

MARIN HEALTHCARE DISTRICT

GREENBRAE, CALIFORNIA

**BASIC
FINANCIAL STATEMENTS**

JUNE 30, 2009

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INDEPENDENT AUDITORS' REPORT

Board of Directors
Marin Healthcare District
Greenbrae, California

We have audited the accompanying basic financial statements of the business-type activities and the major fund of Marin Healthcare District as of June 30, 2009 and for the fiscal year then ended, as listed in the table of contents. These basic financial statements are the responsibility of Marin Healthcare District's management. Our responsibility is to express an opinion on these basic financial statements based on our audit. The prior year summarized information has been derived from Marin Healthcare District's June 30, 2008 financial statements and, in our report dated November 17, 2008, we expressed an unqualified opinion on those financial statements.

We conducted our audit in accordance with U.S. generally accepted auditing standards, and the State Controller's Minimum Audit Requirements for California Special Districts. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the basic financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the basic financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall basic 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 financial position of the business-type activities and the major fund of Marin Healthcare District as of June 30, 2009, and the results of its operations and its cash flows for the year then ended in conformity with U.S. generally accepted accounting principles, as well as accounting systems prescribed by the State Controller's Office and state regulations governing special districts.

Management's Discussion and Analysis is supplementary information required by the Governmental Accounting Standards Board, but is not part of the basic financial statements. We have applied certain limited procedures to this information, which consisted principally of inquiries of management regarding the methods of measurement and presentation of this information, but we did not audit this information and we express no opinion on it.



R. J. Ricciardi, Inc.
Certified Public Accountants

San Rafael, California
January 8, 2010

Marin Healthcare District
MANAGEMENT'S DISCUSSION AND ANALYSIS
June 30, 2009

This section of Marin Healthcare District's (the District's) basic financial statements presents management's overview and analysis of the financial activities of the organization for the fiscal year ended June 30, 2009. We encourage the reader to consider the information presented here in conjunction with the financial statements as a whole.

Introduction to the Basic Financial Statements

This discussion and analysis is intended to serve as an introduction to the District's audited financial statements, which are comprised of the basic financial statements. This annual report is prepared in accordance with the Governmental Accounting Standards Board (GASB) Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for States and Local Governments*.

The required financial statements include the Statement of Net Assets; the Statement of Revenues, Expenses and Changes in Net Assets; and the Statement of Cash Flows. Notes to the basic financial statements, supplementary detail and/or statistical information, and this summary support these statements. All sections must be considered together to obtain a complete understanding of the financial picture of the organization.

Statement of Net Assets:

This statement includes all assets and liabilities using the accrual basis of accounting as of the statement date. The difference between the two classifications is represented as "Net Assets"; this section of the statement identifies major categories of restrictions on these assets and reflects the overall financial position of the organization as a whole.

Statement of Revenues, Expenses and Changes in Net Assets:

This statement presents the revenues earned and the expenses incurred during the year using the accrual basis of accounting. Under the accrual basis, all increases or decreases in net assets are reported as soon as the underlying event occurs, regardless of the timing of the cash flow. Consequently revenues and/or expenditures reported during this fiscal year may result in changes to cash flows in a future period.

Statement of Cash Flows:

This statement reflects inflows and outflows of cash, summarized by operating, capital, financing and investing activities. The direct method was used to prepare this information, which means that gross rather than net amounts were presented for the year's activities.

Notes to the Basic Financial Statements:

This additional information is essential to a full understanding of the data reported in the basic financial statements.

The District is a political sub-division of the State of California. It is the lessor of the Marin General Hospital Facility and is governed by a Board of Directors.

Analytical Overview

A. Business-type Activities

The Statement of Net Assets and Statement of Revenues, Expenses and Changes in Net Assets present a summary of the District's business-type activities that are composed of the District's Enterprise fund.

Marin Healthcare District
MANAGEMENT'S DISCUSSION AND ANALYSIS
 June 30, 2009

Table 1
Business-type Net Assets

	6/30/09	6/30/08
Current and other assets	\$ 3,688,799	\$ 2,147,146
Capital assets, net of accumulated depreciation	20,406,926	8,736,742
Total assets	24,095,725	10,883,888
Long term debt outstanding	18,158,306	7,537,385
Other liabilities	2,452,641	413,853
Total liabilities	20,610,947	7,951,238
Net assets:		
Invested in capital assets, net of related debt	8,282,655	8,736,742
Unrestricted	(4,797,877)	(5,804,092)
Total net assets	\$ 3,484,778	\$ 2,932,650

Summary

Total assets of the District have increased this year by \$13,211,837, primarily related to the current year construction in progress of Hospital improvements.

Liabilities have increased this year by \$12,659,709, as a result of the County of Marin, ACS, and Transition loans.

Unrestricted Net Assets have increased \$1,006,215 due to the capitalization of transition expenses for Hospital upgrades. The overall change to Net Assets is an increase of \$552,128, resulting in a June 30, 2009 balance of \$3,484,778.

Comparative Analysis of Current and Prior Year Activities and Balances

	6/30/09	6/30/08	Increase (Decrease)	
Operating revenues	\$ 591,335	\$ 4,241,889	\$ (3,650,554)	Note 2
Operating expenses	1,333,232	3,121,835	(1,788,603)	Note 1
Net operating income	\$ (741,897)	\$ 1,120,054	\$ (1,861,951)	
Non operating revenues (expenses)	\$ 27,490	\$ 80,303	\$ (52,813)	Note 2
Change in net assets	\$ (714,407)	\$ 1,200,357	\$ (1,914,764)	

Note 1 – The decrease in operating expenses is related to the cost of transition related to the settlement agreement and Hospital upgrade costs that was capitalized as construction in progress.

Note 2 – The decrease relates to the decrease in settlement funds related to the settlement agreement and changes to the amortization of deferred lease revenue. The interest income decrease relates to a decrease in interest rates and cash available for investment.

Capital Assets

At the end of fiscal year 2009, the cost of infrastructure and other capital assets recorded in the District's financial statements was as shown in Table 2 below:

Marin Healthcare District
MANAGEMENT'S DISCUSSION AND ANALYSIS
 June 30, 2009

Table 2
Capital Assets at year end

	Balance at June 30, 2009
<u>Business-type activities</u>	
Land and improvements	\$ 2,243,596
Building	25,079,033
Construction in progress	12,436,467
Equipment	19,875,144
Less: accumulated depreciation	(39,227,314)
Business-type activity capital assets, net	\$ 20,406,926

Detail on capital assets, current year additions and construction in progress can be found in Note 3.

Debt Administration

The District's long-term obligations consist of (1) a transition loan related to the settlement agreement; (2) a loan agreement from the County of Marin in the maximum amount of \$20,000,000; (3) a loan from ACS Healthcare Solutions for Hospital IT upgrades. Each of the District's debt issues is discussed in detail in Note 8 to the financial statements. As of June 30, 2009 the District's debt comprised:

Table 4
Outstanding Debt

	June 30, 2009
Government Activity Debt:	
Transition loan	\$ 1,375,000
County of Marin Loan	4,500,000
ACS loan	6,053,177
Total Governmental Activity Debt	\$ 11,928,177

Economic Outlook and Major Initiatives

Economic factors do not have a direct influence on the District's budget. The current lease, effective for fiscal year 2010 and as amended by the Settlement Agreement, requires Marin General Hospital Corporation to pay \$89,600 of rent quarterly, irrespective of the hospital's net earnings. In addition, the District recognizes \$95,133 of deferred lease revenue on a monthly basis. Similarly, the 1999 litigation settlement requires a set annual payment to support the District's transition expenses, irrespective of economic conditions. A Settlement Agreement and related Transfer Agreement with Sutter Health and the Hospital Corporation were approved at the September 12, 2006 District Board meeting with formal agreements entered into on October 4, 2006. As part of those Agreements, the District will become the sole corporate member of the Hospital Corporation on June 30, 2010, and has assumed responsibility for the hospital's seismic obligations.

Contacting the District's Financial Management

This comprehensive Annual Financial Report is intended to provide citizens, taxpayers, and creditors with a general overview of the District's finances. Questions about this Report should be directed to Marin Healthcare District to the attention of Executive Director or the Chair of Management, Finance and Audit Committee, at 415-464-2090.

Marin Healthcare District
STATEMENTS OF NET ASSETS
 June 30, 2009
 (With Comparative Totals for June 30, 2008)

	2009	2008
<u>ASSETS</u>		
Current assets:		
Cash and investments	\$ 3,669,310	\$ 2,142,146
Due from Marin General Hospital Foundation	8,489	-
Total current assets	3,677,799	2,142,146
Prepaid items	11,000	5,000
Property, plant, and equipment, net of accumulated depreciation	20,406,926	8,736,742
Total assets	24,095,725	10,883,888
<u>LIABILITIES AND NET ASSETS</u>		
Current liabilities:		
Accounts payable	984,106	127,648
Accrued expenses	63,815	-
Accrued election expense	176,061	203,289
Deferred rental income	87,061	82,916
Current portion of deferred lease revenue	1,141,598	3,166,817
Total current liabilities	2,452,641	3,580,670
Long term liabilities:		
Transition loan and accrued interest	1,525,938	1,203,750
County loan and accrued interest	4,545,156	-
ACS loan	6,053,177	-
Deferred revenue - lease	6,034,035	3,166,818
Total liabilities	20,610,947	7,951,238
Net assets (deficit):		
Invested in capital assets net of related debt	8,282,655	8,736,742
Unrestricted	(4,797,877)	(5,804,092)
Total net assets (deficit)	\$ 3,484,778	\$ 2,932,650

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

Marin Healthcare District
STATEMENTS OF REVENUES, EXPENSES,
AND CHANGES IN NET ASSETS
For the Year Ended June 30, 2009
(With Comparative Totals for the Year Ended June 30, 2008)

	<u>2009</u>	<u>2008</u>
Operating revenue:		
Lease income-Marin General Hospital Corporation		
Minimum cash payment	\$ 341,335	\$ 325,082
Required capital payment	<u>-</u>	<u>3,166,807</u>
Total lease income	341,335	3,491,889
Reimbursement of operating expenses-Marin General Hospital Corporation	-	-
Settlement transition	<u>250,000</u>	<u>750,000</u>
Total operating revenue	<u>591,335</u>	<u>4,241,889</u>
Operating expenses:		
Depreciation	766,283	1,103,166
Transition expense	20,988	1,552,482
Administration	<u>545,961</u>	<u>466,187</u>
Total operating expense	<u>1,333,232</u>	<u>3,121,835</u>
Operating income	<u>(741,897)</u>	<u>1,120,054</u>
Non-operating revenue:		
Interest revenue	<u>27,490</u>	<u>80,303</u>
Total non-operating revenue	<u>27,490</u>	<u>80,303</u>
Net income	(714,407)	1,200,357
Net assets (deficit), beginning of period as adjusted	<u>4,199,185</u>	<u>1,732,293</u>
Net assets (deficit), end of period	<u>\$ 3,484,778</u>	<u>\$ 2,932,650</u>

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

Marin Healthcare District
STATEMENTS OF CASH FLOWS
For the Year Ended June 30, 2009
(With Comparative Totals for the Year Ended June 30, 2008)

	2009	2008
Cash flows from operating activities:		
Receipts from tenants	\$ 586,991	\$ 1,157,998
Payments to employees	(37,604)	(226,960)
Payments to suppliers	(498,758)	(1,621,384)
Net cash provided (used) by operating activities	50,629	(690,346)
Cash flows from capital and related financing activities:		
Capital purchases	(9,471,476)	-
Loan proceeds	10,920,521	828,750
Net cash provided (used) by capital and related financing activities	1,449,045	828,750
Cash flows from investing activities:		
Interest earned	27,490	80,303
Net cash provided by investing activities	27,490	80,303
Net increase (decrease) in cash and cash equivalents	1,527,164	218,707
Cash and cash equivalents - beginning of period	2,142,146	1,923,439
Cash and cash equivalents - end of period	\$ 3,669,310	\$ 2,142,146
Reconciliation of operating income (loss) to net cash provided (used in) operating activities:		
Operating income (loss)	\$ (741,897)	\$ 1,120,054
Adjustments to reconcile operating income (loss) to net cash provided by operating activities:		
Depreciation	766,283	1,103,166
Required capital payment	-	(3,166,807)
Changes in certain assets and liabilities:		
Prepaid items	(6,000)	(1,650)
Due from Marin General Hospital Foundation	(8,489)	-
Accounts payable	-	86,975
Deferred rental income	4,145	82,916
Accrued expenses	63,815	-
Accrued election expense	(27,228)	85,000
Net cash provided (used) by operating activities	\$ 50,629	\$ (690,346)

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

Marin Healthcare District
NOTES TO BASIC FINANCIAL STATEMENTS
June 30, 2009

NOTE 1 - ORGANIZATION

Marin Healthcare District (the District) is political subdivision of the State of California. District directors are elected officials whose sole mission is to promote the health and welfare of the residents of the communities served by the District. The District operated the Marin General Hospital Facility (the hospital facility) until 1985, when it reorganized in compliance with local hospital district law of the State of California.

The District's principal asset is hospital property, plant and equipment. The hospital is a general acute-care facility located in Marin County, California and provides inpatient and outpatient healthcare services. Inpatient facilities consist of medical-surgical, pediatrics, maternity, nursery, intensive care, coronary, psychology, and radiology and laboratory services. The hospital facility is leased to the Marin General Hospital Corporation (the Hospital Corporation), a California nonprofit public benefit corporation.

In addition to overseeing the Hospital Corporation's compliance with the lease agreement, the District is a forum for discussion of local healthcare issues, promotes healthcare services within the community, and acts on behalf of the public as an advocate of high quality, reasonably priced healthcare services.

The District derives substantially all of its revenue from the Hospital Corporation. The annual rent pursuant to the 30 year lease agreement with the Hospital Corporation, as amended by the Settlement Agreement, is \$1,500,000, most of which the Hospital Corporation has prepaid in the form of capital expenditures on the Hospital facility, and the Hospital Corporation also reimburses the District for administrative expenses through quarterly cash payments, which are increased annually by 5%. (See Note 5 – LEASE OF MARIN HEALTHCARE DISTRICT FACILITY). Operating losses are caused by depreciation expense of property, plant and equipment in excess of the annual rent revenue.

In June, 2005, the Hospital Corporation filed a lawsuit for declaratory relief against the District. At issue was whether the lessor or the lessee was responsible for the seismic upgrade of the Hospital Facility as required by California Senate Bill 1953, enacted in 1994 (the "Hospital Seismic Upgrade Act").

The parties signed a Settlement Agreement dated October 4, 2006. The Settlement Agreement incorporates a Transfer Agreement and an Interim Funding Agreement that describe the rights and obligations of the parties with respect to the Transfer. Pursuant to the Transfer Agreement, the District will become the sole corporate member of the Hospital Corporation on June 30, 2010 (the "Transfer").

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Reporting Entity

The District is the only entity included in these basic financial statements.

Marin Healthcare District
NOTES TO BASIC FINANCIAL STATEMENTS
June 30, 2009

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

B. Basis of Presentation and Accounting

The activities of the District are accounted for as an Enterprise Fund. Enterprise funds are accounted for on the flow of economic resources measurement focus and use the accrual basis of accounting. Under this method, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred. In compliance with Governmental Accounting Standards Board (GASB) Statement No. 20, the District has chosen to apply all applicable GASB pronouncements and all Financial Accounting Standards Board Statements and Interpretations, Accounting Principles Board Opinions and Accounting Research Bulletins issued on or before November 30, 1989, unless they conflict with or contradict GASB pronouncements.

Proprietary fund *operating* revenues, such as charges for services, result from exchange transactions associated with the principal activity of the fund. Exchange transactions are those in which each party receives and gives up essentially equal values. *Non-operating* revenues, such as subsidies and investment earnings, result from non-exchange transactions or ancillary activities.

The District may fund programs with a combination of cost-reimbursement grants, categorical block grants, and general revenues. Thus, both restricted and unrestricted net assets may be available to finance program expenditures. The District's policy is to first apply restricted grant resources to such programs, followed by general revenues if necessary.

C. Budgetary Accounting

The District's procedures in establishing the budgetary data reflected in the financial statements are as follows:

The Management Finance and Audit Committee submit a proposed operating budget to the District's full Board for the fiscal year commencing the following July 1. The operating budget includes proposed expenses and the means of financing them. The Management Finance and Audit Committee and full District Board are open to public comment at scheduled board meetings. The budget is legally enacted through a District Board action.

D. Use of Estimates

The basic financial statements have been prepared in conformity with U.S. generally accepted accounting principles, and as such, include amounts based on informed estimates and judgments of management with consideration given to materiality. Actual results could differ from those estimates.

E. Cash and Cash Equivalents

Cash and investments are used in preparing the statement of cash flows because these assets are highly liquid and are expended to liquidate liabilities arising during the year.

Marin Healthcare District
NOTES TO BASIC FINANCIAL STATEMENTS
June 30, 2009

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (concluded)

F. Property, Plant, and Equipment

Property, plant, and equipment are recorded at cost. Depreciation is provided on the straight-line basis over the estimated useful lives of the assets. Depreciation expense was \$766,283 for the year ended June 30, 2009. The threshold for capitalizing capital expenses is \$5,000.

G. Risk Management

The District is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; and natural disasters for which the District carries commercial insurance.

H. Deferred Revenue-Lease

Deferred revenue represents capital expenditures by the Hospital Corporation in excess of the current commitment, which will be recognized as rental revenue in future years.

I. Revenue Recognition

The District recognizes lease income and reimbursement of operating expenses when earned.

NOTE 3 - CASH AND INVESTMENTS

Cash balances from all funds are combined and invested to the extent possible pursuant to the District Board approved Investment Policy and Guidelines and State Government Code. The District's investments are carried at fair value.

	<u>2009</u>
Cash:	
Demand accounts	<u>\$ 3,669,310</u>

Authorized Investments

In accordance with Section 53601 of the California Government Code, the District may invest in the following types of investments:

- Securities of the U.S. Government, or its agencies
- Negotiable Certificates of Deposits
- Local Agency Investment Fund (State Pool) Deposits

Custodial Credit Risk

Custodial credit risk for deposits is the risk that, in the event of the failure of a depository financial institution, a government will not be able to recover its deposits or will not be able to recover collateral securities that are in the possession of an outside party. The custodial credit risk for deposits and investments is the risk that, in the event of the failure of the counterparty (e.g., broker-dealer) to a transaction, a government will not be able to recover the value of its investment or collateral securities that are in the possession of another party.

Marin Healthcare District
NOTES TO BASIC FINANCIAL STATEMENTS
 June 30, 2009

NOTE 3 - CASH AND INVESTMENTS (concluded)

California Law requires banks and savings and loan associations to pledge government securities with a market value of 110% of the District's cash on deposit or first trust deed mortgage notes with a value of 150% of the deposit as collateral for these deposits. Under California Law, this collateral is held in the District's name and places the District ahead of general creditors of the institution.

The District places certain funds with the State of California's Local Agency Investment Fund (LAIF). The District is a voluntary participant in LAIF, which is regulated by California Government Code Section 16429 under the oversight of the Treasurer of the State of California and the Pooled Money Investment Board. The State Treasurer's office pools these funds with those of other governmental agencies in the state and invests the cash. The fair value of the District's investment in this pool is reported in the accompanying financial statements based upon the District's pro-rata share of the fair value provided by LAIF for the entire LAIF portfolio (in relation to the amortized cost of that portfolio). The monies held in the pooled investment funds are not subject to categorization by risk category. The balance available for withdrawal is based on the accounting records maintained by LAIF, which are recorded on the amortized cost basis. Funds are accessible and transferable to the master account with twenty-four hours notice. Financial statements for LAIF can be obtained from the California State Treasurer's Office: State Treasurer's Office, 915 Capitol Mall, Suite 110, Sacramento, CA 95814.

The management of the State of California Pooled Money Investment Account has indicated to the District that as of June 30, 2009 the carrying amount of the pool was \$50,743,268,380 and the estimated market value of the pool (including accrued interest) was \$50,889,715,337. The District's proportionate share of that value is \$292,537. Included in LAIF's investment portfolio are certain derivative securities or similar products in the form of structured notes, totaling \$5,169,332,000 and asset-backed securities totaling \$2,296,565,000.

NOTE 4 - PROPERTY, PLANT AND EQUIPMENT

The following is a summary of changes in property, plant and equipment during the years ended June 30:

	Life (years)	Balance June 30, 2008	Additions	Deletions	Balance June 30, 2009
Equipment	3-20	\$ 18,784,416	\$ -	\$ -	\$ 18,784,416
Hospital buildings	40	24,974,084	-	-	24,974,084
Construction in progress (not depreciated)	N/A	-	12,436,467	-	12,436,467
Parking structure	40	2,324	-	-	2,324
Phase 1 building	40	102,625	-	-	102,625
Land (not depreciated)	N/A	865,701	-	-	865,701
Other improvements	40	596,491	-	-	596,491
Parking improvements	40	781,404	-	-	781,404
Movable equipment	3-20	<u>1,093,653</u>	-	<u>2,925</u>	<u>1,090,728</u>
Subtotal		47,200,698	<u>\$ 12,436,467</u>	<u>\$ 2,925</u>	59,634,240
Less: accumulated depreciation		<u>(38,463,956)</u>			<u>(39,227,314)</u>
Property, plant and equipment, net		<u>\$ 8,736,742</u>			<u>\$ 20,406,926</u>

Marin Healthcare District
NOTES TO BASIC FINANCIAL STATEMENTS
 June 30, 2009

NOTE 4 - PROPERTY, PLANT AND EQUIPMENT (concluded)

The District's property, plant and equipment are leased to and used exclusively, by the Hospital Corporation. Depreciation expense for the year ended June 30, 2009 was \$766,283.

NOTE 5 - LEASE OF MARIN HEALTHCARE DISTRICT FACILITY

A. Annual Rental Payments

Effective December 1, 1985, the District leased the Marin General Hospital facility to the Hospital Corporation for a term of 30 years pursuant to Section 32126 of the Local Hospital District Law. Per the amended lease agreement dated August 25, 1987, as further amended by the Settlement Agreement, the annual rent payments comprise capital expenditures made by the Hospital Corporation and quarterly payments of \$89,600 effective fiscal year 2010. The minimum cash payment, which is payable in quarterly installments, increases annually by 5% throughout the lease term. The lessee has satisfied this provision of the lease for the year ended June 30, 2009.

Due to the significant capital investment required for the hospital modernization program completed in June 1989, the Hospital Corporation's rental payment commitment for capital expenditures due under the entire lease has been satisfied. The advanced capital commitment (including the excess capital commitment) has been recorded as deferred revenue. As of June 30, 2009, the total deferred lease revenue was \$7,175,633.

The deferred lease revenue will be amortized over the remaining term of the lease, which ends on December 1, 2015. Future amortization of deferred lease revenue is as follows:

<u>Fiscal Year End</u>	<u>Amortization</u>	<u>Cash Payment</u>	<u>Total</u>
2010	\$ 1,141,598	\$ 358,402	\$ 1,500,000
2011	1,123,678	376,322	1,500,000
2012	1,104,862	395,138	1,500,000
2013	1,085,105	414,895	1,500,000
2014	1,064,360	435,640	1,500,000
2015	1,042,578	457,422	1,500,000
2016	<u>613,452</u>	<u>200,122</u>	<u>813,574</u>
Total	<u>\$ 7,175,633</u>	<u>\$ 2,637,941</u>	<u>\$ 9,813,574</u>

B. Capital Improvement Payments

In addition to the capital rental obligation described under annual rental payments, the lease agreement, as amended by the Settlement Agreement, requires the Hospital Corporation to make minimum annual capital expenditures (buildings and equipment) during the lease term. The obligation was approximately \$2,770,000 for the year ended June 30, 2009. These assets automatically revert to the District upon termination of the lease. Accordingly, these assets are a part of the Hospital Corporation's financial statements, and are not included in the accompanying financial statements. Many of these assets will revert without payment by the District; however, reversion of certain assets may also include liabilities (including required payments by the District) related to such assets. The amount of these assets and related liabilities cannot be currently estimated. The lessee has satisfied this provision of the lease for the year ended June 30, 2009.

Marin Healthcare District
NOTES TO BASIC FINANCIAL STATEMENTS
June 30, 2009

NOTE 5 - LEASE OF MARIN HEALTHCARE DISTRICT FACILITY (concluded)

C. Lease Modification

The District, Sutter Health, and the Hospital Corporation signed a Settlement Agreement dated October 4, 2006. In anticipation of the transfer to the District of the sole corporate membership in the Hospital Corporation, the Settlement Agreement modifies the lease to limit the Hospital Corporation's breach or default of the lease to its willful and intentional refusal to perform material duties. The District waives the right to seek consequential damages resulting from a Hospital Corporation default and the District's remedies for any default or breach are limited to specific performance or damages, through a binding arbitration process. The lease cannot be terminated before Transfer and the District's right to possession of the premises is limited until the Transfer.

NOTE 6 - RELATED PARTY TRANSACTIONS

Under its lease obligations, the Hospital Corporation is currently paying some of the operating expenses incurred by the District. The total amount of the operating expenses is minimal.

NOTE 7 - NET ASSETS

Net Assets is the excess of all the District's assets over all its liabilities, regardless of fund. Net Assets are divided into three captions under GASB Statement 34. These captions apply only to Net Assets, which is determined only at the Government-wide level, and are described below:

Invested in Capital, net of related debt describes the portion of Net Assets that is represented by the current net book value of the District's capital assets, less the outstanding balance of any debt issued to finance these assets.

Restricted describes the portion of Net Assets that is restricted as to use by the terms and conditions of agreements with outside parties, governmental regulations, laws, or other restrictions which the District cannot unilaterally alter. These principally include developer fees received for use on capital projects, debt service requirements, and redevelopment funds restricted to low and moderate income purposes. The District has no restricted Net Assets.

Unrestricted describes the portion of Net Assets that is not restricted to use.

NOTE 8 - LOANS PAYABLE AND PURCHASE OBLIGATION

Pursuant to the Interim Funding Agreement executed along with the Settlement Agreement and Transfer Agreement on October 4, 2006, the District has received funding for the establishment of a transition team to implement the Settlement Agreement and Transfer Agreement. These agreements relate to the resolution of legal proceedings from June 30, 2005. Under the Interim Funding Agreement, the District has received \$250,000 on January 1, 2007 and \$500,000 on July 1 and January 1 of each year thereafter through July 1, 2009, and is entitled to receive another \$500,000 on January 1, 2010. The Transfer date will be June 30, 2010. In addition, as of the Transfer, the District will be responsible to execute a promissory note to pay back one half of all amounts provided under the Interim Funding Agreement plus interest at the prime rate plus two percent. As of June 30, 2009, the District owes \$1,525,938 under the Interim Funding Agreement.

Marin Healthcare District
NOTES TO BASIC FINANCIAL STATEMENTS
June 30, 2009

NOTE 8 - LOANS PAYABLE AND PURCHASE OBLIGATION (concluded)

On November 3, 2008, the District entered into a loan agreement with the County of Marin for an amount up to \$20,000,000. The funds are needed to make preparations for the Transfer. The interest rate is prime plus one percent. The term of the loan will end no later than 75 days after the Transfer date, or no later than September 13, 2010. As of June 30, 2009, the District owes the County of Marin \$4,500,000 and accrued interest of \$45,156. There is no formal amortization schedule for the loan.

The District entered into a loan agreement with ACS Healthcare Solutions for the implementation of information technology upgrades to Marin General Hospital. The District is contractually committed for up to \$14,000,000 which may be increased through change orders prior to the Hospital transfer date. As of June 30, 2009 the outstanding balance of the loan is \$6,053,177. There is no interest charged on the loan and the loan is due on approximately July 5, 2010.

NOTE 9 - COMMITMENTS

In June, 2005, the Hospital Corporation filed a lawsuit for declaratory relief against the District. At issue was whether the lessor or the lessee was responsible for the seismic upgrade of the Hospital Facility as required by California Senate Bill 1953, enacted in 1994 (the "Hospital Seismic Upgrade Act").

The parties signed a Settlement Agreement dated October 4, 2006. The Settlement Agreement incorporates a Transfer Agreement and an Interim Funding Agreement that describe the rights and obligations of the parties with respect to the transfer.

A. Compliance with the Hospital Seismic Upgrade Act

Pursuant to settlement, the District will become the sole corporate member of the Hospital Corporation as of June 30, 2010. Pursuant to the Settlement Agreement, the District has assumed full responsibility and all financial liability for compliance with the Hospital Seismic Upgrade Act. The District estimates seismic architectural and engineering costs of approximately \$35,000,000.

The deadline for compliance is January 1, 2013. The Settlement Agreement places sole responsibility on the District for obtaining any extension for compliance with the Hospital Seismic Upgrade Act from the Office of Statewide Health Planning and Development. (See Note 11 – SUBSEQUENT EVENTS).

B. Transfer Agreement

The Transfer Agreement excludes certain IT systems currently provided to the Hospital Corporation by Sutter Health and other specific assets from remaining with the Hospital Corporation after the Transfer. The District is responsible for replacing such information systems, including contracts, hardware, software applications and licenses necessary for hospital operations.

The District estimates the cost of replacement and integration of information systems to be \$14,000,000.

Marin Healthcare District
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NOTE 9 - COMMITMENTS (concluded)

C. Insurance

The Transfer Agreement terminates the lessee's Business and Facilities insurance as of the Transfer date. The District is responsible for obtaining and initially paying for Business and Facilities insurance coverage for the Hospital Corporation and hospital facility. The District anticipates causing the Hospital Corporation to reimburse the District for the costs of such replacement insurance post-Transfer

NOTE 10 - CONTINGENT LIABILITIES

A. Interim Funding Agreement

On October 4, 2006, the District and the Hospital Corporation signed a Settlement Agreement, a Transfer Agreement and an Interim Funding Agreement. (See Note 9 - COMMITMENTS). The agreements require the District to fund all of its preparations for the Transfer, including making certain capital expenditures for the post-Transfer benefit of the Hospital Corporation and the hospital facilities. The District anticipates causing the Hospital Corporation to reimburse the District and/or assume sole responsibility for such expenditures.

As of June 30, 2009, the District has spent \$12,436,467 in connection with these obligations.

B. Compliance with the Hospital Seismic Upgrade Act

On October 4, 2006, the District and the Hospital Corporation signed a Settlement Agreement, a Transfer Agreement and an Interim Funding Agreement. (See Note 9 - COMMITMENTS). The Settlement Agreement places sole responsibility on the District for obtaining any extension for compliance with the Hospital Seismic Upgrade Act from the Office of Statewide Health Planning and Development. The deadline for compliance with the Act is January 1, 2013. (See Note 11 - SUBSEQUENT EVENTS).

C. Pending Litigation

The District is involved in various claims and litigation arising in the ordinary course of business. In the opinion of the District's attorney, there is no pending litigation or unasserted claims which are likely to have a material adverse effect on the District's financial position.

NOTE 11 - SUBSEQUENT EVENTS

The District and the Hospital Corporation signed a Settlement Agreement dated October 4, 2006. Under the Settlement Agreement, the District has assumed full responsibility and all financial liability associated with pre-Transfer compliance with the Hospital Seismic Upgrade Act (AB 1953), including necessary extensions for compliance.

On October 11, 2009, the Governor of the State of California signed AB/SB 523 to extend the compliance deadline to January 1, 2015.

Marin Healthcare District
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NOTE 11 - SUBSEQUENT EVENTS (concluded)

The Settlement Agreement and Transfer Agreement allow, and the District anticipates that it will create, an appointed Subsidiary Operating Board to provide oversight and run the day to day operations of the Hospital Corporation after the District becomes the sole corporate member of the Hospital Corporation. The District is also planning additional Hospital design and construction upgrades which may entail the issuance of public debt in the future.

In preparing these financial statements, the District has evaluated events and transactions for potential recognition or disclosure through December 21, 2009, the date the financial statements were available to be issued.

NOTE 12 - PRIOR PERIOD ADJUSTMENT

During the year ended June 30, 2009, the District discovered an error in the recording of certain assets which should have been capitalized as of June 30, 2008 and were not. The effect of the correction of this error was to increase the change in net assets by \$2,108,533 for the year ended June 30, 2008. In addition, another error was discovered in the amortization of deferred lease revenue. The deferred lease revenue was previously amortized through the settlement agreement transition date in 2010, but should have been amortized through the December 1, 2015 lease date. The effect of the correction of this error was to decrease the change in net assets by \$841,998 for the year ended June 30, 2008. The total prior period adjustment was \$1,266,535. The related adjustment to beginning net assets is as follows:

Net assets, beginning of period	\$ 2,932,650
Prior period adjustment	<u>1,266,535</u>
Net assets, beginning of period as adjusted	<u>\$ 4,199,185</u>

NOTE 13 - OPERATING LEASES

The District leases office facilities under a noncancelable operating lease. The total cost for the lease was \$91,612 for the fiscal year ended June 30, 2009. The future minimum lease payments were as follows:

<u>Year Ending June 30</u>	<u>Amount</u>
2010	\$ 117,216
2011	124,340
2012	63,936