

Report of Independent Auditors and
Consolidated Financial Statements with
Supplemental Schedules for

Tri-City Healthcare District

June 30, 2013

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REPORT OF INDEPENDENT AUDITORS

To the Board of Directors of
Tri-City Healthcare District:

Report on Financial Statements

We have audited the accompanying consolidated financial statements of Tri-City Healthcare District, which comprise the consolidated statement of net position as of June 30, 2013, and the related consolidated statements of revenues, expenses, and changes in net position and of cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated 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 consolidated 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 consolidated financial statements based on our audit. We conducted our audit 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 consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated 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 consolidated 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 consolidated financial statements.

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Tri-City Healthcare District as of June 30, 2013, and the results of its operations and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

MOSS ADAMS LLP***Emphasis of Matter***

As more fully described in Note 2, Tri-City Healthcare District has restated its net position as of June 30, 2012 to correct certain errors.

Other Matters***Required Supplementary Information***

Accounting principles generally accepted in the United States of America require that management's discussion and analysis on pages 3-12 be presented to supplement the basic financial statements. Such information, although not part of the basic consolidated financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing 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.

Other Information

Our audit was conducted for the purpose of forming opinions on the consolidated financial statements that collectively comprise the District's basic financial statements. The consolidating statement of net position and consolidating statement of revenues, expenses, and changes in net position are presented for purposes of additional analysis and are not a required part of the basic financial statements.

The consolidating statement of net position and consolidating statement of revenues, expenses, and changes in net position are the responsibility of management and were derived from and relate directly to the underlying accounting and other records used to prepare the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the consolidating statement of net position and consolidating statement of revenues, expenses, and changes in net position are fairly stated, in all material respects, in relation to the basic financial statements as a whole.



Irvine, California
November 26, 2013

**TRI-CITY HEALTHCARE DISTRICT
MANAGEMENT'S DISCUSSION AND ANALYSIS
AS OF AND FOR THE YEARS ENDED JUNE 30, 2013**

Executive Summary (continued)

Contributing to the 2013 results were the following significant issues: (continued)

- The decrease in the District's revenue related to prior years' cost report settlements totaled \$700,000. Cost reports typically are finalized several years beyond the close of each fiscal year, after review by the appropriate government agency, and after all appeal rights have been exhausted. Tentative settlements occur between the end of a fiscal year and finalization of the settlement process.

During 2012, the District created the Real Estate Holding and Management Company, for the purpose of holding title to various real properties acquired by the District. Real Estate Holding and Management Company holds capital assets totaling \$3.7 million and the related mortgages on those properties with an aggregate balance of \$1.8 million as of June 30, 2013.

The District entered into an agreement with a local developer to construct an on-campus, three-story medical office building adjacent to the hospital. As of June 30, 2013, the construction project was still in process. The District has an agreement with the developer to lease approximately 25,000 square feet in the building for its own purposes. The District has pre-paid approximately \$5.0 million of future rental payments.

The District also continued or started the following initiatives which are anticipated to provide future financial benefit:

- During the year, the District acquired a second piece of equipment designed to provide robotic spine surgery capabilities. This technology continues to move the hospital forward as a leader in robotic surgery procedures in the area.
- The District continued to recruit physicians to improve medical coverage for the communities it serves. Among the specialties recruited, and incurred physician costs for, since inception of the recruitment process are wound care, colon/rectal, pulmonary and family practice. Loans to physicians accrue interest during the draw period and during the forgiveness period. During the three years ended June 30, 2013, a total of \$4.1 million has been loaned to physicians, of which \$650,000 has been forgiven.
- Development of the District's EHR continued during 2013. Major portions of the application were made operational during 2012, with one of the most important applications, the computerized physician order entry system ("CPOE") becoming operational in June 2012. The District received \$1,009,000 from Medi-Cal and \$1,828,000 from Medicare in Meaningful Use payments during 2013.

**TRI-CITY HEALTHCARE DISTRICT
MANAGEMENT'S DISCUSSION AND ANALYSIS
AS OF AND FOR THE YEARS ENDED JUNE 30, 2013**

Required Consolidated Financial Statements (continued)

Accounts payable and accrued liabilities and Accrued payroll and related liabilities - Accounts payable and accrued liabilities and Accrued payroll and related liabilities were under-stated by approximately \$807,000 at June 30, 2012. The financial statements did not properly reflect a \$500,000 legal settlement, and workers' compensation and professional liability reserves were previously reported at approximately \$307,000 less than discounted actuarial values. In addition, the effect of a change in accounting principle from reflecting workers' compensation and professional liability reserves at undiscounted values in prior years to discounted values at June 30, 2012 was previously reported as a decrease in expense during the fiscal year ended June 30, 2012, resulting in an understatement of expense amounting to approximately \$1.2 million.

The misstatements described above were corrected and the consolidated financial statements have been restated. The following sets forth the previously reported and restated amounts of selected items within the Statement of Net Position as of June 30, 2012:

	As Previously Reported	Restatement	As Restated
Selected Statement of Net Position Data as of June 30, 2012:			
Patient accounts receivable, net	\$ 44,679,519	\$ (2,000,000)	\$ 42,679,519
Capital assets, net	\$ 113,424,613	\$ (960,661)	\$ 112,463,952
Accounts payable and accrued liabilities	\$ 27,743,378	\$ 500,000	\$ 28,243,378
Accrued payroll and related liabilities	\$ 17,970,988	\$ 307,330	\$ 18,278,318
Net position (net investment in capital assets)	\$ 69,489,718	\$ (960,661)	\$ 68,529,057
Net position (unrestricted)	\$ 39,330,565	\$ (2,807,330)	\$ 36,523,235

The following sets forth the previously reported and restated amounts of selected items within the Statement of Revenues, Expenses and Changes in Net Position for the year ended June 30, 2012:

	As Previously Reported	Restatement	As Restated
Selected Statement of Revenues, Expenses and Changes in Net Position for the year ended June 30, 2012:			
Net patient service revenue	\$ 281,607,391	\$ (2,000,000)	\$ 279,607,391
Salaries and related expenses	\$ 182,800,310	\$ 2,096,876	\$ 184,897,186
Other operating expense	\$ 15,518,824	\$ 376,739	\$ 15,895,563
Professional and medical fees	\$ 14,119,706	\$ 500,000	\$ 14,619,706
Excess of revenues over expense	\$ 8,185,807	\$ (4,973,615)	\$ 3,212,192

**TRI-CITY HEALTHCARE DISTRICT
MANAGEMENT'S DISCUSSION AND ANALYSIS
AS OF AND FOR THE YEARS ENDED JUNE 30, 2013**

2013 Analysis of Changes in the Consolidated Statement of Net Position

- Current assets totaling \$75.3 million reflect a decrease in 2013 of \$59.7 million from prior year. The decrease is a combination of \$51.0 million of restricted cash moving to non-current assets, and a decrease of \$3.8 million in patient accounts receivable.
- Noncurrent assets increased \$51 million as a result of the reclassification of restricted assets from current assets.
- Estimated net third-party payor settlements increased \$3.3 million. The majority of third-party settlements at June 30, 2013 relates to the 2013 Low Income Health Provider ("LIHP") accrual and the 2013 inter-governmental transfers ("IGT") program.
- Capital assets, net of accumulated depreciation, decreased \$4.6 million, and totaled \$107.9 million net of accumulated depreciation as of June 30, 2013. A combination of cash payments and equipment financing were utilized to acquire \$10 million in land, equipment, software and other improvement projects during the year.
- Other assets totaling \$18.5 million, increased \$6.7 million in 2013. The District recorded \$4.6 million of goodwill related to the purchase of the oncology infusion practice. See Note 4 for further information regarding the acquisition. Other assets also increased \$2.7 million because of additional prepaid rent for the medical office building on campus.
- Current liabilities decreased \$43.1 million, and totaled \$63.4 million at year end. Long-term debt totaling \$93.5 million at year end reflects an increase of \$51.9 million compared to the June 2012 ending balance. The decrease in current liabilities and increase in long-term debt is related to a term loan being reclassified from short term debt to long term debt as of June 2013.
- Workers' compensation and comprehensive liability insurance reserves classified as long term liabilities decreased based on actuarial analyses of open claims and estimates of claims incurred but not yet reported ("IBNR"). Actuarial studies are commissioned twice each year to determine the potential liabilities and required reserves.

**TRI-CITY HEALTHCARE DISTRICT
MANAGEMENT'S DISCUSSION AND ANALYSIS
AS OF AND FOR THE YEARS ENDED JUNE 30, 2013**

**2013 Analysis of the Consolidated Statement of Revenues, Expenses and Changes in Net Position
(continued)**

- Operating expenses, which include patient care expenses and overhead and administrative expenses increased \$8.1 million. The largest single increase was experienced in salaries and related expenses, which increased \$3.8 million due to several factors including union and non-union wage increases, hiring of staff to support new and/or expanded clinical programs, and additions to staff to meet clinical and regulatory requirements.
- Non-operating income and expense consists of interest earned on invested monies, the District's share of property tax revenue collected by the County, interest expense, and gains or losses due to changes in the fair market value of the District's investments. The resulting non-operating revenue totaled \$3.0 million in 2013 compared to \$2.2 million in 2012.
- The District recognized an increase of \$1.2 million in unrestricted net position as of July 1, 2011 as a result of the impact of a change in accounting principles to record workers' compensation and comprehensive liabilities at a 4% discount instead of undiscounted.

Statement of Cash Flows - The Statement of Cash Flows reports cash receipts, cash payments, and net changes in cash resulting from operations, investing, and capital/noncapital financing activities. It provides answers to such questions as where did cash come from, what was cash used for, and what was the change in the cash balance during the reporting period.

	<u>Years Ended June 30,</u>	
	<u>2013</u>	<u>2012</u>
		<u>(as restated)</u>
Cash flows from:		
Operating activities	\$ 4,866	\$ 12,695
Noncapital financing activities	4,361	5,160
Capital and related financing activities	(14,986)	(16,398)
Investing activities	<u>(1,114)</u>	<u>10,256</u>
Net (decrease) increase in cash and cash equivalents	(6,873)	11,713
Beginning cash and cash equivalents	<u>20,121</u>	<u>8,408</u>
Ending cash and cash equivalents	<u>\$ 13,248</u>	<u>\$ 20,121</u>

Cash flows arise from operating income adjusted for noncash expenditures such as depreciation expense and bad debt expense ("operating activities"), changes in investments and interest income received on investments ("investing activities"), purchase of new capital assets and payments of interest and principal on debt ("capital and capital financing activities"), and county tax revenues ("noncapital financing activities").

TRI-CITY HEALTHCARE DISTRICT
CONSOLIDATED STATEMENT OF NET POSITION
JUNE 30, 2013

ASSETS

CURRENT ASSETS

Cash and cash equivalents	\$ 13,247,831
Short-term investments	3,818,537
Patient accounts receivable — net of estimated uncollectible accounts of \$40,194,229	38,918,150
Other receivables	1,344,612
Supplies inventories	6,478,260
Prepaid expenses and other assets	2,037,712
Estimated third-party payor settlements	<u>9,447,077</u>

Total current assets 75,292,179

NONCURRENT CASH AND INVESTMENTS

Board-designated	386,736
Restricted certificates of deposit and other cash equivalents	<u>54,598,287</u>

Total noncurrent cash and investments 54,985,023

CAPITAL ASSETS — net

107,877,928

OTHER ASSETS

Notes receivable	3,820,885
Other	<u>14,721,563</u>

Total other assets 18,542,448

TOTAL

\$ 256,697,578

**TRI-CITY HEALTHCARE DISTRICT
CONSOLIDATED STATEMENT OF REVENUES, EXPENSES
AND CHANGES IN NET POSITION
YEAR ENDED JUNE 30, 2013**

REVENUE	
Net patient service revenue	\$ 275,061,850
Premium revenue	23,218,427
Other revenue	9,913,093
	<hr/>
Total operating revenue	308,193,370
EXPENSES	
Salaries and related expenses	188,714,785
Supplies	59,684,737
Purchased services	19,040,537
Depreciation and amortization	14,165,789
Other operating expense	16,666,901
Professional and medical fees	12,302,543
Repairs and maintenance	5,407,362
Utilities	3,782,190
Rent	2,782,758
	<hr/>
Total operating expenses	322,547,602
	<hr/>
LOSS FROM OPERATIONS	(14,354,232)
NON-OPERATING REVENUE (EXPENSE)	
District tax revenue	7,932,675
Interest income	444,605
Interest expense	(5,507,926)
Other non-operating income	124,449
	<hr/>
Total non-operating revenue	2,993,803
	<hr/>
DEFICIENCY OF REVENUES OVER EXPENSES	(11,360,429)
	<hr/>
DISTRIBUTIONS TO MINORITY OWNERS	(3,571,711)
	<hr/>
Change in net position	(14,932,140)
	<hr/>
NET POSITION — Beginning of year (as restated)	106,807,737
	<hr/>
NET POSITION — End of year	<u>\$ 91,875,597</u>

**TRI-CITY HEALTHCARE DISTRICT
CONSOLIDATED STATEMENT OF CASH FLOWS
YEAR ENDED JUNE 30, 2013 (CONTINUED)**

**RECONCILIATION OF LOSS FROM OPERATIONS
TO NET CASH PROVIDED BY OPERATING ACTIVITIES**

Loss from operations	\$ (14,354,232)
Adjustments to reconcile loss from operations to net cash provided by operating activities:	
Provision for bad debts	62,900,616
Depreciation and amortization	14,165,789
Changes in assets and liabilities:	
Patient accounts receivable	(59,139,247)
Other receivables	469,443
Other — net	(790,945)
Accounts payable and accrued liabilities	5,478,415
Accrued payroll and related expenses	(536,940)
Estimated third-party payor settlements	<u>(3,326,745)</u>
Net cash provided by operating activities	<u>\$ 4,866,154</u>

NONCASH INVESTING, CAPITAL, AND FINANCING ACTIVITIES

Capital assets acquired through long-term debt	<u>\$ 932,460</u>
Promissory note issued for purchase of oncology infusion practice (see Note 4)	<u>\$ 3,517,500</u>

TRI-CITY HEALTHCARE DISTRICT
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 2 - Restatement (continued)

Accounts payable and accrued liabilities and Accrued payroll and related liabilities - Accounts payable and accrued liabilities and Accrued payroll and related liabilities were under-stated by approximately \$807,000 at June 30, 2012. The financial statements did not properly reflect a \$500,000 legal settlement, and workers' compensation and professional liability reserves were previously reported at approximately \$307,000 less than discounted actuarial values. In addition, the effect of a change in accounting principle from reflecting workers' compensation and professional liability reserves at undiscounted values in prior years to discounted values at June 30, 2012 was previously reported as a decrease in expense during the fiscal year ended June 30, 2012, resulting in an understatement of expense amounting to approximately \$1.2 million.

The misstatements described above were corrected and the consolidated financial statements have been restated. The following sets forth the previously reported and restated amounts of selected items within the Statement of Net Position as of June 30, 2012:

	As Previously Reported	Restatement	As Restated
Selected Statement of Net Position Data as of June 30, 2012:			
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Accounts payable and accrued liabilities	\$ 27,743,378	\$ 500,000	\$ 28,243,378
Accrued payroll and related liabilities	\$ 17,970,988	\$ 307,330	\$ 18,278,318
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Net position (unrestricted)	\$ 39,330,565	\$ (2,807,330)	\$ 36,523,235

The following sets forth the previously reported and restated amounts of selected items within the Statement of Revenues, Expenses and Changes in Net Position for the year ended June 30, 2012:

	As Previously Reported	Restatement	As Restated
Selected Statement of Revenues, Expenses and Changes in Net Position for the year ended June 30, 2012:			
Net patient service revenue	\$ 281,607,391	\$ (2,000,000)	\$ 279,607,391
Salaries and related expenses	\$ 182,800,310	\$ 2,096,876	\$ 184,897,186
Other operating expense	\$ 15,518,824	\$ 376,739	\$ 15,895,563
Professional and medical fees	\$ 14,119,706	\$ 500,000	\$ 14,619,706
Excess of revenues over expense	\$ 8,185,807	\$ (4,973,615)	\$ 3,212,192

Note 3 - Summary of Significant Accounting Policies

Basis of presentation - The consolidated financial statements have been prepared in accordance with the applicable provisions of the American Institute of Certified Public Accountants' Audit and Accounting Guide, *Health Care Organizations*, and pronouncements of the Governmental Accounting Standards Board (GASB). The District uses proprietary (enterprise) fund accounting. Revenues and expenses are recognized on the accrual basis using the economic resources measurement focus.

TRI-CITY HEALTHCARE DISTRICT
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 3 - Summary of Significant Accounting Policies (continued)

Supplies inventories - Supplies inventories are reported at the lower of cost (first-in, first-out) or market value.

Goodwill - Goodwill represents the excess of purchase price of acquired businesses over the net tangible and identifiable intangible assets acquired and liabilities assumed in connection with the acquisition of the oncology infusion practice (see Note 4). At June 30, 2013, goodwill associated with this transaction was approximately \$4,629,000, which is included in Other assets in the consolidated statement of net position of June 30, 2013. The Company evaluates goodwill for impairment at least annually or whenever events or changes in circumstances require an interim impairment assessment. The Company compares the fair value of each reporting unit to its carrying amount to determine if there is potential goodwill impairment. If the fair value of a reporting unit is less than its carrying value, an impairment loss is recorded to the extent that the fair value of the goodwill within the reporting unit is less than the carrying value of its goodwill. Management determined that there was no impairment of goodwill as of June 30, 2013.

Capital assets - Property, plant and equipment are recorded at cost. Depreciation is computed using the straight-line method over the estimated useful life of each class of depreciable asset (the shorter of the estimated useful life or the lease term for leasehold improvements) as follows:

Land improvements	15 years
Buildings and building improvements	10-40 years
Leasehold improvements	3-15 years
Equipment	3-15 years

Interest cost incurred on borrowed funds during the period of construction of capital assets, net of any interest earned on temporary investments of the proceeds for construction projects funded by tax-exempt borrowings, is capitalized as a component of the cost of acquiring those assets. Net interest cost capitalized was \$102,880 for the year ended June 30, 2013.

Capital assets are evaluated for impairment when events or changes in circumstances suggest that the service utility of the capital asset may have significantly and unexpectedly declined. Capital assets are considered impaired if both the decline in service utility of the capital asset is large in magnitude and the event or change in circumstance is outside the normal life cycle of the capital asset. Such events or changes in circumstances that may be indicative of impairment include evidence of physical damage, enactment or approval of laws or regulations or other changes in environmental factors, technological changes or evidence of obsolescence, changes in the manner or duration of use of a capital asset, and construction stoppage. The determination of the impairment loss is dependent upon the event or circumstance in which the impairment occurred. Impairment losses, if any, are recorded in the statements of revenues, expenses, and changes in net position. There were no impairment losses recorded in the year ended June 30, 2013.

TRI-CITY HEALTHCARE DISTRICT
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 3 - Summary of Significant Accounting Policies (continued)

Premium revenue - The District has agreements with various health maintenance organizations (“HMOs”) to provide medical services to subscribing participants. Under these agreements, the District receives monthly capitation payments based on the number of each HMO’s participants, regardless of services actually performed by the District. The District recognizes premium revenue in the period the District is obligated to provide services, which is generally in the month capitation payments are received. In addition, the HMOs make fee-for-service payments to the District for certain covered services based upon discounted fee schedules. Under some of these agreements, the District also participates in shared-risk pools with medical groups, through which it could receive additional reimbursement or pay additional amounts to the medical groups. In conjunction with the risk pools, the District estimates incurred but not reported (IBNR) claims for medical services provided to patients at other facilities. IBNR liabilities of \$1,688,936 are included in accounts payable and accrued liabilities in the accompanying consolidated statement of net position as of June 30, 2013.

Property taxes - The District receives financial support from property taxes. These funds are used to support operations. Property taxes are levied annually by the County of San Diego (the “County”) on behalf of the District and are intended to finance the District’s activities. The County’s fiscal year runs from July 1 through June 30. Amounts of tax levied are based on assessed property values as of the first day of January proceeding the fiscal year for which the taxes are levied.

Income taxes - The District is a governmental subdivision of the state of California and is exempt from federal income and state franchise taxes.

Compensated absences - The District’s benefits-eligible employees earn vacation leave at varying rates based upon qualifying-service hours. Employees may accumulate vacation leave up to a specified maximum. Accrued vacation leave is paid to the employee upon termination of employment or upon conversion to non-benefits-eligible status. The estimated amount of vacation leave payable to employees is reported as a current liability at June 30, 2013. Sick time is also earned at a specific rate per qualified-service hours. However, no payment is made for accrued sick time when employment is terminated.

Note 4 - Acquisition

On April 12, 2013, the District acquired an oncology infusion practice. The consolidated financial statements include the operations of the oncology practice from April 12, 2013 through June 30, 2013. The following table summarizes the consideration paid for the assets acquired and recognized at the acquisition date. No other assets were acquired nor were any liabilities assumed as a result of the acquisition.

TRI-CITY HEALTHCARE DISTRICT
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 5 - Patient Service Revenue and Third-Party Reimbursement Programs (continued)

The hospital also recorded net patient service revenue of approximately \$2,763,000 during the year ended June 30, 2013, from the Low Income Health Provider ("LIHP") program, a five-year California Medicaid Demonstration Waiver program ("Section 1115 waiver") which allows the State to establish low income health programs in each county to expand coverage for the uninsured, in advance of the Medicaid expansion program provisions of the Affordable Care Act of 2010. The District participates in this program through a relationship with the County of San Diego Department of Health and Human Services.

The District has also entered into payment agreements with certain commercial insurance carriers, HMOs, and PPOs. The basis for payment to the District under these agreements includes prospectively determined rates per discharge, discounts from established charges, and prospectively determined daily rates.

The District grants credit without collateral to its patients, most of who are local residents and are insured under third-party payor agreements. The mix of net receivables from patients and third-party payors as of June 30, 2013 were as follows:

Medicare	21 %
Medicare - senior plans	9
Medi-Cal	7
HMO	33
Others	30
	<hr/>
Total	100 %

Note 6 - Cash and Cash Equivalents and Investments

The State of California Government Code generally authorizes the District to invest unrestricted and Board-designated assets in obligations of the U.S. Treasury and certain U.S. government agencies, obligations of the state of California and local government entities, bankers' acceptances, commercial paper, certificates of deposit, repurchase agreements, and mortgage securities. Certain of these investments may be purchased only in limited amounts, as defined in the State of California Government Code.

The California State Treasurer's Office makes available the Local Agency Investment Fund ("LAIF") through which local governments may pool investments. Each governmental entity may invest up to \$40,000,000 in the fund. Investments in the LAIF are highly liquid, as deposits can be converted to cash within 24 hours without loss of interest. The District is a voluntary participant in the LAIF. The fair value of the District's investments in the LAIF is reported in the accompanying consolidated financial statements based on the District's pro rata share of the fair value provided by the LAIF for the entire LAIF portfolio.

TRI-CITY HEALTHCARE DISTRICT
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 6 - Cash and Cash Equivalents and Investments (continued)

Custodial credit risk - deposits - Custodial credit risk is the risk that in the event of a bank failure, the District's deposits may not be returned to it. The District does not have a policy for custodial credit risk. As of June 30, 2013, the District's bank balances totaled \$67,846,118, and were not exposed to custodial credit risk, as the uninsured deposits are with financial institutions which are individually required by state law to have government deposits collateralized at a rate of 110% of the deposits. Such collateral is considered to be held in the District's name.

Custodial credit risk - investments - District policy requires that all investments be insured or registered, or be held by the District's agent in the agent's nominee name, with subsidiary records listing the District as the legal owner. For these reasons, the District is not exposed to custodial credit risk for its investments.

The carrying amount of deposits and investment are included in the District's consolidated statements of net position as follows at June 30, 2013:

Carrying amount		
Deposits	\$	67,846,118
Investments		4,205,273
	\$	72,051,391

The carrying amount of deposits and investments are included in the following statements of net position captions at June 30, 2013:

Cash and cash equivalents	\$	13,247,831
Short-term investments		3,818,537
Board-designated		386,736
Restricted certificates of deposit and other cash equivalents		54,598,287
	\$	72,051,391

TRI-CITY HEALTHCARE DISTRICT
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 9 - Other Assets

Other assets as of June 30, 2013 consisted of the following:

Goodwill	\$	4,629,430
Wellness Center purchase option		5,000,000
Medical office building prepaid rent		5,004,692
Other		87,441
Total	\$	<u>14,721,563</u>

Note 10 - Short-Term Debt

Term loan - In February 2010, the District entered into a term loan, with \$51 million principal amount, due March 31, 2011, and collateralized by \$51 million in a pledged cash account with the term loan bank. In March 2011, the District renewed the term loan for an additional 14 months, with a new due date of May 31, 2012. Interest was charged at 4.9% plus the interest rate on the pledged cash account. The remaining related unamortized premium, discount, and deferred loss were amortized over the life of the new term loan.

In April 2012, the District replaced the existing term loan with a new term loan with an initial maturity date of June 28, 2013. The new term loan maintained the existing principal outstanding of \$51 million and existing collateral of \$51 million with new lenders. The new term loan has an interest rate of 0.75% plus the interest rate of the collateral of the term loan plus LIBOR. During the year ended June 30, 2013, the District extended the term loan maturity to September 26, 2014. As a result, the term loan is included in long-term debt at June 30, 2013.

Line of credit - In April 2012, the District entered into a revolving facility, available for borrowings of up to \$25,000,000, with a due date of February 28, 2015. Interest on the line of credit is 1.75% plus LIBOR. The combined interest rate was 1.95% at June 30, 2013. At June 30, 2013, \$6,800,000 was outstanding on the line of credit. The borrowings on the credit facility are fully collateralized by certain assets of the District.

A schedule of changes in the District's short-term debt as of June 30, 2013 is as follows:

	Beginning Balance	Additions	Payments	Other Allocation	Ending Balance
Insurance financing	\$ -	\$ 1,262,507	\$ (1,262,507)	\$ -	\$ -
Term loan	51,000,000	-	-	(51,000,000)	-
Line of credit	4,800,000	19,000,000	(17,000,000)	-	6,800,000
Total short-term debt	<u>\$ 55,800,000</u>	<u>\$ 20,262,507</u>	<u>\$ (18,262,507)</u>	<u>\$ (51,000,000)</u>	<u>\$ 6,800,000</u>

TRI-CITY HEALTHCARE DISTRICT
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 11 - Long-Term Debt (continued)

A schedule of changes in the District's long-term debt (including current portion) as of June 30, 2013 is as follows:

	Beginning Balance	Additions	Payments	Other Allocation	Ending Balance	Due Within 1 Year
REHM notes payable	\$ 1,920,833	\$ -	\$ (137,500)	\$ -	\$ 1,783,333	\$ 150,000
Bank of the West notes payable	1,064,572	932,460	(288,070)	-	1,708,962	385,068
Promissory note payable (infusion)	-	3,517,500	(182,570)	-	3,334,930	1,126,239
Term Loan	-	-	-	51,000,000	51,000,000	-
Other	149,830	-	(96,531)	-	53,299	-
Total long-term debt	3,135,235	4,449,960	(704,671)	51,000,000	57,880,524	1,661,307
Capital lease obligations	41,001,529	400,154	(2,218,851)	-	39,182,832	1,866,505
Total long-term debt	\$ 44,136,764	\$ 4,850,114	\$ (2,923,522)	\$ 51,000,000	\$ 97,063,356	\$ 3,527,812

Assets acquired through the capital lease as of June 30, 2013 are as follows:

Land and buildings under capital lease	\$ 32,645,716
Equipment under capital lease	3,561,613
Software under capital lease	5,337,117
Total	41,544,446
Accumulated amortization	(8,817,610)
	\$ 32,726,836

A schedule, by year, of future minimum payments under long-term debt obligations as of June 30, 2013, is as follows:

Years Ending June 30,	Principal	Interest	Total
2014	\$ 1,727,105	\$ 178,572	\$ 1,905,677
2015	52,727,299	647,777	53,375,076
2016	1,585,805	44,018	1,629,823
2017	1,740,853	9,521	1,750,374
2018	99,462	846	100,308
Total	\$ 57,880,524	\$ 880,734	\$ 58,761,258

TRI-CITY HEALTHCARE DISTRICT
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 12 - Retirement Plans (continued)

The District also offers its employees a deferred compensation plan created in accordance with Internal Revenue Code Section 457. Employees who elect to participate in the plan make contributions through a reduction in salary. All employee contributions are invested by a funding agency selected by the District. The investments of the NSRP retirement plan and the Section 457 deferred compensation plan and earnings thereon are held by fiduciaries in trust for the benefit of the employees. The NSRP and the Section 457 deferred compensation plan assets are not subject to the claims of the District's general creditors. Accordingly, the plans' assets and the related liabilities are excluded from the accompanying consolidated statements of net position as of June 30, 2013.

The District maintains a tax-deferred capital accumulation account for certain management personnel under which the District has contributed funds to mutual fund investments as directed by the participants. The contributions vest over a period of no less than two years. As of June 30, 2013, the District has invested \$247,544, which is included in other long-term assets on the accompanying consolidated statement of net position. The corresponding compensation liabilities of \$157,213 are included in accrued payroll and related expenses on the accompanying consolidated statements of net position. The plan assets remain the property of the District until paid or made available to participants, subject only to claims of the District's general creditors.

Note 13 - Operating Leases

The District leases certain building space and equipment under non-cancelable operating leases expiring between December 2013 and July 2016. Operating lease expense for all operating leases totaled approximately \$2,657,000 for the year ended June 30, 2013. As of June 30, 2013, future minimum lease payments under non-cancelable operating leases are as follows:

<u>Years Ending June 30,</u>	
2014	\$ 2,513,499
2015	2,481,060
2016	906,908
2017	731,982
2018	577,591
Thereafter	<u>1,092,650</u>
Total	<u>\$ 8,303,690</u>

TRI-CITY HEALTHCARE DISTRICT
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 15 - Partnerships (continued)

During the year ended June 30, 2011, the District formed the Orthopedic Institute, LLC ("Ortho"), a California Limited Liability Company. The purpose of Ortho is to further the District's mission and commitment to promote orthopedic health and provide quality surgical, non-invasive and rehabilitation services for the residents of the District. The District and Ortho entered into a co-management agreement under which Ortho provides certain services to meet this mission.

During the year ended June 30, 2012, the District formed the Tri-City Real Estate Holding and Management Company LLC ("REHM"), a California Limited Liability Company. The purpose of the REHM is to facilitate the acquisition and use of real estate properties to promote the District's mission.

The portion of Consolidated Excess of Revenues Over Expenses attributable to these minority interests for the year ended June 30, 2013 is \$2,254,652.

Note 16 - Commitments and Contingencies

Legal actions - The District is involved in various legal matters arising from time to time in the ordinary course of business. Management believes that these matters will not have a material adverse effect on the District's financial position or results of operations.

The District is exposed to various risks of loss from torts; theft of, damage to, and destruction of assets; business interruption; errors and omissions; natural disasters; and employee health and accident benefits. Commercial insurance coverage is purchased for claims arising from such matters.

The healthcare industry is subject to numerous laws and regulations of federal, state, and local governments. Compliance with these laws and regulations, specifically those relating to the Medicare and Medi-Cal programs, can be subject to government review and interpretation, as well as regulatory actions unknown and unasserted at this time. Federal government activity has increased with respect to investigations and allegations concerning possible violations by health care providers of regulations, which could result in the imposition of significant fines and penalties, as well as significant repayments of previously billed and collected revenues from patient services. Management believes that the District is in compliance with current laws and regulations.

TRI-CITY HEALTHCARE DISTRICT
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 16 - Commitments and Contingencies (continued)

The following is a summary of the changes in the self-insured and claims-made plan liabilities for the year ended June 30, 2013:

Balance, as of June 30, 2012	\$ 11,666,693
Additions	1,843,118
Payments	<u>(2,628,463)</u>
Balance, as of June 30, 2013	<u>\$ 10,881,348</u>

Medical services IBNR - The following is a summary of the changes in the medical services IBNR claims for the years ended June 30, 2013:

Balance, as of June 30, 2011	\$ 2,505,877
Additions	7,159,287
Payments	<u>(7,814,018)</u>
Balance, as of June 30, 2012	1,851,146
Additions	7,867,967
Payments	<u>(8,030,177)</u>
Balance, as of June 30, 2013	<u>\$ 1,688,936</u>

Physician loan agreements - The District has sixteen Physician Recruitment Agreements in effect as of June 30, 2013 under which the District is required to loan the practicing physicians up to a specified amount per month for a period of two or three years (the "loan distribution period"). At the end of the loan distribution period, each physician is obligated by a signed loan agreement to repay the outstanding loan balance. The loan can be repaid in cash or in-kind services. For repayment in-kind, the District forgives the loans monthly over the period defined in the loan agreement (up to 3 years), so long as the physician continues the practice in the defined service area. The unforgiven loan balances outstanding as of June 30, 2013 totaled \$3,803,805, and are included in other long-term assets in the accompanying consolidated statement of net position.

TRI-CITY HEALTHCARE DISTRICT
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 18 - Subsequent Events (continued)

In July 2013, a new revolving line of credit was obtained from Mid Cap, LLC and the prior line of credit was paid in full. The amount available under this new line of credit is up to \$25,000,000, subject to a borrowing base calculation, as defined within the Credit and Security Agreement. The interest rate is LIBOR plus 3.50% subject to a floor on LIBOR of 1%. The term of this line of credit is three years. The borrowings on the credit facility are fully collateralized by certain assets of the District.

During July 2013, the District made an offer for settlement to the Office of Inspector General ("OIG") and Department of Justice ("DOJ") related to a self-disclosure program to resolve a previously self-disclosed matter. The District has yet to receive an acceptance or counter offer. Although the ultimate settlement is unknown, management believes the financial impact related to this matter will not be material.

In August 2013, the Board of Directors commenced a compliance investigation. On September 5, 2013, the CEO, Larry Anderson, was placed on Administrative Leave. On October 17, 2013, the District's Board of Directors voted to terminate Mr. Anderson effective October 18, 2013. Casey Fatch, the District's Executive Vice President and Chief Operating Officer since September 2009, assumed the Interim CEO position on September 5, 2013.

SUPPLEMENTAL SCHEDULES AS OF AND FOR THE YEAR ENDED JUNE 30, 2013

TRI-CITY HEALTHCARE DISTRICT
CONSOLIDATING STATEMENT OF NET POSITION
JUNE 30, 2013

	TCMC	ASCO	CVI	Ortho	REHM	Eliminations	Consolidated
ASSETS							
CURRENT ASSETS							
Cash and cash equivalents	\$ 12,112,855	\$ 911,318	\$ 98,784	\$ 54,038	\$ 70,836	\$ -	\$ 13,247,831
Short-term investments	3,818,537	-	-	-	-	-	3,818,537
Patient accounts receivable - net of estimated uncollectible accounts of \$40,194,229	37,737,226	1,180,924	-	-	-	-	38,918,150
Other receivables	2,297,617	-	402,488	310,515	30,569	(1,696,577)	1,344,612
Supplies inventories	6,477,099	1,161	-	-	-	-	6,478,260
Prepaid expenses and other assets	1,977,678	60,034	-	-	-	-	2,037,712
Estimated third-party payor settlements	9,447,077	-	-	-	-	-	9,447,077
Total current assets	73,868,089	2,153,437	501,272	364,553	101,405	(1,696,577)	75,292,179
NONCURRENT CASH AND INVESTMENTS							
Board-designated	386,736	-	-	-	-	-	386,736
Restricted certificates of deposit and other cash equivalents	54,598,287	-	-	-	-	-	54,598,287
Total noncurrent cash and investments	54,985,023	-	-	-	-	-	54,985,023
CAPITAL ASSETS - net	103,280,613	899,840	-	-	3,697,475	-	107,877,928
OTHER ASSETS							
Notes receivable	3,803,805	-	-	-	17,080	-	3,820,885
Other	19,305,285	(374,761)	136,257	67,593	-	(4,412,811)	14,721,563
Total other assets	23,109,090	(374,761)	136,257	67,593	17,080	(4,412,811)	18,542,448
TOTAL	\$ 255,242,815	\$ 2,678,516	\$ 637,529	\$ 432,146	\$ 3,815,960	\$ (6,109,388)	\$ 256,697,578

See report of independent auditors.

TRI-CITY HEALTHCARE DISTRICT
CONSOLIDATING STATEMENT OF REVENUES, EXPENSES,
AND CHANGES IN NET POSITION
FOR THE YEAR ENDED JUNE 30, 2013

	TCMC	ASCO	CVI	Ortho	REHM	Eliminations	Consolidated
REVENUE:							
Net patient service revenue	\$ 265,974,306	\$ 9,087,544	-	\$ -	-	\$ -	\$ 275,061,850
Premium revenue	23,218,427	-	-	-	-	-	23,218,427
Other revenue	11,529,087	1,095	629,366	476,991	-	(2,723,446)	9,913,093
Total operating revenue	300,721,820	9,088,639	629,366	476,991	-	(2,723,446)	308,193,370
EXPENSES:							
Salaries and related expenses	186,496,748	2,130,628	43,706	43,703	-	-	188,714,785
Supplies	57,785,487	1,899,250	-	-	-	-	59,684,737
Purchased services	19,415,425	579,340	225,548	162,964	-	(1,342,740)	19,040,537
Depreciation and amortization	13,869,216	279,505	11,436	5,632	-	-	14,165,789
Other operating expense	16,148,471	484,570	19,161	14,699	-	-	16,666,901
Professional and medical fees	12,086,108	38,892	108,441	69,102	-	-	12,302,543
Repairs and maintenance	4,825,514	581,848	-	-	-	-	5,407,362
Utilities	3,782,190	-	-	-	-	-	3,782,190
Rent	3,001,079	48,104	-	-	-	(266,425)	2,782,758
Total operating expenses	317,410,238	6,042,137	408,292	296,100	-	(1,609,165)	322,547,602
(LOSS) GAIN FROM OPERATIONS	(16,688,418)	3,046,502	221,074	180,891	-	(1,114,281)	(14,354,232)
NONOPERATING REVENUE (EXPENSE):							
District tax revenue	7,932,675	-	-	-	-	-	7,932,675
Interest income	444,605	-	-	-	-	-	444,605
Interest expense	(5,432,573)	(4,298)	-	-	(71,055)	-	(5,507,926)
Other non-operating revenue (expense)	128,630	(781)	(2,600)	(800)	266,425	(266,425)	124,449
Total non-operating revenue (expense)	3,073,337	(5,079)	(2,600)	(800)	195,370	(266,425)	2,993,803
(DEFICIENCY) EXCESS OF REVENUES OVER EXPENSES	(13,615,081)	3,041,423	218,474	180,091	195,370	(1,380,706)	(11,360,429)
DISTRIBUTIONS TO MINORITY OWNERS							
Change in net position	-	(3,086,101)	(310,074)	(175,536)	-	-	(3,571,711)
Change in net position	(13,615,081)	(44,678)	(91,600)	4,555	195,370	(1,380,706)	(14,932,140)
NET POSITION — Beginning of year (as restated)	105,104,823	2,247,950	395,454	259,535	1,832,081	(3,032,106)	106,807,737
NET POSITION — End of year	\$ 91,489,742	\$ 2,203,272	\$ 303,854	\$ 264,090	\$ 2,027,451	\$ (4,412,812)	\$ 91,875,597

See report of independent auditors.