	1,970,925	(946,841)
Unearned property taxes	46,480	-
Net cash provided by (used in) operating activities	$ 70,909	$ (2,150,735)
SUPPLEMENTAL DISCLOSURE OF NONCASH TRANSACTIONS		
Acquisition of capital assets financed with capital lease obligations	$ 647,099	$ 1,236,357

See accompanying notes.

NOTE 1 – ORGANIZATION

Organization – Palm Drive Health Care District, (the "District") is a public entity organized under Local District Law as set forth in the Health and Safety Code of the State of California. The District is a political subdivision of the State of California and is generally not subject to federal or state income taxes. The District is governed by a five-member Board of Directors, elected from within the district to specified terms of office. The District is located in Sebastopol, California and operated a 37-bed acute care hospital. The District's mission is to provide health care services primarily to individuals who reside in the local geographic area.

NOTE 2 – BANKRUPTCY AND MANAGEMENT'S PLAN

Bankruptcy – By late March 2014, the District's financial circumstances had reached the point that the District was unable to pay all of its debts as they came due. The Board of Directors accordingly adopted a resolution on April 1, 2014, declaring a fiscal emergency under California Government Code Section 53760.5 and authorizing the Chief Executive Officer to cause the District to seek relief under the U.S. Bankruptcy Code. On April 7, 2014, the District filed a petition under Chapter 9 of the Bankruptcy Code. After a mandatory notice period for potential objections, none were received and the Bankruptcy Court determined that the District is eligible for relief under Chapter 9 and confirmed the validity of the District's bankruptcy petition.

To meet its immediate cash flow needs, the District obtained Bankruptcy Court approval for a loan of up to $1,600,000 (See Note 14) from the County of Sonoma. This interim financing is to be repaid in full, from parcel tax fund revenues not dedicated to bond payments, by December 31, 2014.

On April 28, 2014, the District closed the hospital and its emergency room. Thereafter the District has issued Requests for Proposal (RFP) from interested parties who might participate with the District in either resuming operation of the hospital, or offering a different scope of medical services to the residents of the District. The District continues to evaluate the proposals it received in response to the RFP.

With the approval of the Bankruptcy Court, in May-July 2014 the District rejected more than 200 contracts with suppliers and services providers. This step ended current payments on these contracts, but gives rise to claims in the bankruptcy case by the counterparties for contract rejection damages. These claims will be dealt with along with other creditor claims through the bankruptcy process.

The Bankruptcy Court set October 8, 2014, as the deadline for all creditors of the District to file claims for debts of the District. 181 claims have been filed to date, asserting claims amounting to $27,206,080. The validity and amounts of these claims are under review by the District. Through the bankruptcy process, invalid and/or overstated claims may be challenged by the District.

Committees representing general unsecured creditors, and former employees, have been appointed in the bankruptcy process. These two committees have each employed bankruptcy counsel to represent them in the case.

To exit from bankruptcy, the District needs to present a plan for adjustment of its debts that meets criteria under the Bankruptcy Code, and seek its confirmation by the Bankruptcy Court. As of this date a plan of adjustment has not been formulated, or presented to the Bankruptcy Court.

Management's plan –Management, in conjunction with director from the District Board, continues to focus upon the Chapter 9 bankruptcy process and work with all creditors to develop a plan to submit to the Bankruptcy court. This process will continue into the 2014-15 fiscal year. Management, by virtue of a District Board resolution, is negotiating with a community based group to develop a comprehensive plan and model that would lead to a re-opening of the hospital. Management does believe that the District has the ability, vision and resources to address the above actions and to remain an ongoing concern.

NOTE 3 – SIGNIFICANT ACCOUNTING POLICIES

Accounting standards – Pursuant to Government Accounting Standard Board ("GASB") Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 Financial Accounting Standards Board ("FASB") and AICPA Pronouncements*, the District's proprietary fund accounting and financial reporting practices are based on all applicable GASB pronouncements as well as codified pronouncements issued on or before November 30, 1989.

Proprietary fund accounting – The District utilizes the proprietary fund method of accounting whereby revenues and expenses are recognized on the accrual basis and financial statements are prepared using the economic resources measurement focus.

Use of estimates – The preparation of the financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenditures during the reporting period. Although management believes the estimates and assumptions are reasonable, they are based upon information available at the time the estimate or judgment is made and actual amounts could differ from those estimates.

Cash and cash equivalents – Cash and cash equivalents include deposits with financial institutions and investments in highly liquid debt instruments with an original maturity of three months or less. Cash and cash equivalents exclude amounts whose use is limited by board designation or by legal restriction.

Patient accounts receivable – Patient accounts receivable consist of amounts owed by various governmental agencies, insurance companies, and private patients. The District manages its receivables by regularly reviewing the accounts, inquiring with respective payors as to collectability, and providing for allowances on their accounting records for estimated contractual adjustments and uncollectible accounts. Significant concentrations of patient accounts receivable are discussed further in the footnotes.

Inventories – Inventories are consistently reported from year-to-year at cost determined by average costs and replacement values which are not in excess of market. The District does not maintain levels of inventory values such as those under a first-in, first out or last-in, first out method.

Assets limited to use – Assets limited to use are recorded at fair value, securities are generally valued at the last sale price on the last business day of the fiscal year, as quoted on a recognized exchange or utilizing an industry standard pricing service, when available. Assets limited to use include contributor restricted funds, amounts designated by the Board of Directors for replacement or purchases of capital assets, and other specific purposes, and amounts held by trustees under specified agreements. Assets limited to use consist primarily of short term money market funds and cash held with local banking and investment institutions.

Capital assets – Capital assets consist of property and equipment and are reported on the basis of cost, or in the case of donated items, on the basis of fair market value at the date of donation. Routine maintenance and repairs are charged to expense as incurred. Expenditures which increase values, change capacities, or extend useful lives are capitalized. Depreciation of property and equipment and amortization of property under capital leases are computed by the straight-line method for both financial reporting and cost reimbursement purposes over the estimated useful lives of the assets, which range from 10 to 30 years for buildings and improvements, and 3 to 15 years for equipment and software.

The District evaluates prominent events or changes in circumstances affecting capital assets to determine whether impairment of a capital asset has occurred. Impairment losses on capital assets are measured using the method that best reflects the diminished service utility of the capital asset. As of June 30, 2014, the District has determined that an information technology project was impaired. Given that the pause in the construction of this software is significant in duration, and the departure of the team working on this project management believes that the existing project in process has impaired utility.

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 medical malpractice. Commercial insurance coverage is purchased for claims arising from such matters.

Net position – Net position of the District are classified as invested in capital assets, net of related debt, restricted net assets, and unrestricted net assets.

> **Invested in capital assets, net of related debt** – 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 position** – Restricted net position have 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 position** – Unrestricted net position are the remainder that do not meet the definition of invested in capital assets, net of related debt or restricted.

Statements of revenues, expenses, and changes in net assets – For purposes of display, transactions deemed by management to be ongoing, major, or central to the provisions of health care services are reported as revenues and expenses. Peripheral or incidental transactions are reported as gains and losses. These peripheral activities include district tax revenues, investment income, interest expense, and grants, contributions and other and are reported as nonoperating.

Net patient service revenue and patient accounts receivable – Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered, and adjusted in future periods as final settlements are determined. The distribution of gross patient accounts receivable by payor at June 30, 2014 and 2013, is as follows:

	2014	2013
Medicare	16%	32%
Medi-Cal	26%	16%
Other third-party payors	38%	35%
Self-pay	20%	17%
	100%	100%

The distribution of gross patient revenues by payor for the 12 month periods ended June 30, 2014 and 2013, is as follows:

	2014	2013
Medicare	50%	50%
Medi-Cal	11%	8%
CMSP	5%	6%
Commercial	24%	22%
Workers' compensation	2%	7%
Other	5%	3%
Self-pay	3%	4%
	100%	100%

Uncollectible accounts – The District provides care to patients without requiring collateral or other security. Patient charges not covered by a third-party payor are billed directly to the patient if it is determined that the patient has the ability to pay. A provision for uncollectible accounts is recognized based on management's estimate of amounts that ultimately may be uncollectible.

District tax revenues – The District receives approximately 16% of its financial support from property taxes. These funds are used to support operations and meet required debt service agreements. They are classified as non-operating revenue as the revenue is not directly linked to patient care. Property taxes are levied by the County on the District's behalf during the year, and are intended to help finance the District's activities during the same year. Amounts are levied on the basis of the most current property values on record with the County. The County has established certain dates to levy, lien, mail bills, and receive payments from property owners during the year. Property taxes are considered delinquent on the day following each payment due date. For the years ended June 30, 2014 and 2013, district tax revenues included debt service on general obligation bonds of $397,993 and $421,226, debt service on parcel tax revenue bonds of $1,642,522 and $1,662,376, and an operating levy of $2,044,719 and $2,080,818.

Grants and contributions – From time to time, the District receives grants from various governmental agencies and private organizations. The District also receives contributions from related foundation and auxiliary organizations, as well as from individuals and other private organizations. Revenues from grants and contributions are recognized when all eligibility requirements, including time requirements are met. Grants and contributions may be restricted for either specific operating purposes or capital acquisitions.

Compensated absences – District 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. The accrued vacation liability as of June 30, 2014 and 2013 was $661,563 and $856,730, respectively.

WARN Act – The Worker Adjustment and Retraining Notification Act (WARN) protects workers, their families, and communities by requiring notification of 60 calendar days in advance of mass layoffs. The District had such an event occur during 2014 and accordingly has recognized a liability for payments to be made under the WARN act. Expense and the related liability are recognized as salaries and wages using the regular pay rates in effect at the statement of net position 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. The District accrued a WARN Act liability as of June 30, 2014, of $708,894 and it is included in accrued payroll and related liabilities.

Income taxes – The District operates under the purview of the Internal Revenue Code, Section 115, and corresponding California Revenue and Taxation Code provisions. As such, it is not subject to state or federal taxes on income. However, income from the unrelated business activities of the District may be subject to income taxes.

Restatement, **change in accounting principle** – The GASB issued GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities* ("GASB No. 65"), which is effective for financial statements for periods beginning after December 15, 2012. GASB No. 65 establishes accounting and financial reporting standards that reclassify, as deferred outflows of resources or deferred inflows of resources, certain items that were previously reported as assets and liabilities and recognizes, as outflows of resources or inflows of resources, certain items that were previously reported as assets and liabilities. It also provides other financial reporting guidance related to the impact of the financial statement elements deferred outflows of resources and deferred inflows of resources, such as changes in the determination of the major fund calculations and limiting the use of the term deferred in financial statement presentations.

The District has adopted this statement for the fiscal year ended June 30, 2014, and as a result, the financial statements presented herein have been restated retrospectively as follows:

	June 30, 2013		
	As previously Reported	**Adjustment**	**As Adjusted**
Net position, beginning of year	$ (6,509,107)	$ (1,243,957)	$ (7,753,064)
Total net deficit, end of year	$ (7,934,731)	$ (1,186,432)	$ (9,121,163)
Bond issue costs	$ 1,186,432	$ (1,186,432)	$ -
Total assets	$ 24,951,277	$ (1,186,432)	$ 23,764,845
Depreciation and amortization expense	$ 991,910	$ (57,525)	$ 934,385
Total operating expenses	$ 33,318,092	$ (57,525)	$ 33,260,567
Increase in deficit	$ (1,425,624)	$ 57,525	$ (1,368,099)

New accounting pronouncements – GASB issued GASB Statement No. 68, *Accounting and Financial Reporting for Pensions—an amendment of GASB Statement No. 27* ("GASB No. 68"), which is effective for financial statements for periods beginning after June 15, 2014. GASB No. 68 replaces the requirements of Statement No. 27, *Accounting for Pensions by State and Local Governmental Employers*, as well as the requirements of Statement No. 50, *Pension Disclosures*, as they relate to pensions that are provided through pension plans administered as trusts or equivalent arrangements (hereafter jointly referred to as trusts) that meet certain criteria. The requirements of Statements 27 and 50 remain applicable for pensions that are not covered by the scope of this Statement. It establishes standards for measuring and recognizing liabilities, deferred outflows of resources, and deferred inflows of resources, and expense/expenditures. For defined benefit pensions, this Statement identifies the methods and assumptions that should be used to project benefit payments, discount projected benefit payments to their actuarial present value, and attribute that present value to periods of employee service. Note disclosure and required supplementary information requirements about pensions also are addressed. The District is currently evaluating the impact of the adoption of GASB No. 68 for the fiscal year ending June 30, 2015.

GASB also issued GASB Statement No. 69, *Government Combinations and Disposals of Government Operations* ("GASB No. 69"), which is effective for financial statements for periods beginning after December 15, 2013. GASB No. 69 requires the use of carrying values to measure the assets and liabilities in a government merger. Conversely, government acquisitions are transactions in which a government acquires another entity, or its operations, in exchange for significant consideration. This Statement requires measurements of assets acquired and liabilities assumed generally to be based upon their acquisition values. It also provides guidance for transfers of operations that do not constitute entire legally separate entities and in which no significant consideration is exchanged. It defines the term operations for purposes of determining the applicability of this Statement and requires the use of carrying values to measure the assets and liabilities in a transfer of operations, and provides accounting and financial reporting guidance for disposals of government operations that have been transferred or sold. The District is currently evaluating the impact of the adoption of GASB No. 69 for the fiscal year ending June 30, 2015.

Reclassification – Certain amounts in the prior year financial statements have been reclassified to conform to the current year financial statement presentation. These reclassifications had no effect on change in deficit or total deficit for the year ended June 30, 2013.

NOTE 4 – CASH AND CASH EQUIVALENTS AND INVESTMENTS

As of June 30, 2014 and 2013, the District had deposits in various financial institutions of $709,971 and $591,939, respectively. All of these funds are in the form of cash and cash equivalents, which were collateralized in accordance with the California Government Code ("CGC"), except for $250,000 per account that is federally insured.

Under the provisions of the CGC, California banks and savings and loan associations are required to secure the District's deposits by pledging government securities as collateral. The market value of pledged securities must equal at least 110% of the District's deposits. California law also allows financial institutions to secure District deposits by pledging first trust deed mortgage notes having a value of 150% of the District's total deposits. The pledged securities are held by the pledging financial institution's trust department in the name of the District.

District investment policies allow investments in U.S. Government securities and state and local agency funds which invest in U.S. Government securities. These investments, when present, are stated at quoted market values. Changes in market value between years are reflected as a component of investment income in the accompanying statement of revenues, expenses, and changes in net position.

NOTE 5 – NET PATIENT SERVICE REVENUES

The District has agreements with third-party payors that provide for payments to the District 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. Medicare and Medi-Cal revenue accounts for over 50% of the District's gross patient revenues each year. Laws and regulations governing the Medicare and Medi-Cal programs are complex and subject to interpretation. The District 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 inquires 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 is as follows:

> **Medicare** – Payments for inpatient acute care services rendered to Medicare program beneficiaries are based on prospectively determined rates, which vary accordingly to the patient diagnostic classification system. Outpatient services are generally paid under an outpatient classification system subject to certain limitations. The District is, generally, not subject to cost reimbursable services. Certain reimbursement areas are still subject to final settlement determined after submission of annual cost reports and audits thereof by the Medicare fiscal intermediary. At June 30, 2014, cost reports through June 30, 2012, have been tentative or final settled.
>
> **Medi-Cal** – Prior to July 1, 2013, inpatient acute care services rendered to Medi-Cal program beneficiaries were reimbursed under a cost reimbursement methodology; however, the District is also subject to per discharge limits. The District was paid for cost reimbursable items at a tentative rate with final settlement determined after submission of annual cost reports and audits thereof by Medi-Cal. Medi-Cal cost reports have been audited through June 30, 2012. Per discharge limits have been determined by Medi-Cal through June 30, 2009, for the District. Beginning July 1, 2013, inpatient acute care services are rendered to Medi-Cal program beneficiaries under a diagnostic related group (DRG) methodology. Under this methodology, similar to Medicare, services are paid at prospectively determined rates per discharge according to a patient classification system that is based on clinical, diagnostic, and other factors. Inpatient skilled nursing care services rendered to Medi-Cal program beneficiaries are reimbursed at prospectively determined per diem rates. Outpatient services rendered to Medi-Cal program beneficiaries are reimbursed based on prospectively determined fee schedules.
>
> **Other** – Payments for services rendered to other than Medicare and Medi-Cal patients are based on established rates or on 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 year ended June 30, 2014 and 2013, are as follows:

	2014	2013
Daily routine acute and other inpatient services	$ 32,895,215	$ 47,952,024
Outpatient and professional services	45,117,166	45,641,601
Gross patient service revenues	78,012,381	93,593,625
Less contractual adjustments and provision for bad debts	(56,867,582)	(66,105,643)
Net patient service revenues	$ 21,144,799	$ 27,487,982

NOTE 6 – BOARD–DESIGNATED, RESTRICTED FUNDS AND OTHER LONG-TERM INVESTMENTS

As of June 30, 2014 and 2013, District investment balances and average maturities were as follows:

	2014		
		Maturities (in years)	
Type	Fair-Value	Less than 1	1 to 5
Short-term money market funds	$ 2,638,559	$ 2,638,559	$ -
Cash held by county	607,291	607,291	-
Total fair-value	$ 3,245,850	$ 3,245,850	$ -

	2013		
		Maturities (in years)	
Type	Fair-Value	Less than 1	1 to 5
Short-term money market funds	$ 2,858,225	$ 2,858,225	$ -
Cash held by county	569,944	569,944	-
Total fair-value	$ 3,428,169	$ 3,428,169	$ -

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. Management believes that there is minimal exposure related to cash held by the County for bond debt service requirements.

NOTE 7 – CAPITAL ASSETS

At June 30, 2014, capital assets were comprised of the following:

	Balance at June 30, 2013	Increases	Decreases, Transfers, and Retirements	Balance at June 30, 2014
Nondepreciable capital assets				
Land and land improvements	$ 5,876,900	$ -	$ -	$ 5,876,900
Construction work in progress	484,290	732,367	(1,216,657)	-
	6,361,190	732,367	(1,216,657)	5,876,900
Depreciable capital assets				
Land improvements	34,493	-	-	34,493
Buildings and improvements	4,312,855	-	252,521	4,565,376
Property under capital leases	2,554,802	647,099	-	3,201,901
Equipment and software	7,665,405	56,451	124,316	7,846,172
	14,567,555	703,550	376,837	15,647,942
Less accumulated depreciation	(7,479,572)	(1,453,217)	-	(8,932,789)
Capital assets, net	$ 13,449,173	$ (17,300)	$ (839,820)	$ 12,592,053

At June 30, 2013, capital assets were comprised of the following:

	Balance at June 30, 2012	Increases	Decreases, Transfers, and Retirements	Balance at June 30, 2013
Nondepreciable capital assets				
Land and land improvements	$ 5,876,900	$ -	$ -	$ 5,876,900
Construction work in progress	120,777	1,540,750	(1,177,237)	484,290
	5,997,677	1,540,750	(1,177,237)	6,361,190
Depreciable capital assets				
Land improvements	34,493	-	-	34,493
Buildings and improvements	4,120,119	-	192,736	4,312,855
Property under capital leases	1,318,445	1,236,357	-	2,554,802
Equipment and software	6,490,994	189,910	984,501	7,665,405
	11,964,051	1,426,267	1,177,237	14,567,555
Less accumulated depreciation	(6,545,186)	(934,386)	-	(7,479,572)
Capital assets, net	$ 11,416,542	$ 2,032,631	$ -	$ 13,449,173

Total depreciation expense related to capital leases totaled $844,491 and $350,719 for the years ended June 30, 2014 and 2013, respectively. As of June 30, 2014 and 2013, accumulated depreciation related to capital leases was $1,284,228 and $439,736, respectively.

NOTE 8 – MEDICAL MALPRACTICE AND WORKERS' COMPENSATION COVERAGE AND CLAIMS

The District has joined together with other providers of health care services to form Beta Healthcare Group ("Beta"), a public entity risk pool (the "Pool") currently operating as a common risk management and insurance program for its members. The District has purchased an extended coverage period medical malpractice insurance policy from the Pool. It is a claims-occurred policy with limits of $10 million per occurrence, $10 million in the annual aggregate, and with a self-insured retention level of $0 per claim reporting period that extends into perpetuity. This does not cover claims occurring after June 30, 2014. The Pool's governing agreements specify that the Pool will be self-sustaining through member premiums and will reinsure through commercial carriers for claims in excess of stop-loss amounts.

The District also purchases workers' compensation insurance from Alpha Fund, a California self-insured workers' compensation pool, dedicated to public and non-profit health care organizations. The District purchases workers' compensation insurance under a claims-made policy with limits of $1 million per occurrence and $1 million in the annual aggregate.

Based upon the District's claims experiences, the District has estimated that no accrual is necessary as of June 30, 2014 and 2013, for accrued malpractice and workers' compensation costs.

NOTE 9 – BONDS PAYABLE

At June 30, 2014 and 2013, bonds payable were as follows:

	2014	2013
Health Care District Insured General Obligation Bonds, Series 2000; interest rates ranging from 4.7% to 8.0%; principal due each August 1; interest due semi-annually each February 1 and August 1; final due in 2030; repayments through collection of County property taxes.	$ 4,675,000	$ 4,830,000
Parcel Tax Revenue Bonds, Series 2005; interest ranging from 3.0% to 4.6%; principal due each April 1; interest due semi-annually each April 1, and October 1; final due in 2024; secured by parcel property taxes.	7,330,000	7,640,000
Parcel Tax COPs, Series 2010; interest ranging from 7.0% to 7.5%; principal due each April 1; interest due semi-annually each April 1, and October 1; final due in 2035; secured by parcel property taxes.	10,260,000	10,470,000
	22,265,000	22,940,000
Less current maturities of bonds payable.	(715,000)	(675,000)
	$ 21,550,000	$ 22,265,000

Debt service requirements for bonds payable are as follows at June 30, 2014:

	General Obligation Bonds		Revenue Bonds and COPs	
Year Ending June 30,	Principal	Interest	Principal	Interest
2015	$ 165,000	$ 241,224	$ 550,000	$ 1,094,517
2016	175,000	232,703	575,000	1,064,190
2017	185,000	223,510	610,000	1,032,003
2018	200,000	213,390	640,000	1,000,137
2019	210,000	202,530	675,000	964,817
2020-2024	1,250,000	820,815	3,995,000	4,207,413
2025-2029	1,675,000	419,293	5,320,000	2,854,727
2030-2034	815,000	26,348	4,315,000	1,175,138
2035-2038	-	-	910,000	51,189
	$ 4,675,000	$ 2,379,813	$ 17,590,000	$ 13,444,131

The following tables summarize the District's bonds long-term debt transactions for the years ended June 30, 2014 and 2013:

	2014				
	Balance June 30, 2013	**Increases During Year**	**Decreases During Year**	**Balance June 30, 2014**	**Current Portion**
Bonds payable					
Series 2000 General Obligation Bonds	$ 4,830,000	$ -	$ (155,000)	$ 4,675,000	$ 165,000
Series 2005 Parcel Tax Revenue Bonds	7,640,000	-	(310,000)	7,330,000	325,000
Series 2010 Parcel Tax COPs	10,470,000	-	(210,000)	10,260,000	225,000
Capital lease obligations	2,130,838	647,099	(855,910)	1,922,027	682,245
	$ 25,070,838	$ 647,099	$ (1,530,910)	$ 24,187,027	$ 1,397,245

	2013				
	Balance June 30, 2012	**Increases During Year**	**Decreases During Year**	**Balance June 30, 2013**	**Current Portion**
Bonds payable					
Series 2000 General Obligation Bonds	$ 4,980,000	$ -	$ (150,000)	$ 4,830,000	$ 155,000
Series 2005 Parcel Tax Revenue Bonds	7,940,000	-	(300,000)	7,640,000	310,000
Series 2010 Parcel Tax COPs	10,665,000	-	(195,000)	10,470,000	210,000
Notes payable	-	455,169	(455,169)	-	-
Capital lease obligations	1,210,751	1,236,357	(316,270)	2,130,838	1,129,117
	$ 24,795,751	$ 1,691,526	$ (1,416,439)	$ 25,070,838	$ 1,804,117

NOTE 10 – CAPITAL LEASE OBLIGATIONS

Capital lease obligations outstanding as of June 30, 2014 and 2013, are as follows:

Description	**Maturity**	**Interest Rates**	**Original Issue**	**June 30, 2014**	**June 30, 2013**
Capital leases - equipment net of interest	July 2014 - July 2018	4.15% - 8.30%	$ 3,314,670	$ 1,922,027	$ 2,130,838
Less current portion				(682,245)	(1,129,117)
				$ 1,239,782	$ 1,001,721

Description	June 30, 2013	Increases	Decreases	Outstanding June 30, 2014
Capital lease - equipment	$ 2,130,838	$ 647,099	$ (855,910)	$ 1,922,027

Description	June 30, 2012	Increases	Decreases	Outstanding June 30, 2013
Capital lease - equipment	$ 1,210,751	$ 1,236,357	$ (316,270)	$ 2,130,838

Debt service requirements for capital lease obligations are as follows:

Year Ending June 30,		
2015	$	682,245
2016		350,410
2017		327,334
2018		304,590
2019		136,664
2020 - 2024		333,734
Less interest		(212,950)
		1,922,027
Less current portion		(682,245)
	$	1,239,782

NOTE 11 – RELATED PARTY TRANSACTIONS

Palm Drive Health Care Foundation – The Palm Drive Health Care Foundation, formerly the West County Health Care Foundation (the "Foundation"), has been established as a nonprofit public benefit corporation under the Internal Revenue Code Section 501(c)(3) to focus on activities which contribute to the health status of residents in Sebastopol and western Sonoma County. The Foundation periodically accepts donations and raises funds to support the District and makes distributions to the District in amounts and for purposes determined by the Foundation's Board of Trustees and in accordance with any specific donor restrictions. 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.

Contracted physician – On September 4, 2012, the District executed a physician recruitment agreement (the "Agreement") with a contracted physician (the "Physician"). In conjunction with the Agreement, the District provides a practice loan not to exceed $1,100,000 to the Physician for the two years of assistance period. The loan advances are based on the practice expenses plus the guaranteed monthly payment of $45,833, less the practice's revenue. The loan bears an annual interest rate of prime rate plus 2%. As of June 30, 2014, the interest rate is 5.25%. The loan is payable in 60 equal monthly installments starting on September 4, 2014. The District forgives the interest on each month when the physician complies with all terms of the agreement during the assistance period. Subsequent to the assistance period, the District will forgive the principal and interest due each month when the physician complies with all terms of the agreement. As of June 30, 2013, the balance of the note receivable was $456,172. As of June 30, 2014, the District determined that compliance with all of the terms of the agreement by the District is doubtful and has fully reserved for the outstanding gross balance of $754,513.

Lessee – On February 1, 2013, a California nonprofit public benefit corporation (the "lessee") entered into lease agreements with the District to sublease its clinic and lease its equipment. The clinic is leased for $1,187 per month plus the lessee's share of operating expenses until July 31, 2016. The equipment is leased for $813 per month for 2 years and month-to-month for up to six months subsequent to the initial term. Rental income including both clinic and equipment for the year ended June 30, 2014 and 2013, totaled $101,720 and $58,286, respectively. The rental income is included in the other nonoperating revenues and expenses in the statement of revenues, expenses, and changes in net position for the year ended June 30, 2014 and 2013. On the same day, the District entered into a funding agreement to assist the lessee with the clinic's operations for a period of time. The District pays the lessee $22,000 per month at the beginning of February 1, 2013 until January 1, 2015. These payments to the lessee by the District will be repaid only upon dissolution of the lessee and the distribution of its assets. These payments are included in the other nonoperating expenses in the statement of revenues, expenses, and changes in net position for the year ended June 30, 2013. Moreover, the District executed a $160,000 promissory note with the lessee on February 1, 2013. The note bears an annual interest rate of 6%. The note will be payable beginning August 2015 and will be repaid from the future profits of the clinic. Interest income is not accrued since the accrued interest will be forgiven on each anniversary of the note when the lessee complies with the terms of the Funding Agreement. As of June 30, 2014 and 2013, the balance of the note is $160,000.

NOTE 12 – COMMITMENTS AND CONTINGENCIES

Litigation – The District may from time-to-time be involved in litigation and regulatory investigations which arise in the normal course of doing business. While the ultimate liabilities cannot now be determined due to uncertainties that exist, management believes the ultimate resolution of these lawsuits and claims will not have a material effect on the District's financial position.

Operating leases – The District leases various equipment and facilities under operating leases expiring at various dates. Total building and equipment rent expense for the year ended June 30, 2014 and 2013, was $290,459 and $341,752. Future minimum lease payments for the succeeding years under operating leases at June 30, 2013, that have initial or remaining lease terms in excess of one year are not considered material.

Regulatory environment – The health care industry is subject to numerous laws and regulations of federal, state, and local governments. These laws and regulations include, but are not necessarily limited to, matters such as licensure, accreditation, government health care program participation requirements, reimbursement for patient services, and Medicare and Medi-Cal fraud and abuse. Recently, government activity has increased with respect to investigations and allegations concerning possible violations of fraud and abuse statutes and regulations by health care providers. The District is subject to routine surveys and reviews by federal, state, and local regulatory authorities. The District has also received inquiries from health care regulatory authorities regarding its compliance with laws and regulations. Although the District's management is not aware of any violations of laws and regulations, it has received corrective action requests as a result of completed and on-going surveys from applicable regulatory authorities. Management continually works in a timely manner to implement operational changes and procedures to address all corrective action requests from regulatory authorities. Breaches of these laws and regulations and non-compliance with survey corrective action requests could result in expulsion from government health care programs together with the imposition of significant fines and penalties, as well as significant repayments for patient services previously billed. Compliance with such laws and regulations can be subject to future government review and interpretation, as well as regulatory actions unknown or unasserted at this time.

NOTE 13 – EMPLOYEE BENEFIT PLANS

The District maintains a 401(a) defined contribution retirement plan (the "401(a) Plan") on a calendar year-end that covers all employees by a collective bargaining agreement and all non-benefited employees who are 21 years of age and have completed one year of credited service. The Plan provides for contributions up to $40,000 or 100% of eligible participants' annual compensation, if less. The District's contribution is discretionary. Eligible employer contributions are 100% vested.

The District maintains a 457(b) defined contribution retirement plan (the "457(b) Plan") on a calendar year-end that covers all employees not participating in the 401(a) Plan who are 21 years of age and have completed three months of employment. The Plan provides for contributions up to $15,000. Under the Plan, the District matches 100% of employee contributions up to 3% of an employee's compensation. The District's contribution is discretionary. Eligible employer contributions are 100% vested.

For the years ended June 30, 2014 and 2013, total employer contributions for both retirement plans were $42,947 and $187,487, respectively.

NOTE 14 – SUBSEQUENT EVENTS

In April 2014, the District obtained a short-term operating cash loan of $1,600,000 from the County of Sonoma that was approved by the bankruptcy court. This interim financing was funded in July 2014 for $1,200,000 and was repaid in full in January 2015 from parcel tax fund revenues not dedicated to bond payments at 0% interest plus fees of $16,590.

In September 2014, the District terminated the 457(b) Plan.

In October 2014, the District amended a capital lease agreement to extend the payment terms, while not altering the overall balance. The annual payment had been $961,692 and the new annual payment is $121,665, at an interest rate of 4.15% until the amount is repaid.

In October 2014, the District received a request for repayment from the Centers for Medicare and Medicaid Services of a Health Information Technology for Economic and Clinical Health incentive in the amount of $1,154,510. The District appealed this request for repayment in November 2014. The District has accrued for this overpayment incentive expense in the accompanying financial statements for the year ended June 30, 2014.