

**North Sonoma County Healthcare District  
d/b/a Healdsburg District Hospital**

Financial Report  
December 31, 2016

## Contents

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Independent auditor's report	1-2
Management's discussion and analysis	3-11
Financial statements	
Statements of net position	12
Statements of revenues, expenses and changes in net position	13
Statements of cash flows	14-15
Notes to financial statements	16-32

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RSM US LLP

## Independent Auditor's Report

To the Board of Directors  
North Sonoma County Healthcare District  
Healdsburg, California

### Report on the Financial Statements

We have audited the accompanying financial statements of the North Sonoma County Healthcare District d/b/a Healdsburg District Hospital (the Hospital) as of and for the years ended December 31, 2016 and 2015, and the related notes to the financial statements, which collectively comprise the Hospital's basic financial statements as listed in the table of contents.

### Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

### Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Hospital's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Hospital's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

### Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of North Sonoma County Healthcare District as of December 31, 2016 and 2015, and the changes in its financial position and its cash flows for the years then ended, in accordance with accounting principles generally accepted in the United States of America.

**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 a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the 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.

*RSM US LLP*

Davenport, Iowa  
June 30, 2017

**North Sonoma County Healthcare District  
d/b/a Healdsburg District Hospital**

**Management's Discussion and Analysis  
Year Ended December 31, 2016**

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North Sonoma County Healthcare District is a special healthcare district, a political subdivision of the State of California, which owns and operates Healdsburg District Hospital (Hospital) located in Healdsburg, County of Sonoma, State of California. The Hospital is licensed for 43 beds (26 acute medical/surgical beds and 17 distinct part skilled nursing beds). In 2016 the Hospital staffed 38 beds (21 acute medical/surgical beds and 17 distinct part skilled nursing beds) and provided a continuum of medical and surgical inpatient care, as well as diagnostic, therapeutic and clinical outpatient services. The Hospital staffing was an average of 251 full-time equivalent employees in 2016.

**Financial Highlights**

- Current assets increased and current liabilities decreased in 2016. Our focus continued to be on building operational sustainability through cash and debt management while seeking out business growth opportunities. This was accomplished by the increase in cash in cash equivalents of \$1,546,895 or 36.74%, and a decrease in current maturities of long term debt of \$193,184 or 16.12%.
- Noncurrent assets and deferred outflows decreased by \$2,527,758 or 21.47%. The refinancing of the Parcel Tax Certificates of Participation, Series 2008 to a Series 2016 allowed the release of \$1,572,457 of 2008 funds held as restricted. The Hospital also transferred \$342,130 in restricted contributions for the fixed MRI to the local healthcare foundation so that it would have matching funds.
- The refinancing of the Parcel Tax Certificates of Participation, Series 2008 to Series 2016 has provided us with a lower interest rate (2.59%) and an increase in our access to cash funds in the amount of \$7,503,878 due to amounts available to be drawn on the debt.

**Overview of Financial Statements**

Management's Discussion and Analysis is designed to assist the reader in understanding the audited financial statements and provides an overview of the Hospital's financial position and significant financial and operational issues. Please read it in conjunction with the audited financial statements.

Unless otherwise noted, all discussion and analysis pertains to the Hospital's financial condition, operating results, and cash flows, as of, and for the year ended December 31, 2016.

The financial statements and related information disclosed in the Notes to the Financial Statements are presented in accordance with the pronouncements of the Governmental Accounting Standards Boards (GASB).

**Financial Reporting Entity**

The definition of the reporting entity is based on the principal of financial accountability. A primary government entity is financially accountable for the organizations that make up that legal entity. It is also financially responsible for legally separate corporations that have the potential to provide specific financial benefits to, or impose specific financial burdens, on the primary government entity. The financial reporting entity for this report consists of the primary government entity, the North Sonoma County Healthcare District, which is comprised of Healdsburg District Hospital and North Sonoma County Healthcare Services. Note that the Board of Directors approved a change in the name of the District in 2008, from North Sonoma County Hospital District to North Sonoma County Healthcare District. The change in name did not change any of the legal or financial structure, responsibility or obligations of the District.

**North Sonoma County Healthcare District  
d/b/a Healdsburg District Hospital**

**Management's Discussion and Analysis  
Year Ended December 31, 2016**

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**Hospital Financial Statements**

The Financial Statements are designed to provide readers with a broad overview of the Hospital's finances. Hospital Districts are defined as "special purpose governments engaged only in business activities." Approximately 93% of the Hospital's operations were financed through service fees. The Hospital also receives parcel tax revenue. Unlike some governmental entities, the Hospital's financial statements are comprehensive, reflect all financial interests and are similar to most hospitals and other business entities. The statements are prepared utilizing enterprise fund accounting on an accrual basis of accounting using the economic resources measurement focus.

The financial statements follow the guidelines of the American Institute of Certified Public Accountants (AICPA) for Health Care Organizations, and incorporate the reporting requirements of the Government Accounting Standards Board (GASB) to the extent they apply, and, or the reporting requirements of the Financial Accounting Standards Board (FASB).

The financial statements include the following:

The statement of net position, also known as a balance sheet, presents information on all of the Hospital's Assets, Deferred Outflows, Liabilities, Deferred Inflows and Net Position. The balance sheet includes information about the nature of the Hospital's assets and liabilities and classifies them as current or non-current. It also provides the basis for evaluation of the capital structure of the Hospital, and for assessing its liquidity and financial flexibility. Over time, increases or decreases in Net Position serve as a useful indicator of whether the financial position of the Hospital is improving or deteriorating.

The statement of revenue, expenses and changes in net position presents information on the results of the Hospital's operations, its tax support and any contributions during each fiscal year. All changes in revenues and expenses are reported as soon as 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 the statement for some items that will result in cash flows in future fiscal periods (for example, patient charges billed but not collected, earned but unused vacation leave), or result from past cash flows (for example, prepaid insurance, supplies issued from inventory). This statement measures the Hospital's operations and can be used to determine whether the Hospital has been able to recover all of its operating costs from patient services and other revenue sources.

The primary purpose of the statement of cash flows is to provide information about the Hospital's cash from operating, non-capital financing, capital and related financing, and investing activities. It provides answers to such questions as the Hospital's sources of cash, what was the cash used for, and what were the changes in cash balances during the reporting period.

Following the audited financial statements, please find the notes to the financial statements, which provide additional information essential for a full understanding of the information in the financial statements. The notes also present certain required information such as the Hospital's concentration of credit risk, transactions with related organizations, capital asset and long-term debt activity.

The financial statements report historic results and provide a picture of the Hospital's financial performance and position as a point in time. While they provide an indicator of financial health, the reader will need to consider at a minimum other non-financial factors such as changes in the Hospital's patient or physician base, economic factors such as changes in reimbursements, the impact of federal and state legislation on healthcare delivery and financing, and planned changes in the programs or services of the Hospital in order to assess the overall health of the Hospital going forward.

**North Sonoma County Healthcare District  
d/b/a Healdsburg District Hospital**

**Management's Discussion and Analysis  
Year Ended December 31, 2016**

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**Supplemental Tables (Financial Reports)**

To further assist in understanding the operations and financial condition of the Hospital, please find four supplemental tables on the following pages:

**Table 1 – Operating Statistics**

**Table 2 – Condensed Statement of Net Position**

**Table 3 – Condensed Statement of Revenues, Expenses and Changes in Net Position**

**Table 4 – Condensed Statement of Cash Flows**

These tables provide additional supplementary information about the Hospital's operating activities and show comparative information in a condensed financial report format.

There will be further discussion referencing these tables in this report. These tables should be reviewed in conjunction with the audited financial statements.

**North Sonoma County Healthcare District  
d/b/a Healdsburg District Hospital**

**Management's Discussion and Analysis  
Year Ended December 31, 2016**

**Operating and Financial Highlights**

The following discussion provides a summary explanation of the results of the Hospital's operations in 2016, and the changes from 2015 shown in the following tables and the Audited Financial Statements. In the following narrative, capitalized names (Total Assets, Accounts Payable) refer to titles and related values on the Financial Statements rather than a generic reference.

**Table 1**

	2016	2015	2014	2015 vs 2016	
				Amount	Percent
Inpatient statistics:					
Acute care admissions	615	739	681	(124)	(16.78%)
ICU admissions	111	131	139	(20)	(15.27%)
Skilled care (SWG) admissions	54	72	132	(18)	(25.00%)
Subacute care admissions	11	7	10	4	57.14%
<b>Total admissions</b>	<b>791</b>	<b>949</b>	<b>962</b>	<b>(158)</b>	<b>(16.65%)</b>
Acute care patient days	2,698	3,307	2,802	(609)	(18.42%)
ICU patient days	345	470	435	(125)	(26.60%)
Skilled care (SWG) patient days	493	462	973	31	6.71%
Subacute care patient days	5,771	5,131	4,990	640	12.47%
<b>Total admissions</b>	<b>9,307</b>	<b>9,370</b>	<b>9,200</b>	<b>(63)</b>	<b>(0.67%)</b>
Acute/skilled % of occupancy	46.20%	55.30%	54.80%	(9.10%)	
Acute/skilled average daily census	9.7	11.6	11.5	(1.9)	(16.72%)
Acute/skilled average length of stay (days)	4.4	4.5	4.4	(0.1)	(2.22%)
Subacute % of occupancy	91.20%	100.41%	97.90%	(9.21%)	
Subacute average daily census (patients)	15.8	14.1	13.7	1.7	12.06%
Inpatient surgeries	191	267	195	(76)	(28.46%)
Outpatient statistics:					
Outpatient surgeries	553	775	1,318	(222)	(28.65%)
Total emergency room visits	8,956	9,251	9,176	(295)	(3.19%)
Occupational medicine	6,461	6,575	5,162	(114)	(1.73%)
Total laboratory visits	8,566	9,737	9,609	(1,171)	(12.03%)
Total radiology procedures	15,530	16,520	15,582	(990)	(5.99%)
Healdsburg primary care	8,801	9,354	16,877	(553)	(5.91%)
Total outpatient visits	46,384	48,183	52,388	(1,799)	(3.73%)



**North Sonoma County Healthcare District  
d/b/a Healdsburg District Hospital**

**Management's Discussion and Analysis  
Year Ended December 31, 2016**

**Condensed Statement of Net Position**

Table 2	2016	2015	2014	2015 vs 2016	
				Amount	Percent
<b>Assets</b>					
Current assets	\$13,879,680	\$12,135,633	\$12,921,461	\$ 1,744,047	14.37%
Noncurrent assets and deferred outflows	9,245,958	11,773,716	10,575,177	(2,527,758)	(21.47%)
<b>Total assets</b>	<b>\$23,125,638</b>	<b>\$23,909,349</b>	<b>\$23,496,638</b>	<b>\$ (783,711)</b>	<b>(3.28%)</b>
<b>Liabilities and Net Position</b>					
Accounts payable, accrued expenses and estimated third-party payor settlements	\$ 6,553,230	\$ 8,016,273	\$ 8,402,869	\$ (1,463,043)	(18.25%)
Notes and capital leases payable, current	1,005,513	1,198,697	1,063,343	(193,184)	(16.12%)
Notes and capital leases payable, long-term and deferred inflows	6,426,509	7,340,705	8,515,905	(914,196)	(12.45%)
Net position	9,140,386	7,353,674	5,514,521	1,786,712	24.30%
<b>Total liabilities and net position</b>	<b>\$23,125,638</b>	<b>\$23,909,349</b>	<b>\$23,496,638</b>	<b>\$ (783,711)</b>	<b>(3.28%)</b>

As shown on Table 2, total assets decreased by 3.28% over the year due to an increase in current assets of \$1,744,047 and a decrease in the noncurrent assets in the amount of \$2,527,758.

The increase in current assets resulted primarily from the net effect of five areas on the current assets section of the balance sheet. First is the increase in cash of \$1,546,895 or 36.74%. Second is an increase in net patient accounts receivables of \$260,145 or 6.15%. Third is an increase in other receivables of \$375,305 or 506.35%. Fourth is a decrease in assets limited to use in the amount of \$502,326 or 61.19%. The fifth is a decrease in the inventory values of \$127,980 or 13.08%. See Note 5 in the financial statements for details regarding assets limited as to use.

The decrease in non-current assets resulted primarily from the net of the reduction in non-current assets limited to use in the amount of \$2,395,629 or 96.12%. The largest adjustment was the distribution of the cash asset "LAIF - Trustee Investment" in the amount of \$1,572,457 to our operating account and the release of funds from "COP Reserve Trustee" in the amount of \$506,753 both as part of our refinancing process prior to the refinancing of the COP 2008 debt. The final large adjustment was the transfer of funds from the hospital's restricted cash accounts to the healthcare foundation in the amount of \$342,130 in order to receive matching funds for the purchase of a fixed MRI.

Accounts payable and accrued expenses decreased by \$1,463,043 or 18.25% which reflects a decrease in accounts payable as a result of a concerted effort to improve the strength of the balance sheet as previously mentioned.

Net Position (Total Assets less Total Liabilities) increased by \$1,786,712 or 24.30% from 2015 to 2016.

North Sonoma County Healthcare District  
d/b/a Healdsburg District Hospital

Management's Discussion and Analysis  
Year Ended December 31, 2016

**Condensed Statement of Revenues, Expenses and Changes in Net Position**

Table 3

	2016	2015	2014	2015 vs 2016	
				Amount	Percent
Operating revenues, net	\$44,095,112	\$41,757,093	\$34,382,359	\$ 2,338,019	5.60%
Operating expenses	45,809,315	43,494,172	43,549,789	2,315,143	5.32%
<b>Operating loss</b>	(1,714,203)	(1,737,079)	(9,167,430)	22,876	(1.32%)
Nonoperating revenues (expenses)	3,151,915	3,186,855	3,160,747	(34,940)	(1.10%)
<b>Gain before capital contributions</b>	1,437,712	1,449,776	(6,006,683)	(12,064)	(0.83%)
Capital contributions for acquisition of equipment	349,000	389,377	667,308	(40,377)	(10.37%)
<b>Change in net position</b>	1,786,712	1,839,153	(5,339,375)	(52,441)	(2.85%)
Net position, beginning of year	7,353,674	5,514,521	10,853,896	1,839,153	33.35%
Net position, end of year	<u>\$ 9,140,386</u>	<u>\$ 7,353,674</u>	<u>\$ 5,514,521</u>	<u>\$ 1,786,712</u>	24.30%

**North Sonoma County Healthcare District  
d/b/a Healdsburg District Hospital**

**Management's Discussion and Analysis  
Year Ended December 31, 2016**

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**Activity and Operating Revenues**

**Table 1** shows the Hospital's key patient activity levels in 2014, 2015 and 2016.

Comparing Inpatient (I/P) activity from 2015 to 2016 highlights:

- Acute care admissions decreased by 16.78% or 124 admissions
- Acute care patient days decreased by 18.42% or 609 patient days
- Average length of stay decreased by 2.22% or 0.1 patient days
- Inpatient surgeries decreased 28.46% or 76 surgery cases
- ICU patient days decreased by 26.60% or 125 patient days
- The sub-acute unit had an increase in patient days of 12.47% or 640 patient days

Comparing Outpatient (O/P) activity from 2015 to 2016 highlights:

- Total outpatient visits were down by 3.73% or 1,799 visits
- Emergency room visits were down by 3.19% or 295 visits
- Occupational Medicine program initial visits decreased by 1.73% or 114 visits
- Healdsburg Primary Care visits decreased by 5.91% or 553 visits
- O/P surgeries decreased by 28.65% or 222 surgeries

**Table 3** shows a 5.60% increase in net operating revenues or an increase of \$2,338,019. This is the result of improvements in charge capture, charge description master, collections, cost reports and contract negotiations when compared to 2015.

**Operating Expenses**

**Table 3** shows the Hospital's 2016 operating expenses increased 5.32% or \$2,315,143 compared to 2015.

- The most significant expense for any Hospital relates to staffing. Salaries increased by 5.39% or \$915,451 in 2016. This increase is related to changes in leadership positions and the increase in force that occurred throughout 2015. We also increased our payroll by the provision of market basket rate increases for many positions in the organization.
- Benefits expense increased by 12.72% or \$784,017 in 2016. We had increases in both paid time off (PTO) and payroll taxes due to the market basket rate increases provided to the staff in 2016. We also had several employees who exceeded stop-loss expenses as a result of significant health conditions which drove up our insurance cost.
- Registry and other professional fees were down from the prior year, by 4.36% or \$103,791. This is primarily due to the hiring of a pharmacist who replaced a contract pharmacist. The savings that resulted from this replacement was \$290,395.
- Medical professional fees increased by 10.28% or \$586,236 as a result of changes in physician payments after the reorganization of the clinics. Additionally, we recruited new physicians in the Healdsburg Behavioral Health Clinic equating to \$194,110, an increase in our Emergency physician fees of \$334,653, and increased fees for physicians in Healdsburg Physician Group of \$227,040.
- Supply expenses were down by 20.76% or \$1,175,981 from 2015. The decrease in supply costs were primarily due to pharmaceutical cost decreases which were down by \$825,848. With surgery volumes down the Hospital also had big decreases in surgical supplies in the amount of \$266,308. Implants were also down in the amount of \$201,376.

**North Sonoma County Healthcare District  
d/b/a Healdsburg District Hospital**

**Management's Discussion and Analysis  
Year Ended December 31, 2016**

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- Repair and maintenance costs in 2016 were up 6.12% or \$69,154 as a result of increases in maintenance costs for the information technology systems of \$243,174, which were offset by decreases in other areas.

**Operating Income/Loss**

The Hospital's operating expenses were \$1,714,203 more than operating revenues resulting in an operating loss.

**Nonoperating Income and Expenses**

In November 2001, the Hospital electorate overwhelmingly approved a special, or 'parcel' tax of up to \$85 per parcel per year to support the Hospital. In April 2004, the Hospital electorate again overwhelmingly approved an increase in the 'parcel' tax of up to \$150 per parcel per year. The Hospital has approved the levy of the increased parcel tax at \$150 for the tax years starting July 1, 2004. This parcel tax is recorded as a non-operating income on the financial statement. In 2015 and in 2016, the Hospital recorded tax revenues of \$3,383,671 and \$3,358,819, respectively. There was a small decrease in the number of taxable parcels in 2016 and 2015.

Other non-operating revenues come primarily from donations and charitable contributions. In 2015 and in 2016, grants and contributions were \$90,703 and \$32,049, respectively.

In 2015, interest expense decreased by 14.96% as the result of the reduction of the principal owed on the Certificates of Participation. (See Note 7 in the financial statements for more information regarding the debt borrowings.) The reduction is inherent in the established debt repayment schedule.

In Table 3, non-operating revenues are reported net of interest expense and other non-operating costs. The non-operating revenues offset the operating loss so that in 2015 the income before Capital Contributions was a gain of \$1,449,776 compared to a gain of \$1,437,712 in 2016. The parcel tax revenues are the majority of the non-operating income and a critical part of the Hospital's financial framework, providing working capital and capital equipment replacement.

**Capital Contributions and Change in Net Position**

The change in net position is the sum of the operating loss plus net non-operating revenues, plus the capital contributions. In 2015 and 2016, capital contributions for acquisitions of equipment were \$389,377 and \$349,000, respectively. In 2015, the change in net position was an increase of \$1,839,153. The result of each year adds to, or reduces, the prior year's value of the net position. In 2016, the change in net position was an increase of \$1,786,712.

**Capital Assets**

The Hospital's capital assets decreased by \$404,976 or 4.42% in 2016 due to asset acquisitions (of both equipment and facility additions) being less than depreciation. (See Note 6 in the Audited Financial Statements for information on capital assets.)

**North Sonoma County Healthcare District  
d/b/a Healdsburg District Hospital**

**Management's Discussion and Analysis  
Year Ended December 31, 2016**

Continued capital investment will be needed in the next few years to replace aging assets, build new capacity and meet new technology needs for patient care. The Hospital is in the process of implementing an electronic medical records system which has required a large capital outlay and significant retooling of operations in order to make best use of the technology. This technology has become almost a mandate (by the American Recovery & Reinvestment Act of 2009) for healthcare providers, and is perceived as a requirement the Hospital had to address.

**Debt**

During 2016, the Hospital refinanced a Note with the County of Sonoma via the issuance of Certificates of Participation (COPs) (tax exempt bonds). The principal outstanding at the end of 2016, consists of \$4,408,122 of long-term liability and \$528,000 for the current portion, for a total outstanding on the COPs of \$4,936,122. (See Note 7 in the Audited Financial Statements for details of the Hospital's debt.)

**Condensed Statement of Cash Flows**

**Table 4**

	2016	2015	2014	2015 vs 2016	
				Amount	Percent
Cash flows provided by (used in) operating activities	\$ (1,985,376)	\$ 2,388,785	\$ (820,642)	\$ (4,374,161)	(183.11%)
Cash flows provided by noncapital financial activities	3,324,257	3,357,254	3,465,474	(32,997)	(0.98%)
Cash flows used in capital and related activities	(2,774,638)	(3,455,818)	(1,132,890)	681,180	(19.71%)
Cash flows provided by (used in) investing activities	2,982,652	(152,007)	(48,748)	3,134,659	(2,062.18%)
<b>Net change in cash and cash equivalents</b>	<b>1,546,895</b>	<b>2,138,214</b>	<b>1,463,194</b>	<b>(591,319)</b>	<b>(27.65%)</b>
Cash and cash equivalents, beginning of year	4,210,028	2,071,814	608,620	2,138,214	103.20%
Cash and cash equivalents, end of year	<u>\$ 5,756,923</u>	<u>\$ 4,210,028</u>	<u>\$ 2,071,814</u>	<u>\$ 1,546,895</u>	<u>36.74%</u>
Reconciliation of operating loss to net cash (used in) operating activities:					
Operating loss	\$ (1,714,203)	\$ (1,737,079)	\$ (9,167,430)	\$ 22,876	(1.32%)
Adjustments to reconcile	(271,173)	4,125,864	8,346,788	(4,397,037)	(106.57%)
<b>Net cash used in operating activities</b>	<u>\$ (1,985,376)</u>	<u>\$ 2,388,785</u>	<u>\$ (820,642)</u>	<u>\$ (4,374,161)</u>	<u>(183.11%)</u>

**Financial Information Contact**

This report provides a general overview of the Hospital's finances. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the Chief Financial Officer at 1375 University Ave., Healdsburg, California 95448.

John S. Parigi II  
Interim Chief Financial Officer/Consultant

**North Sonoma County Healthcare District  
d/b/a Healdsburg District Hospital**

**Statements of Net Position  
December 31, 2016 and 2015**

	2016	2015
<b>Assets and Deferred Outflows</b>		
Current assets:		
Cash and cash equivalents	\$ 5,756,923	\$ 4,210,028
Assets limited as to use, current portion	318,649	820,975
Patient accounts receivable, net of allowances	4,487,208	4,227,063
Other receivables	449,424	74,119
District tax receivables	1,528,407	1,493,845
Inventories	850,159	978,139
Prepaid expenses and other assets	488,910	331,464
<b>Total current assets</b>	<b>13,879,680</b>	<b>12,135,633</b>
Assets limited as to use	96,595	2,492,224
Capital assets:		
Nondepreciable	494,673	621,120
Depreciable, net	8,268,458	8,546,987
	<b>8,763,131</b>	<b>9,168,107</b>
Other assets	131,740	113,385
Deferred outflows of resources, deferred charge on refunding, net	254,492	-
<b>Total assets and deferred outflows</b>	<b>\$ 23,125,638</b>	<b>\$ 23,909,349</b>
<b>Liabilities, Deferred Inflows and Net Position</b>		
Current liabilities:		
Current maturities of long-term debt	\$ 1,005,513	\$ 1,198,697
Accounts payable and other accrued expenses	4,362,452	5,930,040
Accrued payroll and related liabilities	2,041,849	1,827,612
Estimated third-party payor settlements	148,929	258,621
<b>Total current liabilities</b>	<b>7,558,743</b>	<b>9,214,970</b>
Long-term debt, net of current maturities	4,898,102	5,846,860
<b>Total liabilities</b>	<b>12,456,845</b>	<b>15,061,830</b>
Deferred inflows of resources, deferred inflows related to district tax revenues	1,528,407	1,493,845
<b>Total liabilities and deferred inflows</b>	<b>13,985,252</b>	<b>16,555,675</b>
Commitments and contingencies (Note 10)		
Net position:		
Net investment in capital assets	3,114,008	2,122,550
Restricted for:		
Debt service, under trust agreements	27,078	2,575,471
Other purposes	97,322	439,769
Unrestricted	5,901,978	2,215,884
<b>Total net position</b>	<b>9,140,386</b>	<b>7,353,674</b>
<b>Total liabilities, deferred inflows and net position</b>	<b>\$ 23,125,638</b>	<b>\$ 23,909,349</b>

See notes to financial statements.

**North Sonoma County Healthcare District  
d/b/a Healdsburg District Hospital**

**Statements of Revenues, Expenses and Changes in Net Position  
Years Ended December 31, 2016 and 2015**

	2016	2015
Operating revenues:		
Net patient service revenue, before provision for bad debt	\$ 44,486,496	\$ 41,419,959
Provision for bad debt	<u>(1,821,462)</u>	<u>(1,297,910)</u>
<b>Net patient service revenue</b>	<b>42,665,034</b>	40,122,049
Other operating revenue	<u>1,430,078</u>	<u>1,635,044</u>
<b>Total operating revenues</b>	<b>44,095,112</b>	41,757,093
Operating expenses:		
Salaries and wages	17,892,170	16,976,719
Employee benefits	6,947,106	6,163,089
Registry and other professional fees	2,276,158	2,379,949
Medical professional fees	6,287,255	5,701,019
Supplies	4,487,873	5,663,854
Purchased services	1,600,616	1,414,677
Repairs and maintenance	1,199,848	1,130,694
Utilities	451,818	413,897
Building and equipment rent	1,109,251	1,103,434
Insurance	297,742	357,573
Depreciation	1,856,786	1,567,006
Other operating expenses	<u>1,402,692</u>	<u>579,148</u>
<b>Total operating expenses before long-lived asset impairment</b>	<b>45,809,315</b>	43,451,059
Long-lived asset impairment	-	43,113
<b>Total operating expenses</b>	<b>45,809,315</b>	43,494,172
Operating loss	<u>(1,714,203)</u>	<u>(1,737,079)</u>
Nonoperating revenues (expenses):		
District tax revenues	3,358,819	3,383,671
Investment gain	36,441	36,313
Interest expense	(275,394)	(323,832)
Grants and contributions	<u>32,049</u>	<u>90,703</u>
<b>Total nonoperating revenues, net</b>	<b>3,151,915</b>	3,186,855
<b>Gain before capital contributions</b>	<b>1,437,712</b>	1,449,776
Capital contributions for acquisition of equipment	<u>349,000</u>	<u>389,377</u>
<b>Change in net position</b>	<b>1,786,712</b>	1,839,153
Net position:		
Beginning of year	<u>7,353,674</u>	<u>5,514,521</u>
End of year	<u><b>\$ 9,140,386</b></u>	<u><b>\$ 7,353,674</b></u>

See notes to financial statements.

**North Sonoma County Healthcare District  
d/b/a Healdsburg District Hospital**

**Statements of Cash Flows  
Years Ended December 31, 2016 and 2015**

	<b>2016</b>	2015
Cash flows from operating activities:		
Receipts from patients and other third-party payors	\$ 42,295,197	\$ 42,382,787
Payments to suppliers	(21,609,155)	(19,273,202)
Payments to employees	(24,625,039)	(23,300,416)
Other receipts	1,953,621	2,579,616
<b>Net cash provided by (used) in operating activities</b>	<b>(1,985,376)</b>	2,388,785
Cash flows provided by noncapital financing activities, district tax revenues		
	<b>3,324,257</b>	3,357,254
Cash flows from capital and related financing activities:		
Purchase of capital assets	(1,451,810)	(2,450,720)
Issuance of long-term debt	4,936,122	-
Contributions received for capital asset acquisitions	349,000	389,377
Principal payments on long-term debt	(6,078,064)	(1,070,643)
Deferred financing costs	(254,492)	-
Interest payments on long-term debt	(275,394)	(323,832)
<b>Net cash used in capital and related financing activities</b>	<b>(2,774,638)</b>	(3,455,818)
Cash flows from investing activities:		
Net change in assets limited as to use	2,897,955	(276,203)
Investment income (loss)	52,648	33,493
Grants and contributions	32,049	90,703
<b>Net cash provided by (used in) investing activities</b>	<b>2,982,652</b>	(152,007)
<b>Net increase in cash and cash equivalents</b>	<b>1,546,895</b>	2,138,214
Cash and cash equivalents:		
Beginning of year	4,210,028	2,071,814
End of year	<b>\$ 5,756,923</b>	<b>\$ 4,210,028</b>

(Continued)



**North Sonoma County Healthcare District  
d/b/a Healdsburg District Hospital**

**Statements of Cash Flows (Continued)  
Years Ended December 31, 2016 and 2015**

	<b>2016</b>	<b>2015</b>
Reconciliation of operating loss to net cash (used in) provided by operating activities:		
Operating loss	<b>\$ (1,714,203)</b>	\$ (1,737,079)
Adjustments to reconcile operating loss to net cash (used in) provided by operating activities:		
Depreciation	<b>1,856,786</b>	1,567,006
Long-lived asset impairment	-	43,113
Changes in operating assets and liabilities:		
Patient accounts receivables and other receivables	<b>(635,450)</b>	2,015,662
Other current assets	<b>(157,446)</b>	(91,863)
Inventories	<b>127,980</b>	130,744
Estimated third-party payor settlements	<b>(109,692)</b>	1,041,410
Accounts payable and accrued expenses	<b>(1,353,351)</b>	(580,208)
	<b>\$ (1,985,376)</b>	\$ 2,388,785
<b>Net cash (used in) provided by operating activities</b>	<b>\$ (1,985,376)</b>	<b>\$ 2,388,785</b>

See notes to financial statements.

**North Sonoma County Healthcare District  
d/b/a Healdsburg District Hospital**

**Notes to Financial Statements**

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**Note 1. Nature of Business and Significant Accounting Policies**

**Nature of business:** North Sonoma County Healthcare District (d/b/a Healdsburg District Hospital), heretofore referred to as the Hospital, is a public entity organized under Local Hospital District Law as set forth in the Health and Safety Code of the State of California. The Hospital is a political subdivision of the State of California and is generally not subject to federal or state income taxes. The Hospital is governed by a five-member Board of Directors, elected from within the district to specified terms of office. The Hospital is located in Healdsburg, California. It operates a 21-bed acute care facility with intensive care, a 17-bed hospital-based sub-acute nursing facility and swing bed services. The Hospital provides health care services primarily to individuals who reside in the local geographic area.

**Accrual basis of accounting:** The accrual basis of accounting is used by the Hospital. Under the accrual basis of accounting, revenue is recognized when earned and expenses are recognized when the liability has been incurred.

**Basis of accounting:** The financial statements of the Hospital are prepared in accordance with generally accepted accounting principles (GAAP) as applied to governmental units. The Government Accounting Standards Board (GASB) is the standard-setting body for governmental accounting and financial reporting. The GASB periodically updates its codification of the existing Governmental Accounting and Financial Reporting Standards, which, along with subsequent GASB pronouncements (Statements and Interpretations), constitutes GAAP for governmental units.

**Deferred inflows of resources:** In addition to liabilities, the statements of net position will sometimes report a separate section for deferred inflows of resources. This separate financial statement element, deferred inflows of resources, represents an acquisition of net position that applies to a future period(s) and so will not be recognized as an inflow or resources (revenue) until that time. Property taxes are shown as a deferred inflow of resources under the full accrual basis of accounting and will become an inflow in the year for which they are levied and intended for the Hospital's use.

**Management 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 reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amount of revenues and expenses during the reporting period. Actual results could differ from those estimates.

**Cash and cash equivalents:** For purposes of the statements of cash flows, cash and cash equivalents include deposits on account in banking institutions and certain investments in highly liquid debt instruments, when present, with an original maturity of a short-term nature or subject to withdrawal upon request, excluding cash and cash equivalents included in assets limited as to use. Exceptions are for those investments which are intended to be continuously invested. Investments in securities are reported at fair value.

Interest, dividends and both unrealized and realized gains and losses on investments are included as investment gain (loss) in nonoperating revenues when earned.

**North Sonoma County Healthcare District  
d/b/a Healdsburg District Hospital**

**Notes to Financial Statements**

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**Note 1. Nature of Business and Significant Accounting Policies (Continued)**

**Patient accounts receivable:** Patient accounts receivable consist of amounts owed by various governmental agencies, insurance companies and private patients. The Hospital manages its receivables by regularly reviewing the accounts, inquiring with respective payors as to collectability and providing for allowances for estimated contractual adjustments and uncollectible accounts. Significant concentrations of patient accounts receivable are discussed in Note 4.

Patient accounts receivable, where a third-party payor is responsible for paying the amount, are carried at a net amount determined by the original charge for the services provided, less an estimate made for contractual adjustments or discounts provided to third-party payors.

Patient accounts receivable due directly from the patients are carried at the original charge for the services provided less amounts covered by third-party payors and less an estimated allowance for doubtful receivables based on a review of all outstanding amounts on a monthly basis. Management determines the allowance for doubtful accounts by identifying troubled accounts, by using historical experience applied to an aging of accounts, and by considering a patient's financial and credit history, and current economic conditions. Patient accounts receivable are written off when deemed uncollectible. Recoveries of receivables previously written off are recorded as a reduction of bad-debt expense when received.

**Inventories:** Inventories, which consist primarily of medical supplies and pharmaceutical drugs, are valued at the lower of cost (first-in, first-out method) or market.

**Assets limited as to use:** Assets limited as to use include contributor restricted funds, amounts designated by the Board of Directors for replacement or purchases of capital assets, and other specific purposes, and amounts held by trustees under specified agreements. Assets limited as to use consist primarily of deposits on hand with local banking and investment institutions, and bond trustees.

**Capital assets:** Capital assets consist of property and equipment and are reported on the basis of cost, or in the case of donated items, on the basis of fair value at the date of donation. Routine maintenance and repairs are charged to expense as incurred. Expenditures which increase values, change capacities, or extend useful lives are capitalized. Depreciation of property and equipment and amortization of property under capital leases are computed by the straight-line method over the estimated useful lives of the assets, which range from 10 to 40 years for buildings and improvements, and 3 to 10 years for equipment. Interest costs incurred on borrowed funds during the period of construction of capital assets are capitalized as a component of the cost of acquiring those assets. During the years ended December 31, 2016 and 2015, there were no material amounts of capitalized interest.

Management evaluates whether there has been a significant unexpected decline in the utility of a capital asset that could indicate impairment in the capital asset. If there is an indication that the asset may be impaired, the Hospital follows GASB Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*, to determine whether the impairment loss should be recognized. The amount of impairment, if any, is determined by comparing the historical carrying value of the asset to the valuation method that most appropriately reflects the decline in service utility of the capital asset. The Hospital recorded an impairment loss totaling approximately \$43,000 for the year ended December 31, 2015. The impairment loss is included in total operating expenses.

**North Sonoma County Healthcare District  
d/b/a Healdsburg District Hospital**

**Notes to Financial Statements**

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**Note 1. Nature of Business and Significant Accounting Policies (Continued)**

**Compensated absences:** The Hospital's employees earn paid time off (PTO) benefits at varying rates depending on years of service. Accumulated PTO benefits are paid to an employee upon either termination or retirement. Amounts representing the cost of compensated absences are recorded as current liabilities. These liabilities have been computed based on rates of pay in effect at December 31, 2016 and 2015, and were approximately \$943,000 and \$905,000, respectively, as of those dates.

**Risk management:** The Hospital is exposed to various risks of loss from torts; theft of, damage to, and destruction of assets; business interruption; errors and omissions; employee injuries and illnesses; natural disasters; and medical malpractice. Commercial insurance coverage is purchased for claims arising from such matters.

**Net position:** Net position is classified in three categories. The first category is "net investment in capital assets." This category of net position consists of capital assets (both restricted and unrestricted), net of accumulated depreciation and reduced by the outstanding principal balances of any debt borrowings that were attributable to the acquisition, construction, or improvement of those capital assets.

The second category is "restricted" net position. This category consists of externally designated constraints placed on those net assets by creditors (such as through debt covenants), grantors, contributors, law or regulations of other governments or government agencies, or law or constitutional provisions or enabling legislation. The third category is "unrestricted" net position. This category consists of net position that does not meet the definition or criteria of the previous two categories.

**Net patient service revenue:** Patient service revenue is recorded at the Hospital's established rates when services are provided, with contractual adjustments, provisions for bad debts, and charity care allowances deducted to arrive at net patient service revenue as the net realizable amount.

The Hospital has agreements with third-party payors that provide for reimbursement to the Hospital at amounts different from its established rates. The primary payors are Medicare and Medicaid.

Retroactive adjustments with third-party payors are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined.

**Charity care:** The Hospital accepts all patients regardless of their ability to pay. A patient is classified as a charity patient by reference to certain established policies of the Hospital. Essentially, these policies define charity services as those services for which no payment is anticipated. Because the Hospital does not pursue collection of amounts determined to qualify as charity care, they are not reported as net patient service revenue. Services provided are recorded as gross patient service revenue and then written off entirely as an adjustment to net patient service revenue.

The Hospital maintains records to identify and monitor the level of charity care it provides. These records include the amount of charges forgone for services and supplies furnished under its charity care policy, the estimated cost of those services and supplies, and equivalent service statistics. The cost estimates are based upon the Hospital's cost-to-charge ratio and are on the accrual basis of accounting, thereby including the impact of changes in charity care allowances. Charity care does include the unreimbursed costs of Medi-Cal. Charges forgone based on established rates during 2016, as well as 2015, and estimated costs and expenses to provide those services were deemed immaterial.

**North Sonoma County Healthcare District  
d/b/a Healdsburg District Hospital**

**Notes to Financial Statements**

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**Note 1. Nature of Business and Significant Accounting Policies (Continued)**

**District tax revenues:** Property taxes are levied by the County on the Hospital's behalf on July 1, and are intended to help finance the Hospital's activities during the year ending the following June 30. The County has established certain dates to levy, lien, mail bills and receive payments from property owners during the year. Amounts levied are based on assessed property values as of the preceding January 1. Property taxes are considered delinquent on the day following each payment due date. The Hospital received approximately \$3,359,000 and \$3,384,000 of its financial support from property taxes for the years ended December 31, 2016 and 2015, respectively. These funds are used to support operations and meet required debt service agreements. They are classified as nonoperating revenue as the revenue is not directly linked to patient care and recorded by the Hospital when levied and during the period of their intended use. Management determined that levied amounts not yet received and which are intended for the Hospital's future use should be recorded as other receivables and deferred inflows which totaled approximately \$1,528,000 and \$1,494,000 as of December 31, 2016 and 2015, respectively.

**Grants and contributions:** From time to time, the Hospital receives grants from various governmental agencies and private organizations. The Hospital also receives contributions from foundation and auxiliary organizations, as well as from individuals and other private organizations. Revenues from grants and contributions are recognized when all eligibility requirements, including time requirements are met. Grants and contributions may be restricted for either specific operating purposes or capital acquisitions. These amounts, when recognized upon meeting all requirements, are reported as non-operating revenue.

**340B program:** The Hospital participates in the 340B drug discount program which enables qualifying health care providers to purchase drugs from pharmaceutical suppliers at a substantial discount. The 340B program is managed by the Health Resources and Services Administration (HRSA) Office of Pharmacy Affairs. The Hospital benefits under this program by purchasing pharmaceuticals at a reduced cost. As one of the conditions for participating in the 340B program, the Hospital is subject to audit, although no such audit nor notification of audit has been received, the government audit activity involving the 340B program has and is expected to increase in the foreseeable future.

**Operating revenues and expenses:** The Hospital's statements of revenues, expenses and changes in net position distinguish between operating and non-operating revenues and expenses. Operating revenues result from exchange transactions associated with providing health care services, which is the Hospital's principal activity. Operating expenses are all expenses incurred to provide health care services, other than financing costs. Non-operating revenues and expenses are those transactions not considered directly linked to providing health care services.

**Subsequent events:** The Hospital has evaluated subsequent events through June 30, 2017, the date on which the financial statements were issued.

**North Sonoma County Healthcare District  
d/b/a Healdsburg District Hospital**

**Notes to Financial Statements**

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**Note 2. Deposits and Investments**

As of December 31, 2016 and 2015, the Hospital had deposits invested in various financial institutions in the form of cash and cash equivalents as follows:

	2016	2015
Deposits:		
Deposits with financial institutions	\$ 6,170,883	\$ 5,442,655
Cash on hand	1,284	1,362
	6,172,167	5,444,017
Investments:		
Money market mutual funds	-	2,079,210
	\$ 6,172,167	\$ 7,523,227
Reported as follows in the statement of net position:		
Cash and equivalents	\$ 5,756,923	\$ 4,210,028
Assets limited to use, current portion	318,649	820,975
Assets limited to use, noncurrent portion	96,595	2,492,224
Total	\$ 6,172,167	\$ 7,523,227

**Custodial credit risk – deposits:** At December 31, 2016 and 2015, the Hospital’s cash deposits with financial institutions totaled approximately \$5,628,439 and \$4,784,694, respectively. Funds held in deposits are collateralized in accordance with the California Government Code (CGC), except for \$250,000 per account that is federally insured by the Federal Deposit Insurance Corporation. Under the provisions of the CGC, California banks and savings and loan associations are required to secure the Hospital’s deposits by pledging government securities as collateral. The market value of pledged securities must equal at least 110% of the Hospital’s deposits. California law also allows financial institutions to secure Hospital deposits by pledging first trust deed mortgage notes having a value of 150% of the Hospital’s total deposits. The pledged securities are held by the pledging financial institution’s trust department in the name of the Hospital.

**Custodial credit risk – investments:** For investments, custodial credit risk is the risk that, in the event of failure of the counterparty, the Hospital will not be able to recover the value of the investments or collateral securities that are in the possession of an outside party. Securities held by a third-party are registered in the name of the Hospital.

**Interest rate risk:** The investment policy does not limit investment maturities as a means of managing its exposure to fair value losses from increasing interest rates. The Hospital held no material amounts of investments at December 31, 2016, and all investments at December 31, 2015, were due in less than one year.

**North Sonoma County Healthcare District  
d/b/a Healdsburg District Hospital**

**Notes to Financial Statements**

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**Note 2. Deposits and Investments (Continued)**

**Credit risk:** State law limits investments in authorized securities to certain credit risk ratings and maturities. The Hospital's investments at December 31, 2016 and 2015, were not rated.

**Concentration of credit risk:** The Hospital places no limit on the amounts that may be invested in any one issuer. At December 31, 2016 the Hospital held no material amounts of investments. At December 31, 2015, 100% of the Hospital's investments were in money market mutual funds.

**Note 3. Net Patient Service Revenue**

The Hospital has agreements with third-party payors that provide for payments to the Hospital at amounts different from its established rates. A summary of the payment arrangements with major third-party payors follows:

**Medicare:** Payments for acute care services rendered to Medicare program beneficiaries are paid on cost reimbursement principles. The Hospital was designated as a critical access hospital effective December 1, 2005. The Hospital is paid for services at an interim rate with final settlement determined after submission of annual cost reports and audits thereof by the Medicare fiscal intermediary. At December 31, 2016, cost reports through December 31, 2014, have been final settled.

**Medi-Cal:** Payments for inpatient services rendered to Medi-Cal patients are made based on reasonable costs while outpatient payments are based on pre-determined charge screens. The Hospital is paid for cost-based inpatient services at an interim rate with final settlement determined after submission of annual cost reports and audits thereof by Medi-Cal. At December 31, 2016, cost reports through December 31, 2015, have been final settled.

Retroactive adjustments made to related estimated third-party settlements for prior years are recorded in net patient service revenue in the year the adjustment is determined. The 2016 and 2015 net patient service revenue increased approximately \$187,000 and decreased approximately \$708,000 respectively, as a result of retroactive adjustments related to prior years.

AB 915, sponsored by LA Care Health Plan, requires California Department of Health Care Services (DHCS), in the absence of countervailing considerations and to the extent permitted by federal law, to approve non-monetary incentives offered by Medi-Cal managed care contractors to its Medi-Cal enrollees to promote good health practices. The purpose of this bill is to allow publicly owned health care facilities to obtain federal matching funds for unreimbursed costs for providing outpatient services to Medi-Cal recipients for Medi-Cal covered benefits. The cost of providing Medi-Cal services frequently exceeds the reimbursement rate that Medi-Cal pays for those services. That shortfall is the unreimbursed cost. Currently, the public entity that owns those health care facilities is responsible for paying all the unreimbursed costs. This bill allows those public entities to obtain federal matching funds so that the unreimbursed costs would be split, with 50% coming from the public entity and 50% from the federal government. During the years ended December 31, 2016 and 2015, the Hospital recognized the net impact of approximately \$2,542,000 and \$1,443,000, respectively, as a reduction of contractual adjustment expense, which is included in net patient service revenue.

**North Sonoma County Healthcare District  
d/b/a Healdsburg District Hospital**

**Notes to Financial Statements**

**Note 3. Net Patient Service Revenue (Continued)**

**Other:** Payments for services rendered to other than Medicare and Medi-Cal patients are based on established rates or on agreements with certain commercial insurance companies, health maintenance organizations and preferred provider organizations which provide for various discounts from established rates.

Net patient service revenue for the years ended December 31, 2016 and 2015, is comprised of the following:

	2016	2015
Inpatient services	\$ 27,410,516	\$ 20,302,797
Inpatient ancillary services	17,365,396	20,120,822
Outpatient services	58,578,852	59,511,103
Gross patient service revenue	103,354,764	99,934,722
Less contractual adjustments and provision for bad debts	(60,689,730)	(59,812,673)
Net patient service revenue	<u>\$ 42,665,034</u>	<u>\$ 40,122,049</u>

Medicare and Medi-Cal revenue accounted for approximately 73% of the Hospital's 2016 and 2015 net patient service revenue. Laws and regulations governing the Medicare and Medi-Cal programs are extremely complex and subject to interpretation. As a result, there is a possibility that estimates will change by a material amount in the near term.

**Note 4. Concentration of Credit Risk**

The Hospital grants credit without collateral to its patients and third-party payors. Patient accounts receivable from government agencies represent the only concentrated group of credit risk for the Hospital and management does not believe there is any credit risk associated with these governmental agencies. Contracted and other patient accounts receivable consist of various payors including individuals involved in diverse activities, subject to differing economic conditions and management believes they do not represent any concentrated credit risks to the Hospital. The composition of patient accounts receivable by payor at December 31, 2016 and 2015, was as follows:

	2016	2015
Medicare	\$ 6,954,036	\$ 5,270,020
Medi-Cal	2,510,057	1,997,727
Other third-party payors	14,321,592	16,563,906
Self pay	5,921,098	5,531,642
Gross patient accounts receivable	29,706,783	29,363,295
Less allowances for contractual adjustments and bad debts	(25,219,575)	(25,136,232)
Net patient accounts receivable	<u>\$ 4,487,208</u>	<u>\$ 4,227,063</u>



**North Sonoma County Healthcare District  
d/b/a Healdsburg District Hospital**

**Notes to Financial Statements**

**Note 5. Assets Limited as to Use**

Assets limited as to use as of December 31, 2016 and 2015, were comprised of the following:

	2016	2015
Under trust agreements	\$ 27,078	\$ 2,575,471
Designated by the Board	290,844	297,959
Restricted for specific use	69,517	412,966
For employee flexible spending plan	27,805	26,803
	<u>415,244</u>	<u>3,313,199</u>
Less current portion to match current liabilities	(318,649)	(820,975)
	<u>\$ 96,595</u>	<u>\$ 2,492,224</u>

**Note 6. Capital Assets**

The following summarizes changes in the capital assets of the Hospital for the years ended December 31, 2016 and 2015:

	Balance at December 31, 2015	Additions and Transfers	Transfers/ Retirements/	Balance at December 31, 2016
Capital assets not being depreciated:				
Land and land improvements	\$ 487,432	\$ -	\$ -	\$ 487,432
Construction-in-progress	621,120	1,418,208	(2,032,087)	7,241
Total capital assets not being depreciated	<u>1,108,552</u>	<u>1,418,208</u>	<u>(2,032,087)</u>	<u>494,673</u>
Capital assets being depreciated:				
Buildings and improvements	6,731,779	107,390	-	6,839,169
Equipment	11,881,067	1,958,299	-	13,839,366
Total capital assets being depreciated	<u>18,612,846</u>	<u>2,065,689</u>	<u>-</u>	<u>20,678,535</u>
Less accumulated depreciation for:				
Buildings and improvements	2,796,252	349,294	-	3,145,546
Equipment	7,757,039	1,507,492	-	9,264,531
Total accumulated depreciation	<u>10,553,291</u>	<u>1,856,786</u>	<u>-</u>	<u>12,410,077</u>
Total capital assets being depreciated, net	<u>8,059,555</u>	<u>208,903</u>	<u>-</u>	<u>8,268,458</u>
Capital assets, net	<u>\$ 9,168,107</u>	<u>\$ 1,627,111</u>	<u>\$ (2,032,087)</u>	<u>\$ 8,763,131</u>

**North Sonoma County Healthcare District  
d/b/a Healdsburg District Hospital**

**Notes to Financial Statements**

**Note 6. Capital Assets (Continued)**

	Balance at December 31, 2014	Additions and Transfers	Transfers/ Retirements/ Impairment	Balance at December 31, 2015
Capital assets not being depreciated:				
Land and land improvements	\$ 487,432	\$ -	\$ -	\$ 487,432
Construction-in-progress	494,762	1,989,075	(2,009,643)	621,120
Total capital assets not being depreciated	982,194	1,989,075	(2,009,643)	1,108,552
Capital assets being depreciated:				
Buildings and improvements	6,721,526	60,473	-	6,731,779
Equipment	9,675,080	585,559	227,561	11,881,067
Total capital assets being depreciated	16,396,606	646,032	227,561	18,612,846
Less accumulated depreciation for:				
Buildings and improvements	2,451,867	341,329	-	2,796,252
Equipment	6,534,418	1,053,153	-	7,757,039
Total accumulated depreciation	8,986,285	1,394,482	-	10,553,291
Total capital assets being depreciated, net	7,410,321	(748,450)	227,561	8,059,555
Capital assets, net	\$ 8,392,515	\$ 1,240,625	\$ (1,782,082)	\$ 9,168,107

**North Sonoma County Healthcare District  
d/b/a Healdsburg District Hospital**

**Notes to Financial Statements**

**Note 7. Long-Term Debt**

As of December 31, 2016 and 2015, debt borrowings were as follows:

	December 31, 2015	Borrowings	Payments	December 31, 2016	Due Within One Year
Capital lease obligation	\$ 1,425,557	\$ -	\$ (458,064)	\$ 967,493	\$ 477,513
North Sonoma County Healthcare District Certificates of Participation – 2008 Parcel Tax Secured Financing Program	5,620,000	-	(5,620,000)	-	-
North Sonoma County Healthcare District Certificates of Participation – 2016 Financing Project	-	4,936,122	-	4,936,122	528,000
	<u>\$ 7,045,557</u>	<u>\$ 4,936,122</u>	<u>\$ (6,078,064)</u>	<u>\$ 5,903,615</u>	<u>\$1,005,513</u>
	December 31, 2014	Borrowings	Payments	December 31, 2015	Due Within One Year
Capital lease obligation	\$ 1,781,200	\$ -	\$ (355,643)	\$ 1,425,557	\$ 463,697
North Sonoma County Healthcare District Certificates of Participation – 2008 Parcel Tax Secured Financing Program	6,335,000	-	(715,000)	5,620,000	735,000
	<u>\$ 8,116,200</u>	<u>\$ -</u>	<u>\$ (1,070,643)</u>	<u>\$ 7,045,557</u>	<u>\$1,198,697</u>

Scheduled principal and interest repayments on long-term debt are as follows:

Years ending December 31:	Note Payable		Capital Lease		Total Debt Service Requirements
	Principal	Interest	Principal	Interest	
2017	\$ 528,000	\$ 214,373	\$ 477,513	\$ 19,341	\$ 1,239,227
2018	728,000	303,833	489,980	6,874	1,528,687
2019	746,000	284,861	-	-	1,030,861
2020	767,000	265,410	-	-	1,032,410
2021	787,000	245,415	-	-	1,032,415
2022-2026	1,380,122	908,494	-	-	2,288,616
	<u>\$ 4,936,122</u>	<u>\$ 2,222,386</u>	<u>\$ 967,493</u>	<u>\$ 26,215</u>	<u>\$ 8,152,216</u>

**North Sonoma County Healthcare District  
d/b/a Healdsburg District Hospital**

**Notes to Financial Statements**

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**Note 7. Long-Term Debt (Continued)**

**Capital lease:** In December 2013, the Hospital entered into a purchase agreement with a third-party (vendor) to acquire an Electronic Health Records (EHR) system including software and equipment. Concurrently, the Hospital executed a "Lease Purchase Agreement" with an unrelated third party (creditor) to finance the aforementioned EHR system and other equipment. Subsequent to execution of the agreement with creditor, the creditor reduced the amount to be financed from \$2.9 million to \$1.6 million which represented the estimated cost of the EHR and related software and equipment. By December 31, 2016, all project costs were incurred. The Lease Purchase agreement with the creditor was superseded by the Master Lease Purchase agreement as of December 30, 2014, which includes a bargain purchase option. Based on this agreement, the total capital lease is \$1,781,200, with monthly principal and interest payments of \$41,405 at a rate of 2.58% beginning January 30, 2015 through December 30, 2018.

As of December 31, 2016, the creditor had paid for \$1,781,200 of the costs directly to the vendor. The Hospital is currently making the monthly payments of \$41,405.

Subsequent to December 31, 2014, the Hospital has decided to abandon certain assets required under the lease described above and to utilize another EHR system. As a result, there is not a related asset for this capital lease recorded on the accompanying statements of net position.

**Certificates of participation:** In September 2008, the Hospital issued Certificates of Participation (COP), 2008 Parcel Tax Secured Financing Program (2008 COP), in the original principal amount of \$10,115,000. The outstanding principal of the 2008 COP was refunded on December 29, 2016, using a portion of the proceeds of the 2016 COP.

On December 29, 2016, the Hospital issued COP, 2016 Financing Program (2016 COP), in the original principal amount of \$12,440,000. As of December 31, 2016, the initial proceeds of \$4,936,122 representing the first draw-down, was transferred to the Hospital. The difference between the net carrying value of the 2008 COP at the refunding date and the re-acquisition price of approximately \$254,000 was recognized as a deferred outflow of resources. Issuance costs of approximately \$230,000, which are included within registry and other professional fees on the statements of revenues, expenses and changes in net position, were also expensed in connection with the refunding.

The 2016 COP provided funds to: (i) refund its outstanding 2008 COP, executed to finance and refinance the acquisition and improvement of its health facilities; (ii) finance the improvement, renovation, replacement and equipping of the Hospital; and (iii) pay for costs associated with the execution and delivery of the COP. The COP evidence the direct, undivided fractional interests of the registered owners thereof (the Owners) in lease payments to be made by North Sonoma Hospital District (the District) for the lease of the Hospital pursuant to a lease agreement, dated as of December 1, 2016 by and between the District and Northern California Health Care Authority (the Authority). The District leases the Hospital to the Authority to enable the Authority to lease the Hospital back to the District pursuant to the Lease Agreement. Pursuant to an Assignment Agreement, dated as of December 1, 2016 between the Authority and the Trustee (the Assignment Agreement) the Authority assigned to the Trustee, for the benefit of the Owners, its rights under the Lease Agreement, including: (i) its right to receive Lease Payments; (ii) the District's pledge of its Parcel Tax Revenues to secure payment of Lease Payments; and (iii) its right to enforce amounts payable upon default.

**North Sonoma County Healthcare District  
d/b/a Healdsburg District Hospital**

**Notes to Financial Statements**

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**Note 7. Long-Term Debt (Continued)**

**Pledge of parcel tax revenues:** The District is required to pay to the Trustee, from a first and prior lien on the Parcel Tax Revenues, Lease Payments, in which the Certificates represent undivided fractional interests. "Parcel Tax Revenues" are the annual amounts collected by the County on behalf of the District from the Parcel Tax. If Parcel Tax Revenues are insufficient to pay Lease Payments when due, the District promises to pay the Lease Payments from any other available revenues of the District, subject to existing and future liens and encumbrances on its other revenues; provided, however, that there is no assurance that such revenues will be available. Until such time as all of the Lease Payments have been fully paid or prepaid, the District: (a) will not suspend, abate, or discontinue any payments provided for in the Lease Agreement; (b) will perform and observe all other agreements contained in the Lease Agreement; (c) will take appropriate action to oppose any effort to modify the Parcel Tax that would adversely affect the payment of the Certificates; and (d) will not terminate the term of the Lease Agreement for any cause.

**Optional redemption:** The 2016 COP are subject to redemption in whole or in part on any date on or after September 1, 2026, at the principal amount with respect thereto, together with accrued interest to the date fixed for redemption from the proceeds of optional prepayments made by the Hospital pursuant to the lease agreement. The 2016 COP are subject to optional redemption prior to their stated maturity, once per year on any date, at the option of the Hospital, in part, in inverse order of mandatory sinking fund installment payment date, up to 10% of the outstanding principal amount of the COP.

**Mandatory sinking fund redemption:** The 2016 COP are subject to mandatory redemption on March 1 and September 1 in each year on and after March 1, 2017, in the respective principal amounts set forth in the official statement.

**Note 8. Retirement Plans**

Effective October 1, 2004, the Hospital adopted a Section 457 retirement plan. Employees can contribute to this plan pursuant to plan documents. The Hospital also provides a defined contribution plan under Section 401(a) which allows the Hospital to match 50% of the employee's Section 457 contributions limited to a 3% maximum compensation level. All permanent employees who have completed 1,000 hours of service are eligible. Employer contributions to these plans for the years ended December 31, 2016 and 2015, were approximately \$261,000 and \$254,000, respectively, which is included in employee benefits expense.

The Hospital used to provide a 403(b) contributory plan. Effective October 1, 2004, this plan was frozen as the new Section 457/401(a) plan previously mentioned replaced it. There have been no contributions to this plan since it was frozen.

**Note 9. Healthcare Foundation Support**

The Healthcare Foundation of North Sonoma County (the Foundation), is an independent 501(c)(3) organization that has operated a capital campaign to fund a new emergency room, ICU and other capital improvements to the Hospital. In 2016 and 2015, the Foundation disbursed approximately \$349,000 and \$389,000, respectively, in capital contributions to the Hospital.

**North Sonoma County Healthcare District  
d/b/a Healdsburg District Hospital**

**Notes to Financial Statements**

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**Note 10. Commitments and Contingencies**

**Electronic health record payments:** The American Recovery and Reinvestment Act of 2009 included provisions for implementing health information technology under the Health Information Technology for Economic and Clinical Health Act (HITECH). The provisions were designed to increase the use of electronic health record (EHR) technology and establish the requirements for a Medicare and Medicaid incentive payment program for eligible providers that adopt and meaningfully use certified EHR technology.

The Hospital is entitled to receive Medicare and Medicaid incentive payments for the adoption of certified EHR technology, as it has satisfied the statutory and regulatory requirements. The Hospital recognizes income related to Medicare and Medicaid incentive payments using a grant model based upon when it has determined that it is reasonably assured that the Hospital will be meaningfully using EHR technology for the applicable period and the cost report information is reasonably estimable. The Hospital recognized revenue from Medicare and Medicaid incentive payments totaling \$410,000 and \$314,000, respectively, for the years ended December 31, 2016 and 2015. The incentive payments are included in other operating revenue in the statement of revenues, expenses and changes in net position. The Hospital's attestation of compliance with the meaningful use criteria is subject to audit by the federal government or its designee. Additionally, Medicare EHR incentive payments received are subject to retrospective adjustment upon final settlement of the applicable cost report from which payments were calculated.

**Operating leases:** The Hospital leases various equipment and facilities under operating leases expiring at various dates. Total building and equipment rent expense for the years ended December 31, 2016 and 2015, were approximately \$1,109,000 and \$1,103,000, respectively, and included in building and equipment rent expense. Future minimum lease payments for the succeeding years under operating leases that have initial or remaining lease terms in excess of one year as of December 31, 2016, are as follows:

Years ending December 31:	
2017	\$ 868,357
2018	882,861
2019	476,930
2020	465,055
2021	457,578
Thereafter	225,915
	<u>\$ 3,376,696</u>

**Litigation:** The Hospital may from time-to-time be involved in litigation and regulatory investigations which arise in the normal course of doing business. After consultation with legal counsel, management estimates that matters existing as of December 31, 2016, will be resolved without material adverse effect on the Hospital's future financial position, results from operations or cash flows.

**North Sonoma County Healthcare District  
d/b/a Healdsburg District Hospital**

**Notes to Financial Statements**

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**Note 10. Commitments and Contingencies (Continued)**

**Regulatory and compliance matters – general regulatory compliance:** The health care industry is subject to voluminous and complex laws and regulations of federal, state and local governments. Compliance with such laws and regulations can be subject to future government review and interpretation as well as regulatory actions unknown or unasserted at this time. These laws and regulations include, but are not necessarily limited to, matters such as licensure, accreditation, government health care program participation requirements, reimbursement laws and regulations, anti-kickback and anti-referral laws and false claims prohibitions, and in the case of tax-exempt hospitals, the requirements of tax exemption. In recent years, government activity has increased with respect to eligibility for critical access hospital designation, investigations and allegations concerning possible violations of reimbursement, false claims, anti-kickback, and anti-referral statutes and regulations by health care providers. The Hospital believes it is generally in compliance with applicable laws and regulations and is not aware of any pending or threatened investigations involving allegations of potential wrongdoing. The Hospital records a liability when it becomes aware that it has billed amounts or entered into transactions or relationships that may violate these governmental laws or regulations.

**Medical malpractice insurance:** The Hospital maintains commercial malpractice liability insurance coverage under a claims-made policy covering losses up to \$5 million per claim and up to \$15 million in the aggregate, with a per claim deductible of \$10,000. The Hospital plans to maintain the insurance coverage by renewing its current policy, or by replacing it with equivalent insurance. Based upon the Hospital's claims experience, management has determined that the potential liability for such claims is not material to the financial statements.

**Workers' compensation program:** The Hospital maintains workers' compensation self-insurance coverage under a claims-made policy covering losses on a per-occurrence basis in excess of \$1,000,000 for fiscal year 2016, with an aggregate limit of \$2,000,000. The Hospital has recorded an estimated liability for claims in the amount of \$219,000 as of December 31, 2016.

**Health self-insurance:** The health care plan for the Hospital's employees is administered by a third-party administrator. The Organization acts as a self-insurer for employee health care claims with excess coverage for claims exceeding \$100,000 per covered person with an aggregate stop loss of \$2,616,091 for the policy year ending December 31, 2016. Administrative expenses and claims for the health care plan included in expense were approximately \$2,250,000 and \$1,635,000 for the years ended December 31, 2016 and 2015, respectively.

Liabilities are reported when it is probable that a loss has occurred and the amount of loss can be reasonably estimated. Liabilities include an amount for claims that have been incurred but not reported (IBNR). Claim liabilities are calculated considering the effects of inflation, recent claim settlement trends including frequency and amount of payouts, and other economic and social factors.

Change in the balance of claims liabilities, which are included in accounts payable and other accrued expenses on the balance sheet, is approximately as follows:

	2016	2015
Claims payable, beginning of year	\$ 297,959	\$ 526,885
Incurred claims	2,250,220	1,634,531
Claim payments	(2,257,335)	(1,863,457)
Claims payable, end of year	<u>\$ 290,844</u>	<u>\$ 297,959</u>

**North Sonoma County Healthcare District  
d/b/a Healdsburg District Hospital**

**Notes to Financial Statements**

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**Note 10. Commitments and Contingencies (Continued)**

**Health care reform:** As a result of enacted federal health care reform legislation, substantial changes are anticipated in the United States health care system. Such legislation includes numerous provisions affecting the delivery of health care services, the financing of health care costs, reimbursement of health care providers and the legal obligations of health insurers, providers and employers. These provisions are currently slated to take effect at specified times over approximately the next decade.

**Medicare reimbursement:** Congress passed the Medicare Modernization Act in 2003, which among other things established a demonstration of The Medicare Recovery Audit Contractor (RAC) program. The RAC's identified and corrected a significant amount of improper overpayments to providers. In 2006, Congress passed the Tax Relief and Health Care Act of 2006 which authorized the expansion of the RAC program to all 50 states. The Hospital has been subject to such an audit and may continue to be subject to additional audits at some time in the future. The impact of this program cannot be quantified at this time.

**Seismic retro-fit:** The State of California issued seismic safety regulations in 1994, which have been amended on several occasions since then. The regulations call for stringent structural building standards. The Hospital is required to comply with earthquake retrofit requirements and has until 2030 to be compliant with such regulations. Management is evaluating its facilities and is considering all options.

**Note 11. Management Plans**

The Hospital has experienced two years of profitability after several years of operating losses. Profitability has resulted in an increase in cash reserves. The nursing staff received raises that brought them to the market rate in 2016. Accounts Payable has been notably decreased. The improved financial performance enabled the Hospital to refinance its COP and enter into a new loan to fund needed capital projects. The Hospital's organizational structure has adjusted to meet the needs of the evolving financial and operational situation. The senior leadership continues to use consultants in key positions while candidates are hired to improve their respective departments/areas of responsibilities and clinic operations. The Revenue Cycle Consultant was replaced with a Revenue Director and the organization was flattened to decrease the department from three managers to two managers.

The CEO, in conjunction with the senior leadership team, and under the review of the Board of Directors, created a new division in the district allowing clinics to be developed off the campus of Healdsburg District Hospital. The first clinic opened in Windsor in late 2015. The plan is to continue to focus on out-patient service development in the District.



**North Sonoma County Healthcare District  
d/b/a Healdsburg District Hospital**

**Notes to Financial Statements**

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**Note 11. Management Plans (Continued)**

Listed below is a brief non-comprehensive list of the initiatives that have been and are currently under development:

- Eliminate consultants in Materials Management and Peri-operative Services.
- Continue focus in interfacing information technology and out-patient software to improve efficiency to optimize the operating systems and financial software.
- Re-filed, from 2014 forward, federal and state cost reports.
- A Strategic Pricing Initiative was put in place and a 5% increase occurs annually to the charge description master, item master.
- Many other significant operational changes focused on increasing service volumes, cash collections, and reducing operating expenses.
- In 2015 opened a Women’s Clinic in Windsor.
- Towards the end of the year, a Physician Recruiter/Business Development Director was hired as the passage of AB 2024 allows Critical Access Hospitals to directly employ physicians. A podiatrist was contracted to begin work in early 2017. There will be a heavy focus to recruit primary care doctors and a surgeon to replace the retiring surgeon sometime in 2017.
- The involvement of the community and local foundation helped raise enough money to purchase an MRI.

In summary, the strategic focus of senior leadership and the Board of Directors have been in the following areas:

1.	People	Assure that HDH is an excellent place to work.
2.	Risk/Compliance	Develop an effective health care compliance program that focuses on confidentiality, privacy, work environment, reporting concerns of misconduct and protects NSCHD interests.
3.	Quality/Service	Deliver patient care that meets or exceeds targeted standards for quality and safety.
4.	Finance	Assure that financial and other resources are available to support our future growth.
5.	Community	Achieve thoughtful growth in services that are valued by our community and viable to the organization.
6.	IT/Technology	Enhance the use of technology for clinical and business purposes.
7.	Board/Governance	To ensure that the Board fulfills its legal, ethical, and functional responsibilities through adequate governance, policy development, recruitment strategies, training programs, monitoring of Board activities, and evaluation of Board members’ performance.
8.	Strategic Partnerships	Enhance the long-term viability of the organization to provide additional and specialized services to the community that connects care with NSCHD and other organizations.

**North Sonoma County Healthcare District  
d/b/a Healdsburg District Hospital**

**Notes to Financial Statements**

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**Note 11. Management Plans (Continued)**

- Building new services
- Increasing current service utilization
- Managing compliance
- Improving cash collections
- Improving cash management
- Improving net revenue
- Managing salaries, wages, and benefit cost while implementing a three-year staged wage increase for the Hospital
- Managing supply cost
- Managing contracted services

The aforementioned are regularly monitored and the results validated in an effort to continuously improve the Hospital's operational and financial performance. However, there can be no assurances that these initiatives will enable the Hospital to generate sufficient cash flow to fund operations, acquire needed capital assets, and pay debts.

**Note 12. Recently Adopted Accounting Standards**

GASB Statement No. 72, *Fair Value Measurement and Application*, issued February 2015, was adopted during the year ended December 31, 2016 with no material impact to the Hospital.

GASB Statement No. 77, *Tax Abatement Disclosures*, issued in August 2015, was adopted during the year ended December 31, 2016 with no material impact to the Hospital.

**Note 13. Recent Accounting Standards Not Yet Adopted**

GASB Statement No. 83, *Certain Asset Retirement Obligations*, issued November 2016, is effective for the year ended December 31, 2019. Management is currently evaluating the potential impact that the adoption of this update will have on its financial reporting.