MARIN HEALTHCARE DISTRICT

REPORT ON AUDITS OF FINANCIAL STATEMENTS

for the years ended June 30, 2004 and 2003

MARIN HEALTHCARE DISTRICT

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MARIN HEALTHCARE DISTRICT
MANAGEMENT'S DISCUSSION AND ANALYSIS
June 30, 2004

The management of the Marin Healthcare District (the District) is pleased to present the following discussion and analysis of the operating results, financial condition, and liquidity of the District for the fiscal year ended June 30, 2004. This discussion should be read in conjunction with the financial statements and notes to the financial statements included with this report.

Overall Program Highlights

The purpose of the Marin Healthcare District, as stated in its By-Laws, primarily relates to:

(1) Over-sight of the lease with Marin General Corp. to ensure the optimum operation of the Hospital for the benefit of the communities served by the District; (2) Enhancing the provision of quality health care in the communities served by the District; and (3) Being a strong advocate for the public for quality and reasonably priced health care. During the 2004 fiscal year, the Directors monitored the activities of Marin General Hospital through regular quarterly reports on the Hospital's patient care services and its financial status, and raised questions and concerns with Hospital management as warranted. In addition, Directors were diligent in raising quality of care issues and following up with Hospital management and also with the Department of Health Services if necessary. Medicare identified several condition level deficiencies that could result in the Hospital losing Medicare certification status if not corrected in subsequent surveys. The District Board is monitoring this process diligently; as of June 30, 2004, a final determination had not yet been made.

Description of 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 (pages 7-9), and the footnotes (pages 10-17). This annual report is prepared in accordance with the Governmental Accounting Standards Board Statement 34, *Basic Financial Statements–and Management's Discussion and Analysis–for State and Local Governments.* The Business-Type Activity (BTA) reporting model is used which best represents the activities of the District.

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 financial statements 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 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 expenses reported during this fiscal year may result in changes to cash flow 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.

Continued

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

Burr, Pilger & Mayer LLP has performed an independent audit of our financial statements in accordance with generally accepted auditing standards. Their opinion is included in the Financial Section of this report.

Analytical Overview

Summary. Total Assets of the District has decreased this year by $1.3 million. This classification comprises Current Assets (Cash and Cash Equivalents), which increased overall by $117 thousand, and Capital Assets, which decreased by $1.4 million. The latter category is presented net of accumulated depreciation, and the decrease is due primary to depreciation expense during the year.

Total Liabilities has decreased this year by 1.2 million. This classification is comprised of current liabilities (accounts payable and other liabilities due within one year) and deferred lease revenue. The decrease in total liabilities is due primarily to a decrease in the deferred lease revenue by $1.2 million.

Total Net Assets has decreased this year by $96 thousand. Net Assets consists of Net Assets Invested in Capital Assets, which has decreased by $1.4 million to $12.7 million, and Unrestricted Net Assets which has increased by $1.3 million to a deficit of $13 million.

Revenue and Expenses with Year over Year Change
(In thousands)

	2004	2003	Increase (Decrease)	% Change	
Total operating revenue	$1,650	$1,650	-	-	
Total operating expenses	1,653	1,805	$(152)	-8%	Note 1
Excess (deficit) of operating revenues over expenses	(3)	(155)	152	98%	
Nonoperating revenue (expense):					
Interest revenue	3	4	(1)	-25%	
Other expenses	(96)	-	(96)	-	Note 2
Total nonoperating revenue (expense)	(93)	4	(97)	-2425%	
Change in net assets	$ (96)	$ (151)	$ 201	133%	

Note 1
Total operating expenses includes both the District's administrative expenses and depreciation. The District's administrative expenses increased to $369,000 this fiscal year from $281,000 the previous fiscal year, a 31% increase. This was primarily due to an increase in legal fees and in staff expense. These increased expenses were partially offset by an over allocation of the District's reserve account for election expenses in the previous year which resulted in no allocation this fiscal year. Depreciation, on the other hand, was $240,000 less than the previous fiscal year and the net result was a $152,000 decrease in total operating expenses.

Continued

Note 2
The figure listed for other expenses represents the loss on the disposal of fully depreciated equipment due to obsolescence.

Assets, Liabilities, and Net Assets with Year-over-Year Change
(In thousands)

ASSETS	2004	2003	Increase (Decrease)	% Change
Current assets	$ 290	$ 173	$ 117	68%
Property, plant, and equipment, net of accumulated depreciation	12,711	14,091	(1,380)	-10%
Total assets	13,001	14,264	(1,263)	-9%
LIABILITIES				
Current liabilities	218	152	66	43%
Deferred revenue–lease	13,124	14,357	(1,233)	-9%
Total liabilities	13,342	14,509	(1,294)	-9%
NET ASSETS				
Invested in capital assets	12,711	14,091	(1,380)	-10%
Unrestricted deficit	(13,052)	(14,336)	(1,284)	9%
Total net assets	$ (341)	$ (245)	$ (96)	-39%

Property, Plant and Equipment

The property owned by the District is 250 Bon Air. Rd., Greenbrae, CA. It includes all of the buildings and grounds. The buildings and grounds were leased to Marin General Hospital Corporation in 1985 primarily for acute care inpatient services. The Hospital's services also include the Surgery Center of Marin, Trauma Center Level III, the birthing center and radiology. Acute psychiatric and outpatient psychiatric services are also provided. The Marin Community Clinic is located on the Hospital campus and rents two structures from MGH Corporation, at below market rates, to provide non-acute medical services to county indigent, uninsured and Medical patients. The District also owns hospital equipment present at the time the lease was signed and equipment purchased since then per lease terms.

Deferred Revenue–Lease

The District leased the Hospital to MGH Corporation in 1985. The District had several million dollars of bonds outstanding at the time. In 1987, a First Amendment to the lease was approved which established the terms of rent and MGH Corporation assumed ownership of the outstanding bonds. Rent was set at $1,500,000 per year of which a portion was cash and the balance was allocated to paying down the value of the bonds. In 1987, the cash rent was set at $125,000 to be increased 5% per year. The required capital payment figure represents the annual amount allocated toward paying down the bonds.

Continued

Budgetary Highlight

The District has four major expense categories: (1) election costs/reserves; (2) staff costs; (3) legal fees; (4) auditor and other consultants' fees. Any other allocations, such as for community grants, are discretionary. The initial budget is prepared by staff working with the Board Chair or Chair of the Management, Finance and Audit Committee (MFA) and is based primarily on established revenue and expense patterns. Discretionary allocations depend on the availability of discretionary funds. Recommendations for the use of discretionary funds are made by Directors and voted on. Presently a policy is in place, which establishes a goal of a $1,000,000 reserve before any new programs are considered. The initial budget is reviewed by the MFA Committee and accepted or revised on discussion. This draft budget is referred to the full Board for review, discussion and approval at a public meeting.

Actual Results Versus Budget for the Year Ending June 30, 2004
(In thousands)

	Actual	Budget	Variance Favorable (Unfavorable)
Operating revenue:			
Lease income–Marin General Hospital Corporation:			
Minimum cash payment	$ 267	$ 267	-
Required capital payment	1,233	1,233	-
Reimbursement of operating expenses–Marin General Hospital Corporation	150	150	-
Total operating revenue	1,650	1,650	-
Operating expenses:			
Depreciation	1,284	1,284	-
Administration	369	325	$44
Total operating expenses	1,653	1,609	44
Nonoperating revenue (expense):			
Interest revenue	3	4	1
Other expenses	(96)	*	(96)
Total nonoperating revenue (expense)	(93)	4	
Change in net assets	$ (96)	$ 45	

*Not budgeted.

Significant variances between the approved budget and actual results are as follows:

(1) The Administrative Operating Expense variance was due to higher than anticipated attorney's fees as a result of one time special matters including conflict of interests, sale of the District's reversionary interest in Marin Home Care and staff labor issues. These unanticipated higher administrative costs were partially offset by reductions in other budget line items including communications and other consultants' fees.

Continued

(2) The District does not budget for non-operating other expenses. Periodically, the Hospital writes off fully depreciated equipment due to obsolescence as was done this fiscal year but it is not an anticipated transaction.

Economic Factors

Economic factors do not have a direct influence on the District's budget. The current lease requires MGH Corporation to pay $1.5 million of rent annually irrespective of the Hospital's net earnings. Similarly, the litigation settlement requires a set annual payment irrespective of economic conditions.

Description of Facts or Conditions that are Expected to have a Significant Effect on Financial Position or Results of Operations

The only foreseeable condition that is expected to have a significant effect on the District's finances or operations is a change in the relationship between the Hospital (lessee) and the District (lessor). As of June 30, 2004, preliminary discussions between the Hospital and the District about their future relationship had periodically taken place with no action taken.

Contacting the District's Financial Management

This Annual Financial Report is intended to provide citizens, taxpayers, investors, and creditors with a general overview of the District's finances. Questions about this Report should be directed to the Marin Healthcare District to the attention of staff or the Chair of Management, Finance and Audit Committee, at 415-461-5700.

INDEPENDENT AUDITORS' REPORT

To the Board of Directors
of Marin Healthcare District

We have audited the statements of net assets of Marin Healthcare District as of June 30, 2004 and 2003, and the related statements of revenue, expenses, and changes in net assets, and cash flows for the years then ended, collectively known as the basic financial statements These basic financial statements are the responsibility of the District's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the *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 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 significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide 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 Marin Healthcare District as of June 30, 2004 and 2003, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America as well as accounting systems prescribed by the State Controller and State regulations governing special districts.

The basic financial statements referred to above follow the requirements of Government Accounting Standards Board Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - For State and Local Governments,* No. 37, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments; Omnibus, and* No. 38, *Certain Financial Statement Note Disclosures*, as discussed in Note 1 to the basic financial statements.

Management's Discussion and Analysis is supplementary information required by the Government Accounting Standards Board, but is not part of the basic financial statements. We have applied certain limited procedures to this information, principally 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.

Burr, Pilger & Mayer, LLP

San Francisco, California
September 23, 2004

MARIN HEALTHCARE DISTRICT

STATEMENTS OF NET ASSETS

June 30, 2004 and 2003

ASSETS	2004	2003
	(in thousands)	
Current assets–cash and cash equivalents	$ 290	$ 173
Total current assets	290	173
Property, plant, and equipment, net of accumulated depreciation	12,711	14,091
Total assets	$13,001	$14,264
LIABILITIES AND NET ASSETS		
Current liabilities:		
Accounts payable	$ 11	$ 51
Accrued election expenses	101	101
Prepaid rent and operating expense reimbursement	106	-
Total current liabilities	218	152
Deferred lease revenue	13,124	14,357
Total liabilities	13,342	14,509
Net assets	(341)	(245)
Total liabilities and net assets	$13,001	$14,264

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

MARIN HEALTHCARE DISTRICT

STATEMENTS OF REVENUE, EXPENSES, AND CHANGES IN NET ASSETS
for the years ended June 30, 2004 and 2003

	2004	2003
	(in thousands)	
Operating revenue:		
Lease income–Marin General Hospital Corporation		
Minimum cash payment	$ 267	$ 255
Required capital payment	1,233	1,245
Total lease income	1,500	1,500
Reimbursement of operating expenses–Marin General Hospital Corporation	150	150
Total operating revenue	1,650	1,650
Operating expenses:		
Depreciation	1,284	1,524
Administration	369	281
Total operating expenses	1,653	1,805
Excess of operating expenses over revenue	(3)	(155)
Nonoperating (expense) revenue:		
Interest revenue	3	4
Other expenses	(96)	-
Total nonoperating (expense) revenue	(93)	4
Change in net assets	(96)	(151)
Net assets, beginning of year	(245)	(94)
Net assets, end of year	$ (341)	$ (245)

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

MARIN HEALTHCARE DISTRICT

STATEMENTS OF CASH FLOWS

for the years ended June 30, 2004 and 2003

	2004	2003
	(in thousands)	
Cash flows from operating activities:		
Cash received from lease income	$ 335	$ 92
Cash received from reimbursement of operating expenses	188	150
Cash paid for administrative expenses	(409)	(265)
Interest income	3	4
Net cash provided by (used in) operating activities	117	(19)
Cash flows from investing activities-proceeds from sale of fixed assets	-	4
Net cash provided by investing activities	-	4
Net increase (decrease) in cash	117	(15)
Cash and cash equivalents, beginning of year	173	188
Cash and cash equivalents, end of year	$ 290	$ 173

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

1. Accounting Policies

Description of Business

Marin Healthcare District (the District), a political subdivision of the State of California, is the lessor of the Marin General Hospital facility. The District operated the hospital facility until December 1, 1985, at which time the District reorganized in compliance with local hospital district law of the State of California and agreed to lease the hospital facility to Marin General Hospital Corporation (the Hospital Corporation), a California nonprofit public benefit corporation.

The lessee is a general acute-care hospital located in Marin County that provides both inpatient and outpatient healthcare services. The Hospital Corporation inpatient facilities consist of medical, surgical, pediatrics, maternity, nursery, intensive care, cardiology, oncology, psychiatric, radiology, laboratory, and pathology services.

As further described in Note 4, the District leases the hospital facility to the Hospital Corporation for a term of 30 years. During the term of this lease, the District derives substantially all of its revenue from the lease obligation.

The District incurs operating losses due to excess operating expenses (principally depreciation) over the annual rent of $1,500,000. The depreciation expense is significant in the early years of the lease, due to the shorter life of equipment. In September 1999, the parties entered into a settlement agreement whereby the District receives $150,000 annually from the Hospital Corporation to cover administrative expenses. Commencing in 2005 the amount paid to the District will increase annually by a Consumer Price Index factor with a minimum of 3% and a maximum of 5%.

In addition to providing oversight of the Hospital Corporation's compliance with the Lease Agreement, the District provides a community forum for discussion of local healthcare issues, promotes healthcare services in the community, and acts as an advocate and overseer for the public for quality, reasonably priced, healthcare services.

Accounting Method

The accompanying financial statements have been prepared using the economic resources measurement focus and the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America, as prescribed by the Governmental Accounting Standards Board (GASB). Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. The District records revenue in part from lease income to an external user, and accordingly has chosen to present its financial statements using the reporting model for special-purpose governments engaged only in business-type activities.

The accompanying financial statements are presented on the basis set forth in Government Accounting Standards Board Statements No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - For State and Local Government*, No. 37, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments; Omnibus*, and No. 38, *Certain Financial Statement Note Disclosures.*

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1. **Accounting Policies**, continued

Accounting Method, continued

The District uses all applicable GASB pronouncements and all Financial Accounting Standards Board Statements and Interpretations issued on or before November 30, 1989, unless these pronouncements conflict with or contradict GASB pronouncements.

Adoption of New Accounting Standard–GASB Statement No. 34

GASB Statement No. 34, as implemented in the current year, restructures much of the information the District has presented in the past. The new financial statements, along with the footnotes, are called *Basic Financial Statements;* the term General Purpose Financial Statements is no longer used. The financial statements required by GASB Statements No. 34 include a statement of net assets, a statement of revenues, expenses, and changes in net assets, and a statement of cash flows.

GASB Statement No. 34 adds the concept of Net Assets. The Statement of Net Assets reports the difference between the District's total assets and the District's total liabilities, including all the District's long term assets and debt. The Statement of Net Assets presents similar information to the old balance sheet format, but presents it in a way that focuses the reader on the composition of the District's net assets, by subtracting total liabilities from total assets.

In addition, Net Assets are divided into separate captions under GASB Statement No. 34, and are described below:

Invested in Capital Assets describes the portion of Net Assets which 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. The District's Net Assets, Invested in Capital Assets at June 30, 2004 and 2003 were $12,711,000 and $14,091,000, respectively.

Unrestricted describes the portion of Net Assets which is not restricted to use. The District's Unrestricted Net Assets at June 30, 2004 and 2003 were deficits of $13,052 and $14,336, respectively.

GASB Statement No. 34 also mandates that the Statement of Cash Flows be prepared using the direct method as opposed to the indirect method used in prior years. Unlike the indirect method which begins with net income and arrives at the net change in cash, the direct method shows cash flows directly from the three categories of cash flows: cash flows from operating activities, cash flows from financing activities and cash flows from investing activities.

Cash and Cash Equivalents

For purposes of the statement of cash flows, the District considers all highly liquid financial instruments with maturities of three months or less when purchased to be cash equivalents.

Continued

1. **Accounting Policies**, continued

Property, Plant, and Equipment

Property, plant, and equipment are stated at cost. Depreciation is estimated by using the straight-line method over estimated useful lives of 40 years for buildings and 3 to 20 years for equipment. Upon sale or retirement of property, plant, and equipment, the related costs and accumulated depreciation or amortization are removed from the accounts and any resulting gain or loss is included in revenues and expenses.

Deferred Revenue–Lease

Deferred revenue represents capital expenditures by the Hospital Corporation in excess of the current commitment, which will be recognized as lease income in future years (Note 4).

Revenue Recognition

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

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Significant estimates used in preparing these financial statements include those used in calculating the carrying value of the District's property, plant, and equipment. Actual results could differ from those estimates.

Concentration of Credit Risk

Financial instruments that potentially subject the District to credit risk consist primarily of cash and cash equivalents. The District maintains cash and cash equivalents with commercial banks.

Classification of Current and Noncurrent Assets and Liabilities

The District considers assets to be current that can reasonably be expected, as part of its normal business operations, to be converted to cash and be available for liquidation of current liabilities within 12 months of the statement of net assets date. Liabilities that reasonably can be expected, as part of normal business operations, to be liquidated within 12 months of the statement of net assets date are considered to be current. All other assets and liabilities are considered to be noncurrent.

Continued

2. **Cash and Cash Equivalents**

Cash and cash equivalents included the following at June 30, 2004 and 2003:

	2004	2003
	(in thousands)	
Operating accounts	$ 45	-
Local agency investment fund (LAIF)	245	$173
	$290	$173

Local Agency Investment Fund

The District's investments are carried at fair value instead of cost, as required by U.S. generally accepted accounting principles. The District adjusts the carrying value of its investments to reflect their fair value at each fiscal year end only if material, and it includes the effects of these adjustments in income for that fiscal year.

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, 2004 the carrying amount of the pool was $57,600,699,158 and the estimated market value of the pool (including accrued interest) was $57,536,996,461. The District's proportionate share of that value is $245,000. Included in LAIF's investment portfolio are certain derivative securities or similar products in the form of asset-backed securities totaling $923,459,000. LAIF's (and the District's) exposure to risk (credit, market or legal) is not currently available.

Continued

3. Property, Plant, and Equipment

Property, plant and equipment at June 30, 2004 and 2003 consisted of the following:

	2004	2003
	(in thousands)	
Capital assets not being depreciated– land, including improvements	$ 2,244	$ 2,244
Capital assets being depreciated:		
Building	25,080	26,294
Equipment	20,527	22,761
Total capital assets being depreciated	45,607	49,055
Total capital assets	47,851	51,299
Less accumulated depreciation	(35,140)	(37,208)
Capital assets, net of accumulated depreciation	$ 12,711	$ 14,091

The District's property, plant, and equipment are leased to and used exclusively by the Hospital Corporation (Note 4). Depreciation expense for the years ended June 30, 2004 and 2003 was $1,284,000 and $1,524,000, respectively.

4. Lease of Marin Healthcare District Facility

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, rent is due in annual installments of $1,500,000.

The annual rent payments comprise capital expenditures and a $125,000 minimum cash payment. 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 years ended June 30, 2004 and 2003. Under the terms of the lease, the minimum cash components of the annual rental payments from the Hospital Corporation for the next five fiscal years and thereafter are as follows:

Fiscal year ended June 30:	(in thousands)
2005	$ 281
2006	295
2007	310
2008	325
2009	341
Thereafter	2,631
	$4,183

4. **Lease of Marin Healthcare District Facility**, continued

Annual Rental Payments, continued

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. Additionally, the Hospital Corporation has exceeded its capital commitment by approximately $151,000 and $183,000 as of June 30, 2004 and 2003, respectively. The advanced capital commitment (including the excess capital commitment) has been recorded as deferred lease revenue. As of June 30, 2004 and 2003, the total deferred lease revenue (in thousands) was $13,124 and $14,357, respectively.

Capital Improvement Payments

In addition to the capital rental obligation described under annual rental payments, the lease agreement requires the Hospital Corporation to make minimum annual capital expenditures (buildings and equipment) during the lease term. The obligation was approximately $2,740,000 for the year ended June 30, 2004 and $2,610,000 for the year ended June 30, 2003 and will increase thereafter for inflation (not to exceed 5% per year). 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 lessee has satisfied this provision of the lease for the years ended June 30, 2004 and 2003.

5. **Related Party Transactions**

The Hospital Corporation has floated revenue bonds totaling approximately fifty million dollars. If the Hospital Corporation is in default of the lease, the District can terminate the lease. If the lease is terminated the District, however, must pledge all revenues from the operation of the hospital as security for the payment of all the Hospital Corporation's bond obligations.

Under its lease obligations, the Hospital Corporation is currently paying some of the operating expenses incurred by the District. Examples of expenses paid include supplies, telephone charges, office equipment, and business insurance premiums. Total expenses paid by the Hospital Corporation on behalf of the District for the year ended June 30, 2004 were approximately $22,000. In addition, the Hospital Corporation paid the District's Directors' and Officers' liability insurance for the policy year ended March 25, 2003. The Hospital Corporation also provides office space for the District.

6. **Employee Benefit Plan**

On August 14, 2001, the Marin Healthcare District passed a resolution creating the Miscellaneous Plan of the Marin Healthcare District (Plan), a single-employer defined benefit plan providing retirement, disability, and death benefits to plan participants and beneficiaries. The Plan is administered by the California Public Employees' Retirement System (CalPERS) and is subject to all the provisions of the Public Employees' Retirement Law.

Continued

6. **Employee Benefit Plan**, continued

The contribution requirements of plan members and the District are established and may be amended by the state legislature. Plan members are required to contribute 7.0% on their annual reportable earnings. The District is required to contribute at an actuarially determined rate; currently determined to be 25.1% of annual reportable payroll.

The District's annual pension cost to CalPERS for the years ended June 30, 2004 and 2003 was $17,513 and $16,000, respectively. The net pension obligation was zero for both years.

The annual required contribution was determined as part of the April 1, 2001 actuarial valuation using the entry age normal cost method. The actuarial assumptions include an 8.25% investment rate of return (net of expense) and projected salary increases of 3.75% per year. Both the investment rate of return and the projected salary increase include an inflation component of 3.5%. The unfunded actuarial accrued liability is being amortized over a period ending 2015.

7. **Arbitration Settlement**

During the year ended June 30, 2000, the Hospital Corporation failed to provide the District with written notice of its election to pay minimum cash rent for the year by October 1, 1999, as required by the lease. Written notice of the election was received by the District on November 9, 1999. The District subsequently notified the Hospital Corporation that it was in default and was obligated to pay the entire $1,500,000 annual rent in cash. Accordingly, the Hospital Corporation paid additional rent of approximately $638,000 under protest.

Pursuant to the arbitration award dated July 18, 2000, the additional rent paid to the District was determined to be prepaid or deferred rent to be credited to amounts otherwise due and payable in the future. In addition, the Hospital Corporation was entitled to recover related attorney fees from the District. The deferred rent was completely amortized during the fiscal year ended 2003.

8. **Litigation Issues**

The District was named jointly in a lawsuit with Marin General Hospital Corporation in November 2002. In the lawsuit, the plaintiff is suing the Hospital Corporation and the District for damages incurred to property resulting from a mudslide. The Hospital Corporation has agreed to defend the District in this matter, pursuant to the terms of the office lease. There have been no changes in the status of this suit during the current fiscal year.

Continued

9. **Litigation Settlement**

Pursuant to the settlement agreement dated September 20, 1999, the District and the Hospital Corporation settled the claims arising from disputes as to the parties' respective rights and obligations under the lease and administration agreement. Commencing with the year beginning December 1, 1999, and for each year until the termination of the lease, the Hospital Corporation will pay to the District annually the sum of $150,000 in equal quarterly installments, commencing January 1, 2000. As of January 1, 2005, this payment will be increased based on a percentage equal to the Consumer Price Index, not to exceed 5% or be less than 3% of the annual payment of the preceding year.