Report of Independent Auditors and
Financial Statements with
Supplementary Information

Palm Drive Health Care District

Year Ended June 30, 2015

MOSS-ADAMS LLP
Certified Public Accountants | Business Consultants

CONTENTS

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 year ended June 30, 2015 and 2014, respectively. It should be read in conjunction with the accompanying financial statements and footnotes of the District.

During fiscal year 2014 the District was under significant economic stress. This was caused by a significant decline in patient volumes and specifically commercial patient volumes and the irregular postings of projected accounts receivable. The decision was made in March and April of 2014 to seek relief under Chapter 9 of the U.S. Bankruptcy code, and to close the hospital and the emergency room.

From April of 2014 through the 2015 fiscal year the hospital remained closed. The District remained in Chapter 9 Bankruptcy and through February of 2016 has not submitted a plan to the Bankruptcy court for approval. This means that there are no patient services revenues being generated during 2015, though there are changes in prior estimates which effect the period. There are also significantly less staffing costs as the District operated for most of fiscal year 2015 with eight or less employees. There were significant legal costs incurred in the bankruptcy process.

During the 2015 fiscal year the District solicited and considered plans from several organizations to help the District fulfill its mission of providing healthcare to its constituents. In March of 2015 it entered a Management and Staffing Service Agreement with Sonoma West Medical Center Inc. (SWMC), whereby SWMC would re-open the hospital, retain and employ staff, and provide management services for the hospital. The hospital was renamed Sonoma West Medical Center and was re-opened on October 30, 2015.

In addition, the District did not know how to structure the bankruptcy plan until we were sure that SWMC had reopened or was going to open. The new entity was confident it would open by summer 2015 but this was delayed until October 31, 2015.

SWMC is a separate 501(c)(3) organization which has not been included in the reporting entity of the District for the fiscal year ended June 30, 2015, but will be included as of July 1, 2015, as a blended component unit of the District.

Financial Highlights

Year Ended June 30, 2015

- Total assets decreased by approximately $3,205,000 from June 2014.
- Total cash and equivalents decreased by approximately $390,000 from June 2014.
- Patient accounts receivable decreased by approximately $770,000 from June 2014.
- Current assets decreased by approximately $1,442,000 from June 2014, while current liabilities decreased by approximately $1,252,000 during that same period.
- Long-term capital assets decreased by approximately $1,767,000 from June 2014, while long-term debt increased by approximately $1,535,000 during that same period.
- The increase in net deficit was approximately $418,000 for the year ended June 30, 2014.

Year Ended June 30, 2014

- Total assets decreased by approximately $5,910,000 from June 2013.
- Total cash and equivalents decreased by approximately $319,000 from June 2013.
- Patient accounts receivable decreased by approximately $3,150,000 from June 2013.
- Current assets decreased by approximately $4,229,000 from June 2013, while current liabilities increased by approximately $3,503,000 during that same period.
- Long-term capital assets increased by approximately $675,000 from June 2013, while long-term debt decreased by approximately $122,000 during that same period.

- The increase in net deficit was approximately $8,305,000 for the year ended June 30, 2014.

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 year ended June 30, 2015. The audited financial statements include the report of the independent auditors, statement of revenues, expenses and changes in net assets, 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, 2015 and 2014.

- The statements of revenues, expenses and changes in net position present the operating activities of the District during the year ended June 30, 2015.

- 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, 2015, the District's cash and cash equivalents totaled approximately $320,000 compared to approximately, $710,000 at June 2014. At June 30, 2015, days of operating cash on hand were approximately 37.0 as compared to 7.9 at June 2014. 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, 2015, current assets decreased by approximately $3,205,000 with decreases in patient accounts receivable of approximately $770,000 and a decrease in cash and cash equivalents of approximately $390,000. Current liabilities decreased by approximately $1,252,000 due mainly to a decrease of approximately $776,000 in accounts payable and accrued expenses, and a decrease of approximately $112,000 in accrued payroll and related 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 a decrease 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 accrued expenses and a decrease of approximately $77,000 in accrued payroll and related liabilities.

The current ratio at June 30, 2015, is 0.05 compared to 0.24 at June 2014.

Capital Assets

During the fiscal year ended June 30, 2015, the District divested assets of approximately $715,000 through the return of leased equipment as compared to the years ending June 2014, where the District recorded impairment for Equipment of $715,000. However, the divestment during fiscal year June 30, 2015, did not lower capital lease obligations due to bankruptcy court constraints contrasting fiscal year 2014.

Long-Term Debt and District Tax Revenues

During the fiscal year ending June 30, 2015, the District stopped making payments on most capital leases in effect at July 20, 2014, which resulted in one lessee physically removing some equipment. Again, the long-term debt during fiscal year ending June 30, 2015, was unchanged due to bankruptcy court constraints, which makes it significantly lower than the decrease in long-term debt during fiscal year 2014. During the year ended June 30, 2015, the total tax collections from the District totaled $4,132,780 as compared to $4,085,234 in 2014. These collections service the debt obligations for bond issues totaling $21,550,000 and $22,265,000 in principal as of June 30, 2015 and 2014, respectively.

Volumes

There were no patient days reported for the year ended June 30, 2015, as compared to 2,514 for the year ended June 30, 2014. There were no ER visits for the year ended June 30, 2015, as compared to 4,358 for the year ended June 30, 2014.

Gross Patient Charges

The District charges all its patients equally based on its established pricing structure for the services rendered. However, the District did not provide services to patients during the fiscal year ended June 30, 2015. The reported revenues represent collections on accounts receivable of approximately $221,000 that had been written off in previous years, payments by the Department of Health Care Services ("DHCS") of approximately $66,500 and Partnership Health Plan of approximately $315,000 for uncompensated care provided in fiscal year 2014 under the Assembly Bill 915 program, and payments by the DHCS of approximately $182,000 for Medicaid safety net care provided in fiscal year 2014 under the Assembly Bill 113 Intergovernmental Transfer program.

These results contrast dramatically with inpatient gross service charges of approximately $32,895,000 for the year ended June 30, 2014, as well as outpatient gross service charges of approximately $45,117,000 for the year ended June 30, 2014.

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 HMO-based payers such as Blue Shield and Aetna.

Since the District did not provide services to patients and reported no inpatient or outpatient revenues for the year ended 2015, there were also no deductions from revenue for the fiscal year. These results contrast dramatically with the deductions from revenue (in aggregate and as a percentage of gross patient services charges) of approximately $56,868,000 and 69.0% for the fiscal year ending June 30, 2014.

Net Patient Revenues

Net patient service revenues are the resulting difference between gross patient charges and the deductions from revenue. Net patient service revenues were approximately $803,000 for the year ended June 30, 2015, as compared to $21,145,000 for fiscal year ending June 30, 2014.

Operating Expenses

Total operating expenses were approximately $5,409,354 for the fiscal year ending June 30, 2015, as compared to $32,598,000 for fiscal year ending June 30, 2014. The net decrease from fiscal year ended June 30, 2014, was approximately $27,179,000. The significant changes were:

- Labor-related expenses (salaries and wages, employee benefits and contract labor) decreased from 2014 by approximately $14,500,000 due primarily to the hospital closing and the laying off of staff.

- Supplies expense decreased by approximately $4,194,000 due primarily to the hospital closing and the winding down of patient care activities in late 2014.

- Contract labor, physician fees and various other expenses decreased by approximately $5,515,000 due primarily to the hospital closing and the winding down of patient care activities.

Economic Factors

The current fiscal year saw a surge in community support for reopening an acute health care facility for the community. Through significant voluntary donations of cash and services, a new hospital opened in October 2015 under the name of Sonoma West Medical Center. The District Board of Directors holds five (5) of eleven (11) seats on the hospital's Governing Board.

The District remains in Chapter 9 bankruptcy proceedings for the foreseeable future. However, it continues as a going concern through its ability to levy a parcel tax, allowing it to continue to meet all of its regulatory covenants.

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 statement of net position as of June 30, 2015, and the related statement of revenues, expenses, and changes in net position, and cash flows for the year 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. 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, 2015, and the changes in its net position and its cash flows for the year 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 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.

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
April 12, 2016

FINANCIAL STATEMENTS

STATEMENT OF NET POSITION
June 30, 2015

		2015
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	$	319,799
Restricted trust funds available for current debt service		1,118,321
Property taxes receivable		181,219
Prepaid expenses and deposits		50,100
Total current assets		1,669,439
NONCURRENT INVESTMENTS		
Funds held by county for bond debt service		359,802
Funds held by trustee under bond requirements		1,791,978
Designated by the board or agreements for specific purposes		2,551
		2,154,331
Related party notes receivable		1,538
Capital assets, net of accumulated depreciation		10,824,729
Total assets	$	14,650,037
LIABILITIES AND NET POSITION		
CURRENT LIABILITIES		
Accounts payable and accrued expenses	$	7,095,319
Accrued payroll and related liabilities		1,309,993
Accrued interest payable		368,321
Estimated third party payor settlements		327,099
Unearned property tax revenues		635,037
Current portion of capital lease obligations		1,383,889
Current portion of bonds payable		750,000
Total current liabilities		11,869,658
Capital lease obligations, net of current portion		454,870
Bonds payable, net of current portion		20,800,000
Total liabilities		33,124,528
NET POSITION		
Restricted, by bond indenture agreements and other		3,270,101
Unrestricted (deficit)		(21,744,592)
Total net deficit		(18,474,491)
Total liabilities and net position	$	14,650,037

See accompanying notes.

	2015
OPERATING REVENUES	
EHR incentive revenue	$ 1,154,510
Medi-Cal supplemental reimbursement	381,992
Inter-governmental transfer revenue	181,921
Other operating revenue	116,278
Total operating revenues	1,834,701
OPERATING EXPENSES	
Salaries and wages	433,026
Employee benefits	51,960
Professional fees	724,775
Supplies	140,273
Purchased services	973,922
Utilities and phone	224,368
Repairs and maintenance	119,692
Rents and leases	48,662
Insurance	323,380
Depreciation	1,537,718
Impairment of equipment	714,925
Other operating expenses	116,653
Total operating expenses	5,409,354
OPERATING LOSS	(3,574,653)
NONOPERATING REVENUES AND (EXPENSES)	
District tax revenues	4,132,780
Investment income(expense), net	(962)
Interest expense	(1,368,879)
Other income	393,909
Total nonoperating revenues	3,156,848
INCREASE IN DEFICIT	(417,805)
NET POSITION, beginning of the year	(18,056,686)
NET POSITION, end of the year	$ (18,474,491)

See accompanying notes.

		2015
CASH FLOWS USED IN OPERATING ACTIVITIES		
Cash received from patients and third-parties on behalf of patients	$	864,888
Cash received from operations, other than patient services		2,106,327
Cash payments to suppliers and contractors		(4,611,132)
Cash payments to employees and benefit programs		(596,714)
Net cash from operating activities		(2,236,631)
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
District tax revenues		2,059,420
Grants, contributions and other		393,909
Net cash from noncapital financing activities		2,453,329
CASH FLOWS USED IN CAPITAL AND RELATED FINANCING ACTIVITIES		
District tax revenues		2,073,360
Purchase of capital assets		(485,319)
Principal payments on capital lease obligations		(83,268)
Principal payments on bonds payable		(715,000)
Interest payments on debt borrowings		(1,368,879)
Net cash from capital and related financing activities		(579,106)
CASH FLOWS USED IN INVESTING ACTIVITIES		
Purchases of (proceeds from) sale of investments		(26,802)
Interest and dividends received from investments		(962)
Net cash from investing activities		(27,764)
NET CHANGE IN CASH AND CASH EQUIVALENTS		(390,172)
CASH AND CASH EQUIVALENTS, beginning of the year, as restated		709,971
CASH AND CASH EQUIVALENTS, end of the year	$	319,799

See accompanying notes.

		2015
RECONCILIATION OF OPERATING LOSS TO NET CASH FROM OPERATING ACTIVITIES		
Operating loss	$	(3,574,653)
Adjustments to reconcile operating loss to net cash used in operating activities:		
Depreciation		1,537,718
Impairment of imaging equipment		714,925
Changes in operating assets and liabilities:		
Patient accounts receivable		770,415
Property taxes receivable		(34,035)
Prepaid expenses and deposits		15,940
Related party notes receivable		8,634
Accounts payable and accrued expenses		(775,772)
Accrued payroll and related liabilities		(111,728)
Accrued interest		(20,813)
Estimated third party payor settlements		(795,008)
Unearned property taxes		27,746
Net cash from operating activities	$	(2,236,631)

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.

The District has signed a Management and Staffing Service Agreement ("MSA") with Sonoma West Medical Center ("SWMC") on March 18, 2015, and amended May 22, 2015. This agreement calls for SWMC to operate the hospital facility on behalf of the District, and for the District to provide $1,000,000 to augment the operations of the hospital that SWMC will be operating. Specifically, the funding is to be used to maintain hospital property, purchase or repair equipment and to subsidize charity care and programs that benefit the community. The MSA creates a governing board which will oversee the operations of the hospital. This governing board is a subcommittee of the District, with representation from SWMC and participating physicians.

Management has determined that the District will include SWMC as a component unit of its reporting entity. The inclusion of SWMC will begin on July 1, 2015. Management does not believe that the omission of SWMC from the operations of 2015 and ending net assets of 2015 has a material effect on the District. See the subsequent events Note 13 for more information on what happened after year end with the hospital and SWMC.

NOTE 2 – SUBSEQUENT EVENTS

On July 1, 2015, the District began including SWMC in the results of its operations as a component unit. The hospital was reopened on October 30, 2015, under the MSA as operated by Sonoma West Medical Center. The name of the hospital was changed to Sonoma West Medical Center. On December 17, 2015, the hospital received its Medicare certification. The District has purchased approximately $600,000 in equipment for the hospital.

The District also provided $522,730 to SWMC to complete OSHPD projects that that were necessary for licensure and the reopening of the hospital.

SWMC has faced financial difficulties while operating a hospital without being able to bill and collect from Medicare and certain commercial payors. In January 2016, in accordance with the MSA Article 5.4, the District provided SWMC a $600,000 tranche from the property taxes received in December. On February 5, 2016, the District then loaned $400,000 to SWMC at 4% interest for 90 days and collateralized by SWMC's patient accounts receivable. The hospital has also sought outside gifts and other borrowings to finance its operations during this time period.

NOTE 3 – 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.

On April 28, 2014, the District closed the hospital and its emergency room. Thereafter the District had 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 accepted a proposal from Sonoma West Medical Center to reopen and operate an acute care community hospital. A Management and Staffing Service Agreement was formulated and signed March 18, 2015.

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, and gave 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. There have been 181 claims 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 have been challenged by the District.

Committees representing general unsecured creditors, and former employees, have been appointed in the bankruptcy process.

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 presented to the Bankruptcy Court. It is anticipated that the bankruptcy plan will be completed and presented to the Bankruptcy Court in 2016.

Management's plan – Management, in conjunction with District Board direction, continues to focus upon the bankruptcy process and working with all creditors to develop a plan to submit to the Bankruptcy court. This process will continue into the 2015 and 2016 fiscal years. Management, by virtue of a District Board resolution, negotiated with SWMC to develop a comprehensive plan and model to reopen and manage the hospital. The MSA was signed March 18, 2015, that facilitated the re-opening of the hospital on October 30, 2015, as Sonoma West Medical Center.

NOTE 4 – 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.

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.

District tax revenues – The District receives the majority of its financial support from property taxes. These funds are used to support operations and meet required debt service agreements. They are classified as nonoperating 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 year ended June 30, 2015, district tax revenues included debt service on general obligation bonds of $430,838, debt service on parcel tax revenue bonds of $1,642,522, and an operating levy of $2,057,491.

EHR incentive revenue – The District participates in electronic health record ("EHR") incentive programs. The District recognized an accrued liability of $1,154,510 as of June 30, 2014, that was included as an EHR incentive expense in the year ended June 30, 2014, as a result of a demand letter received from Centers for Medicare and Medicaid Services ("CMS"). CMS reversed its decision upon successful appeal from the District and during the year ended June 30, 2015, the EHR incentive revenue of $1,154,510 was recognized as a result of the cancelation of the accrued liability.

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, 2015, was $590,382.

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 of $708,894 as of June 30, 2015, 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.

New accounting pronouncements –

GASB Statement No. 72 – *Fair Value Measurement and Application* – The provisions of GASB Statement No. 72 are effective for financial statements beginning after June 15, 2015. The District has not made an assessment of any changes that will occur upon this statement's implementation.

GASB Statement No. 74 – *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans* – The provisions of GASB Statement No. 74 are effective for financial statements beginning after June 15, 2016. The District has not made an assessment of any changes that will occur upon this statement's implementation.

GASB Statement No. 75 – *Accounting and Financial Reporting for Postemployment Benefit Plans Other Than* Pensions – The provisions of GASB Statement No. 75 are effective for financial statements beginning after June 15, 2016. The District has not made an assessment of any changes that will occur upon this statement's implementation.

GASB Statement No. 76 – *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments* – The provisions of GASB Statement No. 76 are effective for financial statements beginning after June 15, 2015. The District has not made an assessment of any changes that will occur upon this statement's implementation.

GASB Statement No. 77 – *Tax Abatement Disclosures* – The provisions of GASB Statement No. 77 are effective for financial statements beginning after December 15, 2015. The District has not made an assessment of any changes that will occur upon this statement's implementation.

GASB Statement No. 80 – *Blending Requirements* – The provisions of GASB Statement No 80 are effective for financial statements beginning after June 30, 2015. The District has not made an assessment of any changes that will occur upon this statement's implementation.

NOTE 5 – CASH AND CASH EQUIVALENTS AND INVESTMENTS

As of June 30, 2015, the District had deposits in a financial institution of $319,799. 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 6 – BOARD–DESIGNATED, RESTRICTED FUNDS AND OTHER LONG-TERM INVESTMENTS

As of June 30, 2015, District investment balances and average maturities were as follows:

	2015		
		Maturities (in years)	
Type	Fair-Value	Less than 1	1 to 5
Short-term money market funds	$ 2,637,615	$ 2,637,615	$ -
Cash held by county	635,037	635,037	-
Total fair-value	$ 3,272,652	$ 3,272,652	$ -

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, 2015, capital assets were comprised of the following:

	Balance at June 30, 2014	Increases	Decreases	Balance at June 30, 2015
Nondepreciable capital assets				
Land and land improvements	$ 5,876,900	$ -	$ -	$ 5,876,900
Construction work in progress	-	485,319	-	485,319
	5,876,900	485,319	-	6,362,219
Depreciable capital assets				
Land improvements	34,493	-	-	34,493
Buildings and improvements	4,565,376	-	-	4,565,376
Property under capital leases	3,201,901	-	-	3,201,901
Equipment and software	7,846,172	-	(2,398,498)	5,447,674
	15,647,942	-	(2,398,498)	13,249,444
Less accumulated depreciation	(8,932,789)	(1,537,718)	1,683,573	(8,786,934)
Capital assets, net	$ 12,592,053	$ (1,052,399)	$ (714,925)	$ 10,824,729

Total depreciation expense related to capital leases totaled $808,900 for the year ended June 30, 2015. As of June 30, 2015, accumulated depreciation related to capital leases was $6,020. Equipment and software, related to capital leases, with a cost basis of $1,434,498 and no net book value, were taken back by the lessor as of June 30, 2015. A piece of imaging equipment with a net book value of $714,925 was taken back by the lessor and as such this was recognized as impairment of equipment for the year ended June 30, 2015.

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, $20 million in 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, 2015, but it does insure for claims made after that date, arising before that date, when the hospital was operating. 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. The District also purchases excess insurance coverage up to $2 million per occurrence or statutory limits.

Based upon the District's claims experiences, the District has estimated that no accrual is necessary as of June 30, 2015, for accrued malpractice and workers' compensation costs.

NOTE 9 – BONDS PAYABLE

At June 30, 2015, bonds payable were as follows:

		2015
Health Care District Insured General Obligation Bonds, Series 2000; interest rates ranging from 4.5% 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.	$	4,510,000
Parcel Tax Revenue Bonds, Series 2005; interest ranging from 3.25% to 5.25%; principal due each April 1; interest due semi-annually each April 1, and October 1; final due in 2024; secured by parcel property taxes.		7,005,000
Parcel Tax Certificates of Participation ("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.		10,035,000
		21,550,000
Less current maturities of bonds payable.		(750,000)
	$	20,800,000

Debt service requirements for bonds payable are as follows at June 30, 2015:

	General Obligation Bonds		Revenue Bonds and COPs	
Year Ending June 30,	**Principal**	**Interest**	**Principal**	**Interest**
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	220,000	190,930	715,000	927,163
2021-2025	1,325,000	749,744	4,220,000	3,978,230
2026-2030	1,775,000	323,892	5,655,000	2,519,587
2031-2035	420,000	1,890	3,950,000	863,487
	$ 4,510,000	$ 2,138,589	$ 17,040,000	$ 12,349,614

The following tables summarize the District's bonds long-term debt transactions for the year ended June 30, 2015:

	2015				
	Balance June 30, 2014	**Increases During Year**	**Decreases During Year**	**Balance June 30, 2015**	**Current Portion**
Bonds payable					
Series 2000 General Obligation Bonds	$ 4,675,000	$ -	$ (165,000)	$ 4,510,000	$ 175,000
Series 2005 Parcel Tax Revenue Bonds	7,330,000	-	(325,000)	7,005,000	335,000
Series 2010 Parcel Tax COPs	10,260,000	-	(225,000)	10,035,000	240,000
Capital lease obligations	1,922,027	-	(83,268)	1,838,759	1,383,889
	$ 24,187,027	$ -	$ (798,268)	$ 23,388,759	$ 2,133,889

NOTE 10 – CAPITAL LEASE OBLIGATIONS

Capital lease obligations outstanding as of June 30, 2015, are as follows:

Description	**Maturity**	**Interest Rates**	**Original Issue**	**June 30, 2015**
Capital leases - equipment net of interest	July 2014 - July 2018	4.15% - 8.30%	$ 3,314,670	$ 1,838,759
Less current portion				(1,383,889)
				$ 454,870

Description	June 30, 2014	Increases	Decreases	Outstanding June 30, 2015
Capital lease - equipment	$ 1,922,027	$ -	$ (83,268)	$ 1,838,759

Debt service requirements for capital lease obligations are as follows:

Year Ending June 30,		
2016	$	1,383,889
2017		280,310
2018		256,784
Less interest		(82,224)
		1,838,759
Less current portion		(1,383,889)
	$	454,870

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.

During 2015, the Foundation changed its name to Sonoma West Medical Foundation, which is the sole corporate member of Sonoma West Medical Center (SWMC). See Note 1 and Note 13 for more information on SWMC. SWMC is considered a related party in 2015. SWMC continued with similar activities to what the Foundation had done prior to the name change during 2015.

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, 2015, was $12,862. Future minimum lease payments for the succeeding years under operating leases at June 30, 2015, 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 noncompliance 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 sponsored a 457(b) defined contribution retirement plan (the "457(b) Plan") on a calendar year-end that covered all employees not participating in the 401(a) Plan who are 21 years of age and have completed three months of employment. In September 2014, the District terminated the 457(b) Plan.

There were no contributions to either retirement plan during the year ended June 30, 2015.