

Agenda Item No. 5.A.

Board of Directors Meeting

Date 12-3-08

SEQUOIA HEALTHCARE DISTRICT

**BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2008**

SEQUOIA HEALTHCARE DISTRICT
Basic Financial Statements
For the year ended June 30, 2008

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FINANCIAL SECTION

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ACCOUNTANCY CORPORATION
3478 Buskirk Ave. - Suite 215
Pleasant Hill, California 94523
(925) 930-0902 • FAX (925) 930-0135
maze@mazeassociates.com
www.mazeassociates.com

INDEPENDENT AUDITOR'S REPORT

Board of Directors
Sequoia Healthcare District
Redwood City, California

We have audited the basic financial statements of the governmental and each major fund of Sequoia Healthcare District as of and for the year ended June 30, 2008 as listed in the Table of Contents. These financial statements are the responsibility of Sequoia Healthcare District's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards in the United States of America and the standards for financial audit contained in *Government Audit Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance as to whether the financial statements are free of material misstatement. An audit includes examining on a test basis evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and assessing significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the basic financial statements referred to above present fairly in all material respects the respective financial position of the governmental activities and each major fund of Sequoia Healthcare District as of June 30, 2008 and the respective changes in financial position thereof for the year then ended, in conformity with generally accepted accounting principles in the United States of America.

Management's Discussion and Analysis is not a required part of the basic financial statements but is supplementary information required by the Government Accounting Standards Board. We have applied

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SEQUOIA HEALTHCARE DISTRICT
Management's Discussion and Analysis
June 30, 2008

INTRODUCTION

This report presents Management's analysis of Sequoia Healthcare District's (the "District") financial condition and activities as of and for the year ended June 30, 2008. Management's Discussion and Analysis ("MD&A") is intended to serve as an introduction to the District's basic financial statements. This document has been prepared based on reporting requirements included in Statement No. 34 of the Governmental Accounting Standards Board (GASB). GASB 34 has made changes to the contents and the format of the financial statements of governmental agencies, which include the Government-wide Financial Statements on a full accrual basis including the cost of the capital assets and related depreciation.

This information should be read in conjunction with the District's audited financial statements.

The information in the MD&A includes the following elements:

- Organization and Business
- Overview of Basic Financial Statements
- Financial Analysis
- Capital Assets
- Economic Factors and Future Plans
- Request for Information

ORGANIZATION AND BUSINESS

Sequoia Healthcare District is a governmental entity legally constituted as a special district under California law, and is located in Redwood City, California. Sequoia Healthcare District identifies local healthcare needs and collaboratively develops solutions. District tax revenues are used for programs and activities designed to achieve health, wellness and disease prevention in southern San Mateo County. Communities in the District include Redwood City, San Carlos, Belmont, Menlo Park, Woodside, Atherton and Portola Valley.

The District transferred specific assets, including operations, to Sequoia Health Services ("SHS") on September 30, 1996. SHS is a California nonprofit benefit corporation, whose members are the District and Catholic Healthcare West (CHW). The specific assets transferred include all of the Hospital's assets including property, plant and equipment, except for two medical office buildings, certain other properties and \$10 million in cash, cash equivalents and other assets pursuant to applicable law. The Basic Financial Statements addressed in this MD&A do not relate to Sequoia Hospital's operations or any other transferred assets to SHS.

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Effective April 19, 2005, the District adopted policies and procedures pursuant to Section 32104 of the California Health and Safety Code. The purpose of these policies and procedures is to provide the Board of Directors the time and place of holding its regular meetings and the manner of calling the same, and establish rules for its proceedings and possibly adopt such rules and regulations not inconsistent with law as may be necessary for the exercise of the powers conferred and the performance of the duties imposed on the Board.

The District entered into a Development Agreement with Catholic Healthcare West to modernize, upgrade and seismically retrofit Sequoia Hospital to meet codes and continue to operate as a licensed acute care facility well into the twenty-first century. This agreement, entered into on December 7, 2007, provides that Sequoia Healthcare District will contribute \$75 million, along with equal amounts contributed by Catholic Healthcare West and Sequoia Health Services (a non-profit corporation which ceased to exist as of December 31, 2007) towards the Hospital Development Project. This is a \$240 million project as estimated at the time of the agreement and the remaining \$15 million after the contributions would be raised by charitable contributions. The District contributed \$50 million in cash into an escrow account, as specified in the Development Agreement and transferred the ownership of the Medical Office Building located at 2900 Whipple Avenue in Redwood City, valued at \$14.5 million to CHW. The District will contribute the remaining amount (towards its \$75 million contribution) in annual amounts of \$1 million on each anniversary of the effective date of the Agreement. In return for its investment, the District will receive a Return on Investment which is equal to one half of the Operating Earnings Before Interest, Depreciation and Amortization (EBIDA) from Sequoia Hospital in excess of 9.3%. The contributions of capital are recorded on the books and reflected in these financial statements.

OVERVIEW OF BASIC FINANCIAL STATEMENTS

The District's basic financial statements comprise the Government-Wide Statement of Net Assets and Statement of Activities; the Governmental Fund Balance Sheet, the Reconciliation of the Governmental Fund – Balance Sheet with the Statement of Net Assets, the Statement of Revenues, Expenditures and Changes in Fund Balance; the Reconciliation of the Net Change in Fund Balance – Governmental Fund with the Statement of Activities; and the Proprietary Fund Statement of Net Assets, Statement of Revenues, Expenses and Changes in Fund Net Assets, and the Statement of Cash Flows; and the Notes to the Financial Statements.

Government-Wide Financial Statements

Government-Wide Financial Statements utilize the economic resources measurement focus using the full accrual basis of accounting similar to commercial enterprises. The Statement of Net Assets includes all of the District's assets and liabilities. All of the current year's revenues and expenses are accounted for in the Statement of Activities, regardless of when cash is received or paid.

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For the current year the only difference between the Government-Wide Financial Statements and the Fund Financial Statements is the classifications within the fund balances. Under GASB 34 board designated reserves of fund balances are considered unrestricted. The Fund Financial Statements reduce the unrestricted portion of the fund balance by the amounts designated for specific purposes by the District. Therefore, the following discussion and analysis will generally be equally applicable to the Government-Wide and Fund Financial Statements.

Fund Financial Statements

A fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. The District uses Government and Proprietary fund accounting to ensure and demonstrate compliance with financial-related legal requirements. As indicated above, the Governmental Fund is used to account for the District's basic services and the Proprietary Fund is used to account for the District's leasing activity.

Governmental fund accounting uses a flow of current resources measurement focus and the modified accrual basis of accounting. Modified accrual accounting recognizes revenues when available for current operations, normally those revenues that will be received within 90 days of year end. For the current year, substantially all revenues receivable at year end were collected within the 90 day period resulting in no difference between modified and full accrual in these financial statements. Proprietary (Enterprise) fund accounting uses the full accrual basis of accounting.

The District's financial statements include:

Balance Sheet

The Governmental Fund Balance Sheet presents information on the District's assets and liabilities, with the difference between the two reported as fund balance. Over time, increases or decreases in fund balance may serve as a useful indicator of the financial health of the District. To assess the overall health of the District, achievement of the District's mission needs to be considered as well.

The Governmental Fund Balance Sheet provides detail of assets and liabilities and describes the components of the \$20.7 million fund balance.

Statement of Revenues, Expenses, and Changes in Fund Balance

While the balance sheet provides information about the nature and amount of resources and obligations at year-end, the Statement of Revenues, Expenditures, and Changes in Fund Balance presents the results of the District's operations over the course of the fiscal year and information as to how the fund balance changed over the year. This can be used as an indicator of the extent to which the District has successfully recovered its costs through user fees (rental income) or other funds received (tax revenues). All changes in fund balance are reported during the period on the modified accrual method of accounting which had no significant differences from full

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accrual accounting, in which the underlying event giving rise to the change occurs, regardless of the timing of the related cash flows. Thus, revenues and expenses are reported in this statement for some items that will result in cash flows in future fiscal periods.

Statement of Cash Flows

The Proprietary Fund Statement of Cash Flows presents changes in cash and cash equivalents resulting from operational, capital, non-capital, and investing activities. This statement summarizes the annual flow of cash receipts and cash payments, without consideration of the timing of the event giving rise to the obligation or receipt and excludes non-cash accounting measures of depreciation or amortization of assets.

Notes to Basic Financial Statements

The notes provide additional information that is essential to a full understanding of the data provided in the basic financial statements. The notes to basic financial statements can be found following the financial statements in the audited financial statements.

Other Information

In addition to the basic financial statements and accompanying notes, this report may present certain required supplementary information comparing budget to actual results of operations. The District is not required to adopt an annual budget however during fiscal 2007-2008 the District approved and adopted a budget.

FINANCIAL ANALYSIS

Financial Highlights

- The government-wide total assets of the District exceed the total liabilities by \$11.412 million (*net assets*) (Table 1).
- Net Assets decreased by \$62.9 million or 84.7 percent during the fiscal year (Table 2). This was due primarily to the transfer of funds to build the new Hospital under the Development Agreement mentioned above.
- During the year, overall revenues on the Statement of Activities increased by \$9.313 million or 64.6 percent to \$23.739 million. There was a decrease of Rental Revenue with the transfer of the Medical Office Building to CHW, as part of the Development Agreement mentioned earlier. Investment Income decreased with the decrease in the capital, which was donated as part of the Agreement mentioned above (Table 2).
- Total expenses on the Statement of Activities increased by \$74.643 million or 620 percent to \$86.684 million. The variance represents an increase of grant expense of \$75.424 million due primarily to the donation made to the fund to rebuild Sequoia Hospital under the Development Agreement (Table 2). Administrative Expenses decreased by \$.262 million or 6.79%. This reflects the lower legal and administrative

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costs associated with the Development Agreement. The property expenses decreased \$519,000 or 44.1% due to the transfer of the Medical Office Building, in December 2007, as part of the Development Agreement.

Financial Position

During the year, the District's net assets decreased by \$62.945 million or 84.7 percent.

The fund balance of the general fund included, as of June 30, 2007, a Board designated depreciation amount of \$7.4 million and a Board designated \$41.1 million for preservation of corpus. The net assets included \$6.3 million for investment in capital assets and \$19.5 million in unrestricted funds. The transfer of assets under the Development Agreement has reduced the Fund Balance by \$62.945 million (85%) and eliminated the various categories which were primarily created for the type of re-building program contemplated under the Development Agreement. The resulting fund balance consists of \$221,000 invested in Capital Assets and an Unrestricted Net Assets of \$11.19 million.

Tables 1 and 2 provide summarized Government-Wide comparative information reported by Fund statement classifications. The functional expenses are detailed on the Statement of Activities and consist of grants to the Sequoia Hospital and Community non-profit organizations and General Administration expenses.

Net Assets

Table 1
Comparative Statement of Net Assets
June 30, 2008 and 2007
(In thousands)

	<u>2008</u>	<u>2007</u>	<u>Variance</u>	<u>Percentage</u>
Current and Other Assets	\$ 23,741	\$ 69,610	\$ 45,869	65.89%
Capital Assets, net	<u>221</u>	<u>6,344</u>	<u>6,123</u>	<u>96.52%</u>
Total Assets	<u>\$ 23,962</u>	<u>\$ 75,954</u>	<u>\$ 51,992</u>	<u>68.45%</u>
Current Liabilities	\$ 3,050	\$ 1,597	\$ (1,453)	-90.98%
Long Term Liability	\$ 9,500	\$ -	\$ (9,500)	100.00%
Net Assets				
Depreciation	-	7,444	\$ 7,444	100.00%
Restricted	-	41,122	\$ 41,122	100.00%
Investment in Capital Assets	221	6,344	\$ 6,123	96.52%
Unrestricted Net Assets	<u>11,191</u>	<u>19,447</u>	<u>8,256</u>	<u>42.45%</u>
Governmental Fund Balance	<u>\$ 11,412</u>	<u>\$ 74,357</u>	<u>\$ 62,945</u>	<u>84.65%</u>