Palomar Health

Consolidated Financial Statements as of and for the Years Ended June 30, 2015 and 2014, and Independent Auditors’ Report

PALOMAR HEALTH

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PALOMAR HEALTH

MANAGEMENT'S DISCUSSION AND ANALYSIS

Overview

Palomar Health (PH) is a public health care district and is a political subdivision in the State of California (the "State") organized pursuant to Division 23 of the Health and Safety Code of the State.

This section of PH's annual financial report presents management's discussion and analysis of the financial performance for the years ended June 30, 2015 and 2014. Although the 2013 condensed consolidated statement of net position, the condensed consolidated statement of revenue, expenses, and changes in net position, and the condensed consolidated statement of cash flows are presented in this section, they are not presented in the accompanying consolidated financial statements and notes to the consolidated financial statements. We encourage the reader to consider the information presented here in conjunction with the consolidated financial statements as a whole that follow this section.

This annual financial report includes:

- Management's Discussion and Analysis

- Independent Auditors' Report

- Consolidated financial statements of PH, including notes that explain in more detail some of the information in the consolidated financial statements.

The consolidated financial statements of PH include the financial statements of Arch Health Partners, Inc. ("Arch"). In accordance with Governmental Accounting Standards Board (GASB) Codification Section 2100, *The Financial Reporting Entity,* for financial reporting purposes, PH's reporting entity now includes Arch as a blended component unit as a result of the fiscal dependency of Arch on PH. Accordingly, the change in reporting entity has been applied retrospectively to include Arch as a blended component unit of PH for all years presented. Additionally, as discussed in Note 1 to the consolidated financial statements, the deferred rent liability was previously restated in the financial statements of Arch for the year ended June 30, 2013, resulting in an adjustment to reduce net position by $1,963 as of June 30, 2013.

Required Financial Statements

Consolidated Statements of Net Position — The consolidated statements of net position include all of PH's assets and liabilities and provide information about the nature and amounts of investments in resources (assets) and obligations to PH's creditors (liabilities) and net position — the difference between assets and liabilities — of PH and the changes in them. The consolidated statements of net position also provide the basis for evaluating the capital structure of PH and assessing the liquidity and financial flexibility of PH.

CONDENSED CONSOLIDATED STATEMENTS OF NET POSITION
AS OF JUNE 30, 2015, 2014, AND 2013
($ in thousands)

ASSETS	2015	2014 (As Restated, See Note 1)	2013 (As Restated, See Note 1)
Current assets	$ 355,385	$ 314,047	$ 299,103
Capital assets—net	1,154,277	1,208,784	1,265,756
Noncurrent assets	71,502	70,017	77,234
TOTAL	$ 1,581,164	$ 1,592,848	$ 1,642,093
LIABILITIES AND NET POSITION			
Current liabilities	$ 137,148	$ 110,960	$ 115,966
Workers' compensation—net of current portion	699	744	1,068
Fair value of interest rate swap	28,664	26,528	26,343
Long-term debt—net of current portion	1,136,411	1,131,405	1,123,398
Total liabilities	1,302,922	1,269,637	1,266,775
Deferred inflow of resources—Deferred revenue and deferred rent liability	11,151	10,749	9,344
Total liabilities and deferred inflow of resources	1,314,073	1,280,386	1,276,119
Invested in capital assets—net of related debt	49,173	120,027	184,340
Restricted for repayment of debt	11,701	10,192	13,753
Restricted for capital acquisitions	10,363	11,485	13,167
Restricted for other purposes	345	1,844	329
Unrestricted	195,509	168,914	154,385
Total net position	267,091	312,462	365,974
TOTAL	$ 1,581,164	$ 1,592,848	$ 1,642,093

2015: Analysis of the Consolidated Statements of Net Position

- Current assets increased by $41,338 or 13% in 2015, primarily due to increases in investments of $46,613 and net patient accounts receivable of $4,832. Investments increased by $46,613 because of $40,400 purchases of marketable securities and net patient accounts receivable increased by $4,832 mainly due to a shift in payor mix as a result of an increase in patients qualifying for governmental programs and a shift from traditional Medicare and Medi-Cal to managed care plans. These increases were offset by a decrease in estimated third-party settlements — receivable for $6,482 due to settlement of prior year receivables.

- Capital assets – net decreased by $54,507 or 5% primarily due to depreciation and amortization expense of $52,537 and net disposals of $10,159, offset by purchases related to major building projects of $8,189. Net disposals included sale of the Innovation property and Black Mountain property, which had a combined net book value of $9,854.

- Noncurrent assets increased by $1,485 or 2% primarily due to an increase of $1,098 of a loan receivable from Palomar Health Foundation.

- Current liabilities increased by $26,188 or 24% primarily due to an increase in the current portion of long-term debt of $11,578, accrued compensation and related liabilities of $4,176, and other accrued liabilities of $9,716.

- Long-term liabilities increased by $7,097 or 1% primarily due to an increase in the negative fair value of the interest rate swap of $2,136 and an increase in long-term debt of $5,006.

- Net position decreased by $45,371 or 15% primarily due to loss from operations of $15,513 and interest expense of $63,994, offset by property tax revenue of $32,033.

2014: Analysis of the Consolidated Statements of Net Position

- Current assets increased by $14,944 or 5% in 2014, primarily due to increases in cash of $27,621 and the current portion of assets whose use is limited — G.O. Bonds of $1,377. These were offset by decreases in investments of $5,728, estimated third-party settlements receivable of $2,243, and the current portion of assets whose use is limited of $3,388.

- Capital assets decreased by $56,972 or 5% primarily due to depreciation and amortization expense of $58,382 and net disposals of $9,949, offset by purchases related to major building projects of $11,359.

- Noncurrent assets decreased by $7,217 or 9% primarily due to a decrease in assets whose use is limited of $6,985.

- Current liabilities decreased by $5,006 or 4% primarily due to a decrease in the current portion of long-term debt of $7,465, offset by an increase in estimated third-party settlements liability of $2,046, other accrued liabilities of $902, the current portion of the G.O. Bonds of $574, and accrued compensation and related liabilities of $290.

- Long-term liabilities increased by $7,868 or 1% primarily as a result of the increase in G.O. Bonds of $15,452 and the fair value of the interest rate swap of $185, which were offset by decreases in the long-term debt of $7,445, and the long-term portion of workers' compensation of $324.

- Net position decreased by $53,512 or 15% primarily due to loss from operations of $27,450, and the interest expense of $64,870. The decrease is offset by property tax revenue of $29,868, investment income of $1,942 and other nonoperating-net of $7,183.

Consolidated Statements of Revenue, Expenses, and Changes in Net Position — All of PH's revenue, expenses, and changes in net position are included in the consolidated statements of revenue, expenses, and changes in net position. The consolidated financial statements measure the success of PH's operations during the years presented and are used to determine if PH has successfully recovered all of its costs through its fees and other sources of revenue. It also shows profitability and creditworthiness. Over time, increases or decreases in PH's net position are one indicator of PH's financial health.

CONDENSED CONSOLIDATED STATEMENTS OF REVENUE, EXPENSES, AND CHANGES IN NET POSITION FOR THE YEARS ENDED JUNE 30, 2015, 2014, AND 2013

($ in thousands)

	2015	2014 (As Restated, See Note 1)	2013 (As Restated, See Note 1)
OPERATING REVENUE:			
Net patient service revenue	$ 619,636	$ 583,616	$ 579,516
Net premium revenue	52,846	55,113	61,310
Other revenue	17,205	13,962	16,710
Total operating revenue	689,687	652,691	657,536
OPERATING EXPENSES	705,200	680,141	695,241
LOSS FROM OPERATIONS	(15,513)	(27,450)	(37,705)
NONOPERATING INCOME (EXPENSE):			
Investment income	1,834	1,942	1,571
Unrealized (loss) gain on interest rate swap	(2,136)	(185)	14,032
Interest expense	(66,278)	(64,870)	(56,036)
Property tax revenue—unrestricted	14,303	13,451	12,914
Property tax revenue—G.O. bonds	17,730	16,417	15,799
Other—net	4,689	7,183	2,831
Total nonoperating expense—net	(29,858)	(26,062)	(8,889)
DEFICIENCY OF REVENUE OVER EXPENSES	(45,371)	(53,512)	(46,594)
INTERFUND			695
DECREASE IN NET POSITION	(45,371)	(53,512)	(45,899)
NET POSITION—Beginning of year	312,462	365,974	411,873
NET POSITION—End of year	$ 267,091	$ 312,462	$ 365,974

2015: Analysis of the Consolidated Statement of Revenue, Expenses, and Changes in Net Position

- In accordance with accounting principles generally accepted in the United States of America (also known as GAAP or "generally accepted accounting principles") for governmental health care providers, PH's consolidated statements of revenue, expenses, and changes in net position reflect that nonoperating income (expenses) includes interest expense, which for nongovernmental hospitals is typically grouped as an operating expense. While these Governmental Accounting Standards Board (GASB) requirements make district hospitals conform to other governmental entities, such as colleges and universities, they may be less comparable to nongovernment hospitals because the GASB requirements do not apply to them. This must be a consideration if trying to compare PH to nonprofit and for-profit hospitals. Interest expense was $66,278 in the year ended June 30, 2015, and $64,870 in the year ended June 30, 2014.

- Operating revenue is primarily generated through the treatment of patients (providing inpatient and outpatient, ancillary, and other patient care service) as well as other affiliated revenue. Operating revenue increased by $36,996 or 6% in the year ended June 30, 2015, primarily due to increases in net patient service revenue of $36,020, a decrease in net premium revenue of $2,267, and an increase in other revenue of $3,243. The increase in net patient service revenue is primarily due to revenue recognized from various supplemental funding sources, including the Intergovernmental Transfer Program ("IGT") and Outpatient Supplemental Program of $14,640 in the year ended June 30, 2015.

- Operating expenses are those expenses related to the treatment of patients, including overhead and administration expenses. Operating expenses increased by $25,059 or 4% in the year ended June 30, 2015, primarily due to increase in salaries, wages, and benefits of $20,437 as a result of increased levels of staffing, increase in purchased services of $5,598 as a result of an increase in information technology services to support the Meaningful Use program, and increase in supplies of $6,731 offset by a decrease in depreciation and amortization expense of $5,845.

- Nonoperating expense — net increased by $3,796 or 15% in the year ended June 30, 2015, primarily due to an increase in the unrealized loss on interest rate swap of $1,951 and an increase in interest expense of $1,408. Nonoperating income includes PH's share of unrestricted property tax revenues of $14,303, collected by the County of San Diego, and restricted property tax revenue for repayment of G.O. Bonds of $17,730.

- As a result of the factors noted above, net position decreased by $45,371 for the year ended June 30, 2015.

2014: Analysis of the Consolidated Statement of Revenue, Expenses, and Changes in Net Position

- In accordance with accounting principles generally accepted in the United States of America (also known as GAAP or "generally accepted accounting principles") for governmental health care providers, PH's consolidated statements of revenue, expenses, and changes in net position reflect that nonoperating income (expenses) includes interest expense, which for nongovernmental hospitals is typically grouped as an operating expense. While these GASB requirements make district hospitals conform to other governmental entities, such as colleges and universities, they may be less comparable to nongovernment hospitals because the GASB requirements do not apply to them. This must be a consideration if trying to compare PH to nonprofit and for-profit hospitals. Interest expense was $64,870 in the year ended June 30, 2014, and $56,036 in the year ended June 30, 2013.

- Operating revenue is primarily generated through the treatment of patients (providing inpatient and outpatient, ancillary, and other patient care service) as well as other affiliated revenue. Operating revenue decreased by $4,845 or 1% in the year ended June 30, 2014, due to increases in net patient service revenue of $4,100, a decrease in net premium revenue of $6,197, and a decrease in other revenue of $2,748. Increases in inpatient and outpatient ancillary revenue and negotiated increases in contracted payer rates resulted in an increase in net charges during the year. The increase in net patient service revenue is primarily due to revenue recognized from various supplemental funding sources, including the IGT Program and Outpatient Supplemental Program totaling $9,303 in the year ended June 30, 2014.

- Operating expenses are those expenses related to the treatment of patients, including overhead and administration expenses. Operating expenses decreased by $15,100 or 2% in the year ended June 30, 2014, primarily due to increases in supplies of $1,642, professional fees of $26,322 and depreciation and amortization of $2,497. This was offset by decreases in purchased services of $29,507 and salaries, wages, and benefits of $16,127 due to the closure of Palomar Continuing Care Center and the outsourcing of the information technology services.

- Nonoperating expense — net increased by $17,173 or 193% in the year ended June 30, 2014, primarily due to an increase in the unrealized loss on interest rate swap of $14,217 and an increase in interest expense of $8,834. Nonoperating income includes PH's share of unrestricted property tax revenues of $13,451, collected by the County of San Diego, and restricted property tax revenue for repayment of G.O. Bonds of $16,417.

- As a result of the factors noted above, net position decreased by $53,512 for the year ended June 30, 2014.

Consolidated Statements of Cash Flows — The consolidated statements of cash flows report cash receipts, cash payments, and net changes in cash resulting from operating, investing, and financing activities, which provides answers to such questions as from where did cash come, for what was cash used, and what was the change in the cash balance during the reporting year.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED JUNE 30, 2015, 2014, AND 2013

($ in thousands)

	2015	2014 (As Restated, See Note 1)	2013 (As Restated, See Note 1)
CASH FLOWS FROM:			
Operating activities	$ 54,046	$ 40,086	$ 9,628
Noncapital financing activities	16,649	15,763	12,185
Capital and related financing activities	(27,488)	(45,545)	(96,391)
Investing activities	(44,893)	17,317	87,008
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(1,686)	27,621	12,430
CASH AND CASH EQUIVALENTS— Beginning of year	46,969	19,348	6,918
CASH AND CASH EQUIVALENTS— End of year	$ 45,283	$ 46,969	$ 19,348

2015: Analysis of the Consolidated Statement of Cash Flows

- Operating activities cash inflow reflected an increase of $13,960 or 35% in the year ended June 30, 2015, over the year ended June 30, 2014. This increase is mostly attributable to increases in cash collections of patient accounts of $44,599, and other sources of $1,577 offset by increases in payments to employees of $16,770 and increased payments to suppliers for $15,446.

- Net cash outflows from capital and related financing activities in 2015 were $27,488, primarily due to interest payments of $45,122, and the payment of long-term debt of $3,767 offset by the receipt of $17,730 of property taxes for debt service and $12,200 on proceeds from sale of fixed assets.

- Investing activities net cash outflows were $44,893 in 2015. This is primarily due to cash outflows from purchases of investments of $172,652, offset by cash inflow on proceeds from sale of investments of $126,016.

- The ending cash and cash equivalents of $45,283 reflect the checking account and overnight investment balances held by PH. In addition, there were current investments of $140,516 at June 30, 2015.

2014: Analysis of the Consolidated Statement of Cash Flows

- Operating activities cash inflow reflected an increase of $30,458 or 316% in the year ended June 30, 2014, over the year ended June 30, 2013. This increase is mostly attributable to increases in cash collections of patient accounts of $31,251 and decreases in payments to employees of $12,348 offset by increased payments to suppliers for $6,447.

- Net cash outflows from capital and related financing activities in 2014 were $45,545, primarily due to interest payments of $45,561, and the payment of long-term debt of $18,414 offset by the receipt of $16,417 of property taxes for debt service.

- Investing activities net cash inflows were $17,317 in 2014. This is primarily due to cash outflows from purchases of investments of $145,199, offset by cash inflow on proceeds from sale of investments of $162,358.

- The ending cash and cash equivalents of $46,969 reflect the checking account and overnight investment balances held by PH. In addition, there were current investments of $93,903 at June 30, 2014.

2015 and 2014: Capital Assets and Long-Term Debt

The Board of Directors approved a facilities master plan (the "Facilities Master Plan") budgeted at $1,057,000. In November 2004, the residents of the district voted and approved to fund $496,000 of this expansion by the issuance of G.O. Bonds. Payment for these bonds is funded by an ad valorem property tax levied on the district residents. The approximate amount of the tax levy for each taxable property remained at $23.50 per $100 of assessed value in the years ended June 30, 2015 and 2014. The levy is established by the Board of Director's resolution each year in an amount sufficient to service the debt for the upcoming year along with a reserve amount.

One of the major components of the Facilities Master Plan included the construction of the new Palomar Medical Center Campus named Palomar Medical Center in Escondido. On August 19, 2012, PH opened the 288-bed facility. It includes critical and general inpatient care, surgical and interventional services, and emergency and trauma services.

Other building projects include the renovation of existing hospital facilities at Pomerado Hospital, renovation of Palomar Health Downtown Campus (PHDC), and construction of ambulatory and outpatient facilities at various locations in the District.

PH has three outstanding revenue bond issues that are classified as long-term debt. These are the 2006 Insured Certificates of Participation (COP), the 2009 COP, and the 2010 COP. There were no principal payments due on these issues, bringing the net long-term bond principal to $568,708 at June 30, 2015 and 2014. All debt payments have been made timely.

During Fiscal Year 2014, the 1999 Insured Revenue Bonds were redeemed. More detailed information about PH's debt and bond redemption is presented in Note 8 to the consolidated financial statements. PH has an underlying Moody's Investor Service ("Moody's) rating of Ba1 on its COP.

In July 2005, PH issued its first series of G.O. Bonds authorized by voter approval in 2004 (measure BB) in the amount of $80,000 for use in funding the building expansion project. In December 2007, PH issued its second series of G.O. Bonds totaling $241,083. In March 2009, PH issued its third series of G.O. Bonds in the amount of $110,000. In November 2010, PH issued the final series of G.O. Bonds in the amount of $64,917. A principal payment of $3,383 and $2,808 reduced the G.O. Bonds' principal to $471,441 and $474,824 as of June 30, 2015 and 2014, respectively. PH continued to have an underlying Moody's rating of A2 on its G.O. Bonds.

Liquidity and Capital Resources

PH's unrestricted liquidity position as of June 30, 2015, was $185,799, including $45,283 in operating cash and $140,516 in unrestricted investments stated at fair value. PH's unrestricted liquidity position as of June 30, 2014, was $140,872, including $46,969 in operating cash and $93,903 in unrestricted investments stated at fair market value. The available liquidity of $185,799 at June 30, 2015, represents a $44,927 or 32% increase over the $140,872 in available liquidity as of June 30, 2014, and equals 33% of total outstanding debt exclusive of the G.O. Bonds, payments on which are funded separately from ad valorem taxes, as of June 30, 2015.

Economic and Other Factors

On June 24, 2015, PH's Board of Directors voted to transfer all services from the PHDC to other PH owned facilities and to close the seismically-challenged facility. This process is expected to take 8-12 months and result in significant overhead savings for the system. The next few years are anticipated to require additional capital outlay for the transition of services as well as Information System upgrades required to meet Meaningful Use requirements and ICD-10 coding requirements in addition to the replacement of outdated equipment and associated technology.

The challenge of meeting these capital needs becomes more difficult as reimbursement for services continues to decline. On the federal level, the provisions of the Affordable Care Act continue to enforce the 2% sequestration for Medicare, Tricare, and Medicare HMOs, which were first experienced in fiscal year 2013. Other federal programs now allow Medicare to penalize hospitals. While minimal in 2015, potential penalties and loss of Medicare reimbursement for re-admissions, RAC takebacks, the two midnight rule, and value based purchasing may increase each year. Other penalties and loss of reimbursement for quality measures and patient experience will impact PH within the next fiscal year. Additional federal cuts are slated to go into effect in fiscal year 2017 that will reduce the amount of Medicaid Disproportionate Share (DSH) allotments to the states, which will translate into less funding for uncompensated care.

On a State level, the California legislature continues to change reimbursement laws and regulations to create continued uncertainty over future healthcare reimbursement. Medi-Cal reimbursement has been reduced significantly with across-the-board rate cuts and the State moved to several new methods of reimbursement in 2014, which reduced reimbursement on a go-forward basis. The effects of these reductions are considered particularly troublesome with the Medi-Cal expansion from the introduction of the State exchanges. In addition, there is still uncertainty of select NDPH-IGT, Hospital Fee, and other funding programs as the Centers for Medicare and Medicaid Services continue to delay approval of legislatively created programs. The 2015-16 state budget eliminates the partial restoration of the Medi-Cal reimbursement cuts to distinct-part nursing facilities.

A long-standing challenge for PH is a weak local economy and a challenging payor mix. Legislation mandated by the state of California relative to staffing ratios, and improved clinical quality and safety standards that are tied to government reimbursement contributes to higher staffing costs, increased uncompensated care expense but lowered reimbursement.

Finance Contact — PH's consolidated financial statements are designed to present users with a general overview of PH's finances and to demonstrate PH's accountability. If you have any questions about the report or need additional financial information, please contact the Executive Vice-President — Finance, Palomar Health, 456 E. Grand Avenue, Escondido, California 92025.

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INDEPENDENT AUDITORS' REPORT

To the Board of Directors of
Palomar Health:

We have audited the accompanying consolidated financial statements of Palomar Health (PH), which comprise the consolidated statements of net position as of June 30, 2015 and 2014, and the related consolidated statements of revenue, expenses, and changes in net position and of cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Consolidated Financial Statements

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

Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We did not audit the consolidated financial statements of Arch Health Partners, Inc. ("Arch"), a blended component unit, which statements reflect total assets constituting 1% of consolidated total assets as of June 30, 2015 and 2014, and total revenues constituting 5% and 6%, respectively, of consolidated total revenues for the periods then ended. Those statements were audited by other auditors, whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for Arch, is based solely on the report of the other auditors. We conducted our audits 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 consolidated financial statements are free from material misstatement.

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

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of PH as of June 30, 2015 and 2014, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As discussed in Note 1 to the consolidated financial statements, the accompanying 2014 consolidated financial statements have been restated as a result of a change in reporting entity. Our opinion is not modified with respect to this matter.

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 1 through 10 be presented to supplement the basic consolidated financial statements. Such information, although not a part of the basic consolidated financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic consolidated 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 consolidated financial statements, and other knowledge we obtained during our audit of the basic consolidated 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.

Deloitte & Touche LLP

November 25, 2015

PALOMAR HEALTH

CONSOLIDATED STATEMENTS OF NET POSITION
AS OF JUNE 30, 2015 AND 2014
(Dollars in thousands)

	2015	2014 (As Restated, See Note 1)
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 45,283	$ 46,969
Investments	140,516	93,903
Patient accounts receivable—net of allowances for uncollectible accounts of $34,581 in 2015 and $48,328 in 2014	126,618	121,786
Other receivables	6,260	7,957
Supplies/inventories	9,862	9,215
Prepaid expenses and other	3,594	4,708
Estimated third-party payor settlements receivable	1,688	8,170
Assets whose use is limited—current portion	132	1,857
Assets whose use is limited—general obligation bonds—current portion	21,432	19,482
Total current assets	355,385	314,047
ASSETS WHOSE USE IS LIMITED:		
Held by trustee under indenture agreements	44,362	44,598
Held by trustee under general obligation bonds indenture	21,432	19,482
Held in escrow for street improvements	10,363	11,485
Restricted by donor and other	345	1,843
Total assets whose use is limited	76,502	77,408
Less current portion	21,564	21,339
Total assets whose use is limited—long-term portion	54,938	56,069
CAPITAL ASSETS—Net	1,154,277	1,208,784
OTHER ASSETS:		
Prepaid debt insurance costs	8,176	8,759
Investment in and amounts due from affiliated entities	3,884	3,787
Other	4,504	1,402
Total other assets	16,564	13,948
TOTAL	$ 1,581,164	$ 1,592,848

(Continued)

PALOMAR HEALTH

CONSOLIDATED STATEMENTS OF NET POSITION
AS OF JUNE 30, 2015 AND 2014
(Dollars in thousands)

LIABILITIES AND NET POSITION	2015	2014 (As Restated, See Note 1)
CURRENT LIABILITIES:		
Accounts payable	$ 28,426	$ 28,761
Accrued compensation and related liabilities	41,824	37,648
Current portion of general obligation bonds	3,941	3,382
Current portion of long-term debt	11,383	364
Estimated third-party payor settlements liability	11,574	10,740
Other accrued liabilities	30,139	20,423
Accrued interest payable	9,861	9,642
Total current liabilities	137,148	110,960
WORKERS' COMPENSATION—Net of current portion	699	744
LONG-TERM DEBT—General obligation bonds—net of current portion	586,134	570,217
LONG-TERM DEBT—Net of current portion	550,277	561,188
FAIR VALUE OF INTEREST RATE SWAP	28,664	26,528
Total liabilities	1,302,922	1,269,637
DEFERRED INFLOW OF RESOURCES—Deferred revenue and deferred rent liabilities	11,151	10,749
Total liabilities and deferred inflow of resources	1,314,073	1,280,386
COMMITMENTS AND CONTINGENCIES (Note 14)		
NET POSITION:		
Net investment in capital assets	49,173	120,027
Restricted for repayment of debt	11,701	10,192
Restricted for capital acquisitions	10,363	11,485
Restricted for other purposes	345	1,844
Unrestricted	195,509	168,914
Total net position	267,091	312,462
TOTAL	$ 1,581,164	$ 1,592,848

See notes to consolidated financial statements. (Concluded)

PALOMAR HEALTH

CONSOLIDATED STATEMENTS OF REVENUE, EXPENSES, AND CHANGES IN NET POSITION
FOR THE YEARS ENDED JUNE 30, 2015 AND 2014
(Dollars in thousands)

	2015	2014 (As Restated, See Note 1)
OPERATING REVENUE:		
Net patient service revenue	$ 619,636	$ 583,616
Net premium revenue	52,846	55,113
Other revenue	17,205	13,962
Total operating revenue	689,687	652,691
OPERATING EXPENSES:		
Salaries, wages, and benefits	387,671	367,234
Professional fees	49,467	55,956
Supplies	97,414	90,683
Purchased services	70,025	64,427
Depreciation and amortization	52,537	58,382
Rent expense	19,072	18,029
Utilities	9,350	8,672
Other	19,664	16,758
Total operating expenses	705,200	680,141
LOSS FROM OPERATIONS	(15,513)	(27,450)
NONOPERATING INCOME (EXPENSES):		
Investment income	1,834	1,942
Unrealized loss on interest rate swap	(2,136)	(185)
Interest expense	(66,278)	(64,870)
Property tax revenue	14,303	13,451
Property tax revenue—general obligation bonds	17,730	16,417
Other—net	4,689	7,183
Total nonoperating expenses—net	(29,858)	(26,062)
DEFICIENCY OF REVENUE OVER EXPENSES	(45,371)	(53,512)
NET POSITION—Beginning of year	312,462	365,974
NET POSITION—End of year	$ 267,091	$ 312,462

See notes to consolidated financial statements.

PALOMAR HEALTH

CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED JUNE 30, 2015 AND 2014
(Dollars in thousands)

	2015	2014 (As Restated, See Note 1)
CASH FLOWS FROM OPERATING ACTIVITIES:		
Receipts from:		
Patients, insurers, and other third-party payors	$ 731,824	$ 687,225
Other sources	18,801	17,224
Payments to:		
Employees	(383,540)	(366,770)
Suppliers	(313,039)	(297,593)
Net cash provided by operating activities	54,046	40,086
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:		
Receipt of district taxes	14,303	13,451
Other	2,346	2,312
Net cash provided by noncapital financing activities	16,649	15,763
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:		
Acquisition of capital assets	(8,189)	(10,930)
Interest paid	(45,122)	(45,561)
Repayment of long-term debt	(3,767)	(18,414)
Proceeds from note payable		122
Recovery of owner controlled insurance program (OCIP) premiums		6,000
Proceeds on sale of fixed assets	12,200	6,821
Receipt of property taxes restricted for debt service on general obligation bonds	17,730	16,417
Other	(340)	
Net cash used in capital and related financing activities	(27,488)	(45,545)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of investments	(172,562)	(145,199)
Sale of investments	126,016	162,358
Interest received on investments and notes receivable	1,249	1,659
Receipt of payments on loans receivable	414	
Increase in loans receivable	(1,512)	
Other	1,502	(1,501)
Net cash (used in) provided by investing activities	(44,893)	17,317
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(1,686)	27,621
CASH AND CASH EQUIVALENTS—Beginning of year	46,969	19,348
CASH AND CASH EQUIVALENTS—End of year	$ 45,283	$ 46,969

(Continued)

PALOMAR HEALTH

CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED JUNE 30, 2015 AND 2014
(Dollars in thousands)

	2015	2014 (As Restated, See Note 1)
RECONCILIATION OF OPERATING LOSS TO NET CASH FLOWS PROVIDED BY OPERATING ACTIVITIES:		
Loss from operations	$ (15,513)	$ (27,450)
Adjustments to reconcile income from operations to net cash provided by operating activities:		
Depreciation and amortization	52,537	58,382
Provision for bad debts	60,347	76,198
Equity in earnings of affiliates	(97)	(628)
Changes in assets and liabilities:		
Patient accounts receivable	(65,179)	(75,836)
Other receivables	2,578	3,650
Supplies/inventories	(647)	560
Prepaid expenses and other	(886)	(51)
Estimated third-party payor settlements	7,316	4,289
Other—net	(885)	240
Accounts payable	226	(503)
Accrued compensation and related liabilities	4,131	464
Other accrued liabilities	9,716	(634)
Deferred revenue and deferred rent liability	402	1,405
NET CASH PROVIDED BY OPERATING ACTIVITIES	$ 54,046	$ 40,086
NONCASH INVESTING AND CAPITAL AND FINANCING ACTIVITIES—Capital expenditures included in accounts payable	$ 900	$ 1,461

See notes to consolidated financial statements.

(Concluded)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization—Palomar Health (PH), a public health care district, is organized under the provisions of the Health and Safety Code of the State of California to provide and operate health care facilities. The accompanying consolidated financial statements include the accounts of the following commonly controlled divisions and related entities of PH:

- Palomar Medical Center (PMC), located in west Escondido, California, includes a 288-bed general acute care hospital, including tertiary services, trauma services, and cardiovascular surgery

- Pomerado Hospital, located in Poway, California, includes a 107-bed general acute care hospital, and Villa Pomerado, a distinct part skilled nursing facility and sub-acute facility

- Palomar Health Downtown Campus (PHDC), formerly known as Palomar Medical Center (PMC), located in east Escondido, California, includes women's services, Center for Behavioral Health, and Rehabilitation Institute

- Home Health, located in Escondido, California

- San Marcos Ambulatory Care Center, located in San Marcos, California

- San Marcos Behavioral Medicine Center, located in San Marcos, California

- Central Office, providing management, financial, data processing, materials management, and public affairs services to the other divisions

- Palomar Health Development, a charitable nonprofit organization created to provide assistance and support for PH by obtaining grant funding from federal, state, local, and private sources

- Palomar Health expressCare clinics, located in select grocery stores in Escondido, Rancho Penasquitos, Temecula, and San Elijo Hills, California

- Arch Health Partners, Inc. ("Arch"), a non-profit medical foundation established under section 1206(l) of the California Health and Safety Code, with fifteen clinics located in Poway, Escondido, Ramona and San Marcos, California that provide primary and specialty care medical services and add another component in effective health care delivery to residents within PH's community.

Change in Reporting Entity—PH has provided a line of credit to Arch that bears interest at LIBOR plus 2% and is partly secured by certain assets of Arch including amounts on deposit in business bank accounts, furniture, fixtures and equipment, and accounts receivable. The outstanding principal and related accrued interest on the line of credit were $49,000 and $2,187, respectively, at June 30, 2015, and $32,600 and $743, respectively, at June 30, 2014. Under the credit agreement, repayment of the line of credit and accrued interest was scheduled to begin on July 1, 2015, in 60 equal monthly installments.

On July 1, 2015, the line of credit agreement was amended to increase the maximum advances available to Arch to $63,900 through June 30, 2016, and $76,900 through June 30, 2017, and to change the repayment terms to 120 equal monthly installments beginning on July 1, 2017. The line of credit agreement may be terminated without cause upon 90 days' written notice by either PH or Arch, except PH must provide one year's notice if termination of the agreement is due to determination by PH's Board of Directors that Arch's performance does not meet the standards previously agreed upon by PH and Arch. Subsequent to June 30, 2015, Arch has drawn an additional $5,700 on the line of credit. Management of PH believes that amounts due from Arch will be repaid to PH in accordance with the terms of the credit agreement. However, if Arch is unable to begin repaying the line of credit beginning on July 1, 2017, PH may find it necessary to modify the credit agreement to extend the due date of payments, reduce repayments of principal and interest, and agree to other modifications of the terms to attempt to recover amounts owed by Arch. In accordance with Governmental Accounting Standards Board (GASB) Codification Section 2100, *The Financial Reporting Entity,* for financial reporting purposes, PH's reporting entity now includes Arch as a blended component unit as a result of the fiscal dependency of Arch on PH. Accordingly, the change in reporting entity has been applied retrospectively in the accompanying consolidated financial statements to include Arch as a blended component unit of PH as of and for the years ended June 30, 2015 and 2014. The effect of the change as of July 1, 2013, was to decrease PH's consolidated net position by $11,986.

PH uses proprietary (enterprise) fund accounting. Revenues and expenses are recognized on the accrual basis using the economic resources measurement focus. Eliminations of internal activity have been made in the consolidated financial statements.

Use of Estimates—The preparation of consolidated 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 the disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

Accounting Standards—Pursuant to GASB Codification Section P80, *Proprietary Fund Accounting and Financial Reporting*, PH follows applicable pronouncements of the GASB. PH also applies the provisions of all relevant pronouncements of the Financial Accounting Standards Board (FASB), Accounting Principles Board, and the AICPA Committee on Accounting Procedure issued on or before November 30, 1989, that have been incorporated into GASB's authoritative literature.

Cash and Cash Equivalents—Cash and cash equivalents include highly liquid debt instruments with original maturities of three months or less and are intended for use in daily operations.

Investments—Investments in debt securities are carried at fair value, as determined by quoted market prices, in the consolidated statements of net position. Investment income or loss is included in nonoperating income, unless the income or loss is restricted by donor or law.

Supplies/Inventories—Supplies/Inventories are stated at the lower of cost (first-in, first-out) or market value.

Assets Whose Use is Limited—Assets whose use is limited primarily include assets held by trustees under indenture agreements and designated assets set aside by the Board of Directors for future capital improvements over which the Board of Directors retains control and may, at its discretion, subsequently use for other purposes. Amounts required to meet current liabilities of PH have been classified as current assets in the accompanying consolidated statements of net position.

PH has entered into an agreement with the City of Escondido (the "City") to financially participate in street improvements near the site of PMC. Under the agreement, PH was required to deposit $13,000 into an account jointly managed by PH and the City. PH's financial obligation is limited to the deposited amount plus any earned interest on the deposited funds. The balance of $10,363 and $11,485 as of June 30, 2015 and 2014, respectively, is included in assets whose use is limited in the accompanying consolidated statements of net position.

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

	Years
Land improvements	15
Buildings and building improvements	10–40
Leasehold improvements	3–15
Equipment	1-12

Interest cost incurred on borrowed funds during the period of construction of capital assets, net of interest earned, of $0 and $117 for the years ended June 30, 2015 and 2014, respectively, is capitalized as a component of the cost of acquiring those assets. Net interest cost capitalized was $0 and $117 for the years ended June 30, 2015 and 2014, respectively.

Gifts of long-lived assets, such as land, buildings, or equipment, are reported as unrestricted support in other changes in net position and are excluded from the excess of revenue over expenses, unless explicit donor stipulations specify how the donated assets must be used. Gifts of long-lived assets with explicit restrictions that specify how the assets are to be used and gifts of cash or other assets that must be used to acquire long-lived assets are reported as restricted support in other changes in net position. Absent explicit donor stipulations about how long those long-lived assets must be maintained, expirations of donor restrictions are reported when the donated or acquired long-lived assets are placed in service.

Capital assets are reviewed for impairment when events or changes in circumstances suggest that the service utility of the capital asset may have significantly and unexpectedly declined. Capital assets are considered impaired if both the decline in service utility of the capital asset is large in magnitude and the event or change in circumstance is outside the normal life cycle of the capital asset. Such events or changes in circumstances that may be indicative of impairment include evidence of physical damage, enactment, or approval of laws or regulations or other changes in environmental factors; technological changes or evidence of obsolescence; changes in the manner or duration of use of a capital asset; and construction stoppage. The determination of the impairment loss is dependent upon the event or circumstance in which the impairment occurred. Impairment losses are recorded in the consolidated statements of revenue, expenses, and changes in net position. In the years ended June 30, 2015 and 2014, no impairment charges were recorded. On June 24, 2015, PH's Board of Directors voted to close PHDC and transfer all services to other PH facilities. The closure of PHDC is expected to be completed near the end of fiscal year 2016. Management of PH estimates that the market value of the PHDC facility exceeds its carrying value in the consolidated financial statements.

Debt Discounts, Debt Premiums, and Debt Issuance Costs—Debt discounts and debt premiums are amortized by the bonds outstanding method over the life of the related bonds. Debt issuance costs, except prepaid insurance costs, are expensed as incurred. Prepaid insurance costs are reported as an asset and recognized as an expense over the duration of the related debt.

Interest Rate Swaps—PH has entered into variable-to-fixed interest rate swaps, which are reflected at fair value in the consolidated statements of net position. The fair value of the interest rate swaps will fluctuate based generally on changes in market rates of interest. Any unrealized gains or losses resulting from changes in fair value are reported as nonoperating income (expenses) in the consolidated statements of revenue, expenses, and changes in net position. Interest cost on variable interest rate debt is reported based on the fixed interest rate paid by PH under the interest rate swaps. As of June 30, 2015 and 2014, the interest rate swaps are recorded as a liability of $28,664 and $26,528, respectively.

Deferred Rent Liability—Rental expenses for operating leases are recorded on a straight-line basis. Arch has several real estate lease agreements that include rent holidays in addition to annual rental increases of 3%. The difference between straight-line rental expense and cash payments through June 30, 2015 and 2014 resulted in a deferred rent liability of $2,874 and $2,360, respectively. The deferred rent liability was previously restated in the financial statements of Arch for the year ended June 30, 2013, resulting in an adjustment to reduce net position of Arch by $1,963 as of June 30, 2013.

Net Position—Net position of PH is classified in three broad components: net investment in capital assets, restricted (distinguishing between major categories of restrictions) and unrestricted. Net investment in capital assets consists of capital assets, net of accumulated depreciation and reduced by the outstanding balances of borrowings used to finance the purchase or construction of those assets. Net position restricted for repayment of debt includes amounts deposited with trustees as required by bond indentures, as described in Note 8. Net position restricted for capital acquisitions relates to amounts restricted to acquire capital assets. Net position restricted for other purposes relates to noncapital net position that must be used for a particular purpose, as specified by contributors or others external to PH. Unrestricted net position represents the remaining net position that does not meet the definition of net investment in capital assets or restricted.

Consolidated Statements of Revenue, Expenses, and Changes in Net Position—All revenues and expenses directly related to the delivery of health care services are included in operating revenue and expenses in the consolidated statements of revenue, expenses, and changes in net position. Nonoperating income (expenses) consist of those revenues and expenses that result from nonexchange transactions, financing (interest expense and changes in the fair value of interest rate swaps), and investment income.

Net Patient Service Revenue—PH has agreements with third-party payors that provide for payments to PH at amounts different from its established rates. Payment arrangements include prospectively determined rates per discharge, reimbursed costs, discounted charges, and daily rates. Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered, including a provision for bad debts and estimated retroactive adjustments under reimbursement agreements with third-party payors. Retroactive adjustments are accrued on an estimated basis in the year the related services are rendered and adjusted in future years, as final settlements are determined.

Net Premium Revenue—PH has agreements with various third-party payors to provide medical services to subscribing participants. Under some of these agreements, PH receives monthly capitation payments based on the number of each payor's participants, regardless of services actually performed by PH. Under these agreements, PH also participates in shared risk pools with medical groups, through which it could receive additional reimbursement or pay additional amounts to the medical groups. In conjunction with the shared risk pools, PH estimates incurred but not reported (IBNR) claims for medical services provided to patients. IBNR of $10,129 and $8,052 are included in other accrued liabilities in the accompanying consolidated statements of net position as of June 30, 2015 and 2014, respectively.

Charity Care—PH provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. Amounts determined to qualify as charity care are not reported as revenue in the accompanying consolidated financial statements. Charity care charges forgone, at established rates, for the years ended June 30, 2015 and 2014, were $12,670 and $11,291, respectively. PH's cost of providing charity care for years ended June 30, 2015 and 2014, were $2,899 and $2,852, respectively. The cost of providing charity care is calculated using the cost-to-charge ratio.

Property Taxes—PH receives financial support from property taxes. Property taxes are levied by the County of San Diego on behalf of PH to finance PH's activities. Amounts levied for General Obligation Bonds ("G.O. Bonds") are based on assessed property values and are set annually by the Board of Directors. Property tax revenue for the years ended June 30, 2015 and 2014, consists of the following:

	2015	2014
To support operations—unrestricted use	$ 14,303	$ 13,451
For debt service on general obligation bonds—restricted use	17,730	16,417
Total	$ 32,033	$ 29,868

Income Taxes—PH is a governmental subdivision of the State of California and is exempt from federal income and state franchise taxes. Arch is exempt from income taxes under Section 501(c)(3) of the Internal Revenue Code (IRC) and Section 23701(d) of the California Revenue and Taxation Code. Accordingly, no provision for income taxes has been included in the accompanying consolidated financial statements.

Recent Accounting Pronouncements—

In February 2015, the GASB issued GASB Statement No. 72, *Fair Value Measurement and Application*. This statement addresses accounting and financial reporting issues related to fair value measurements. The definition of fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. This statement provides guidance for determining a fair value measurement for financial reporting purposes. This statement also provides guidance for applying fair value to certain investments and disclosures related to all fair value measurements. The requirements of this statement are effective for financial statements for periods beginning after June 15, 2015. Management has not determined the effect of GASB Statement No. 72 on the financial statements.

In June 2015, the GASB issued GASB Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*. The primary objective of this Statement is to improve accounting and financial reporting by state and local governments for postemployment benefits other than pensions (other postemployment benefits or OPEB). The Statement establishes standards for recognizing and measuring liabilities, deferred outflows of resources, deferred inflows of resources, and expense/expenditures. The requirements of this Statement are effective for financial statements for periods beginning after June 15, 2017. Earlier application is permitted. Management has not determined the effect of GASB Statement No. 75 on the financial statements.

In June 2015, the GASB issued GASB Statement No. 76, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*. The objective of this statement is to identify—in the context of the current governmental financial reporting environment—the hierarchy of generally accepted accounting principles (GAAP). The “GAAP hierarchy” consists of the sources of accounting principles used to prepare financial statements of state and local governmental entities in conformity with GAAP and the framework for selecting those principles. This statement reduces the GAAP hierarchy to two categories of authoritative GAAP and addresses the use of authoritative and nonauthoritative literature in the event that the accounting treatment for a transaction or other event is not specified within a source of authoritative GAAP. The requirements of this statement are effective for financial statements for periods beginning after June 15, 2015, and should be applied retroactively. Earlier application is permitted. Management has not determined the effect of GASB Statement No. 76 on the financial statements.

2. NET PATIENT SERVICE REVENUE

PH renders services to certain patients under contractual arrangements with the Medicare and Medi-Cal programs and various health maintenance and preferred provider organizations. The Medicare program generally pays a prospectively determined fee for services rendered to Medicare patients. Additionally, Medicare reimburses PH for certain inpatient services (primarily mental health unit services) on the basis of costs incurred. The Medi-Cal program provides for payment on a prospectively negotiated contractual rate per day, percentage of charges for services rendered, or capitated payment arrangement.

Revenue from the Medicare and Medi-Cal programs, inclusive of risk (capitated) and non-risk managed care programs, accounted for approximately 63% and 54% of PH’s net patient service revenue for the years ended June 30, 2015 and 2014, respectively.

Third-party settlements are recorded when received, which includes tentative settlements and lump-sum adjustments and final settlements for current and prior cost reporting years. The cost reports for the Medicare program have been settled through the year ended June 30, 2010, and the cost reports for Medi-Cal programs have been settled through the year ended June 30, 2012. Results of cost report settlements, as well as estimates for settlements of all years through 2015, have been reflected in the accompanying consolidated financial statements.

As of June 30, 2015 and 2014, estimated third-party settlements resulted in a receivable of $1,688 and $8,170, respectively, and a liability of $11,574 and $10,740, respectively. During the years ended June 30, 2015 and 2014, PH settled various prior-year cost reports and appeal issues. These settlements resulted in approximately $13,580 and $22,344 of additional revenues for the years ended June 30, 2015 and 2014, respectively, which are included in net patient service revenue in the accompanying consolidated statements of revenue, expenses, and changes in net position.

PH also has entered into payment agreements with certain commercial insurance carriers, health maintenance organizations, and preferred provider organizations. The basis for payment to PH under these agreements includes prospectively determined rates per discharge, discounts from established charges, and prospectively determined daily rates.

Beginning October 1, 2013, PH implemented a policy to provide a 40% discount on all charges billed to self-pay patients. The discount is recorded as an adjustment to gross patient service revenues to arrive at net patient service revenues prior to the provision for bad debts.

3. CASH AND CASH EQUIVALENTS AND INVESTMENTS

The State of California Government Code (the “Government Code”) authorizes PH to invest unrestricted and board-designated assets in obligations of the U.S. Treasury and certain U.S. government agencies, obligations of the State of California and local government entities, bankers’ acceptances, commercial paper, certificates of deposit, repurchase agreements, and mortgage securities. Certain of these investments may be purchased only in limited amounts and limited maturity dates, as defined in the Government Code.

PH's bond indenture agreements authorize trustee-held assets to be invested in obligations of the U.S. Treasury and certain U.S. government agencies, repurchase agreements, and obligations of financial institutions meeting certain criteria defined in the indentures.

The California State Treasury makes available the Local Agency Investment Fund (LAIF) through which local governments may pool investments. Each governmental entity may invest up to $50,000 of unrestricted monies in the fund and an unlimited amount of qualified bond proceeds. PH had invested $49,061 and $42,932 of unrestricted funds in this fund as of June 30, 2015 and 2014, respectively. PH had invested $10,171 and $10,147 in jointly managed funds under an escrow agreement with the City of Escondido as of June 30, 2015 and 2014, respectively. Investments in the LAIF are highly liquid, as deposits can be converted to cash within 24 hours without loss of interest. PH is a voluntary participant in the LAIF. The fair value of PH's investments in the LAIF is reported in the accompanying consolidated statements of net position based on PH's pro rata share of the fair value provided by LAIF for the entire LAIF portfolio.

As of June 30, 2015 and 2014, PH had the following investments:

	2015	**2014**
Investments—current	$ 140,516	$ 93,903
Assets whose use is limited—current	21,564	21,339
Assets whose use is limited—long-term	54,938	56,069
Total	$ 217,018	$ 171,311

As of June 30, 2015 and 2014, PH had investments by type and maturity as follows:

	2015		
		Investment Maturities (in Years)	
Investment Type	**Fair Value**	**Less Than 1**	**1–5**
LAIF	$ 59,232	$ 59,232	$ -
U.S. government bonds	39,635		39,635
U.S. Treasury bills	23,601	2,268	21,333
Corporate bonds	25,388	1,257	24,131
Money market mutual funds	69,162	69,162	
Total	$217,018	$131,919	$85,099

	2014		
		Investment Maturities (in Years)	
Investment Type	**Fair Value**	**Less Than 1**	**1–5**
LAIF	$ 53,079	$ 53,079	$ -
U.S. government bonds	22,009		22,009
U.S. Treasury bills	13,242	2,477	10,765
Corporate bonds	14,642		14,642
Money market mutual funds	66,838	66,838	
Other	1,501	1,501	
Total	$171,311	$123,895	$47,416

There are many factors affecting the value of investments. Some, such as interest rate risk, credit risk, concentration of credit risk, and custodial credit risk, may affect both equity and fixed income securities. Equity and debt securities respond to such factors as economic conditions, individual company earnings performance, and market liquidity, while fixed income securities are particularly sensitive to credit risks and changes in interest rates.

Interest Rate Risk—Interest rate risk is the risk that the value of fixed income securities will decline due to increasing interest rates. The terms of a debt investment may cause its fair value to be highly sensitive to interest rate changes. As a means of limiting exposure to fair value losses arising from increasing interest rates, PH's investment policy, as per statutory requirements, limits the term of any investment to a maturity not exceeding five years.

Credit Risk—Fixed income securities are subject to credit risk, which is the chance that an issuer will fail to pay interest or principal in a timely manner or that negative perceptions of the issuer's ability to make these payments will cause security prices to decline. Certain fixed income securities, including obligations of the U.S. government or those explicitly guaranteed by the U.S. government, are not considered to have credit risk. State law limits PH's investment in commercial paper, corporate bonds, and bond mutual funds with an "A" rating issued by nationally recognized statistical rating organizations. PH has no investment policy that would further limit investment choices. As of June 30, 2015 and 2014, PH's investments, excluding U.S. government obligations, consisted of the following: corporate bond investments rated "A" or better by Standard & Poor's (S&P) and Moody's Investors

Service (Moody's), U.S. Government Agency investments rated "AA+" by S&P and "AAA" by Moody's, and PH's investments in the LAIF, which were not rated.

Concentration of Credit Risk—Concentration of credit risk is the risk associated with a lack of diversification, such as having substantial investments in a few individual issuers, thereby exposing PH to greater risks resulting from adverse economic, political, regulatory, geographic, or credit developments. Investments issued or guaranteed by the U.S. government and investments in external investment pools, such as the LAIF, are not considered subject to concentration of credit risk. In accordance with state law, no more than 5% of total investments may be invested in the securities of any one issuer, except obligations of the U.S. government, no more than 10% may be invested in any one mutual fund, and no more than 30% may be invested in bankers' acceptances of any one commercial bank.

Investments in any one issuer (other than U.S. Treasury securities and external investment pools) that represent 5% or more of the total investments as of June 30, 2015 and 2014, are as follows:

	Investment Type	2015	2014
Federal National Mortgage Association	Federal Agency Securities	$ 28,519	$ 12,255
Federal Home Loan Mortgage Corp.	Federal Agency Securities	11,116	9,753
U.S. Bank, Trustee	U.S. Bank Money Market	44,362	44,598
Wells Fargo Advantage Government Money Market	U.S. Government Money Market Funds	21,624	20,727
Total		$ 105,621	$ 87,333

Custodial Credit Risk—Investments—All of PH's investments are insured or registered or held by PH's agent in the agent's nominee name, with subsidiary records listing PH as the legal owner. For these reasons, PH is not exposed to custodial credit risk for its investments.

Custodial Credit Risk—Deposits—Custodial credit risk is the risk that in the event of a bank failure, PH's deposits may not be returned to it. PH does not have a policy for custodial credit risk. As of June 30, 2015 and 2014, PH's bank balances totaled $50,159 and $48,707, respectively, and were not exposed to custodial credit risk, as the uninsured deposits are with financial institutions that are individually required by state law to have government deposits collateralized at a rate of 110% of the deposits. Such collateral is considered to be held in PH's name. Arch maintains bank deposit accounts that are insured by the Federal Deposit Insurance Corporation (FDIC) up to a limit of $250,000 per depositor. Arch had a cash balance of $1,526 and $677 that was above the insured limit at June 30, 2015 and 2014, respectively.

4. CONCENTRATIONS OF CREDIT RISK

PH grants credit without collateral to its patients, most of who are local residents and are insured under third-party payor agreements. The mix of gross receivables from patients and third-party payors as of June 30, 2015 and 2014, was as follows:

	2015	2014
Medicare	15 %	18 %
Medi-Cal	11	11
HMO/PPO/commercial	63	47
Patient	5	20
Others	6	4
Total	100 %	100 %

5. CAPITAL ASSETS

A summary of changes in capital assets for the years ended June 30, 2015 and 2014, is as follows:

	Beginning Balance Fiscal 2015	Additions	Disposals	Transfers	Ending Balance Fiscal 2015
Land improvement	$ 50,107	$ -	$ (15)	$ 25,329	$ 75,421
Buildings and leasehold improvements	1,133,574	623	(6,014)	(14,642)	1,113,541
Equipment	289,651	2,333	(827)	1,029	292,186
Land	77,096		(6,593)	(7,733)	62,770
Construction in progress	33,855	5,233	(21)	(3,983)	35,084
	1,584,283	8,189	(13,470)		1,579,002
Less accumulated depreciation and amortization	(375,499)	(52,537)	3,311		(424,725)
Capital assets—net	$ 1,208,784	$ (44,348)	$ (10,159)	$ -	$ 1,154,277

	Beginning Balance Fiscal 2014	Additions	Disposals	Transfers	Ending Balance Fiscal 2014
Land improvement	$ 48,507	$ -	$ (78)	$ 1,678	$ 50,107
Buildings and leasehold improvements	1,166,672	265	(9,598)	(23,765)	1,133,574
Equipment	289,290	2,813	(5,308)	2,856	289,651
Land	50,572		(244)	26,768	77,096
Construction in progress	33,111	8,281		(7,537)	33,855
	1,588,152	11,359	(15,228)	-	1,584,283
Less accumulated depreciation and amortization	(322,396)	(58,382)	5,279		(375,499)
Capital assets—net	$ 1,265,756	$ (47,023)	$ (9,949)	$ -	$ 1,208,784

During the construction of PMC, PH was insured under an Owner Controlled Insurance Program ("OCIP") and the insurance premiums for the OCIP were capitalized as part of the cost of construction. During fiscal year 2014, PH was informed that $8,000 of the previously paid OCIP premiums would be returned to PH as a result of favorable loss experience and was reversed from the carrying value of PMC. PH received $6,000 during fiscal 2014 and the remaining $2,000 is included in other assets in the accompanying consolidated statement of net position at June 30, 2015.

During fiscal year 2014, Palomar Continuing Care Center (PCCC), a 96-bed skilled nursing facility, terminated its operations and the facility was sold with net gain on sale of $4,900. During fiscal year 2015, PH sold properties located on Innovation Drive and Black Mountain Road with a net gain on sale of $2,327. The net gain on the sale of these properties is included in other—net in nonoperating income (expenses) in the accompanying consolidated statement of revenue, expenses, and changes in net position.

6. INVESTMENT IN AND AMOUNTS DUE FROM AFFILIATED ENTITIES

During fiscal year 2007, PH entered into a partnership agreement with PDP Pomerado, LLC in exchange for a ground lease agreement. During fiscal year 2010, the partnership with PDP Pomerado, LLC was terminated and the ground lease agreement was transferred to NHP/PMP Pomerado, LLC. In conjunction with the termination of the partnership, PDP Pomerado, LLC was dissolved and its assets were liquidated. PH received proceeds of $9,672 for its interest in PDP Pomerado, LLC, which was recorded as deferred revenue. Unamortized deferred revenue of $7,434 and $7,541 in the accompanying consolidated statements of net position as of June 30, 2015 and 2014, respectively, will be recognized as income based on the terms of the ground lease agreement.

PH's investment in affiliated entities, which are generally accounted for under the equity method because PH does not control the entities, was $3,884 and $3,787 at June 30, 2015 and 2014, respectively.

7. RELATED ORGANIZATIONS

Palomar Health Foundation—Palomar Health Foundation (the "Foundation") is a charitable nonprofit organization created to provide assistance and support for PH. The Foundation is a separately governed organization. Its financial position, results of operations, and cash flows are not included in the accompanying consolidated financial statements.

The Foundation funds various programs on behalf of PH. Funding for these programs provided by the Foundation totaled $553 and $2,041 for the years ended June 30, 2015 and 2014, respectively.

PH has entered into a management services agreement with the Foundation, whereby PH provides administrative support to the Foundation. Support provided to the Foundation totaled $1,512 and $1,801 for the years ended June 30, 2015 and 2014, respectively. Under the management services agreement renewed on June 30, 2015 and expiring on June 30, 2016, PH provides a line of credit to the Foundation with a $5,000 limit with interest at 2.5% above London InterBank Offered Rate (LIBOR). The amount outstanding on the line of credit was $2,180 and $1,083 as of June 30, 2015 and 2014, respectively.

A summary (unaudited) of the Foundation’s assets, liabilities, and net assets as of June 30, 2015 and 2014, is as follows:

	2015	2014
Assets	$ 9,277	$ 8,675
Liabilities	$ 2,486	$ 2,066
Net assets	6,791	6,609
Total liabilities and net assets	$ 9,277	$ 8,675

Professional Service Agreements and Advance to PIMG, Inc.—In April 2010, Arch entered into a 25-year professional services agreement with PIMG, Inc. (PIMG) under which PIMG provides professional medical services to patients seeking services from and enrolled with Arch. Prior to an amendment to the Arch bylaws in April 2015, the President of PIMG was a designated board member of Arch under the bylaws. For the years ended June 30, 2015 and 2014, Arch expensed $13,355 and $12,510, respectively, as compensation to PIMG for services provided. At the inception of the professional service agreement with PIMG in 2010, Arch also advanced $702 to PIMG. The amount advanced is to be repaid upon Arch’s request and does not bear interest. The outstanding amount at June 30, 2015 and 2014 was $702.

8. LONG-TERM DEBT

A summary of changes in long-term debt for the years ended June 30, 2015 and 2014, is as follows:

	Beginning Balance Fiscal Year 2015	Additions	Reductions	Ending Balance Fiscal Year 2015	Amounts Due within One Year
Bonds payable:					
Series 2010 certificates of participation	$ 159,647	$ 197	$ -	$ 159,844	$ 2,255
Series 2010A general obligation bonds	65,689		(30)	65,659	
Series 2009 certificates of participation	228,970	247		229,217	3,515
Series 2009A general obligation bonds	114,180		(222)	113,958	
Series 2007A general obligation bonds	241,992		(2,253)	239,739	2,461
Series 2006 certificates of participation	171,731	50		171,781	5,300
Series 2005A general obligation bonds	64,173		(1,555)	62,618	1,470
Accrued interest on capital appreciation bonds	87,565	20,526		108,091	1,231
Note Payable	97			97	10
Capital leases	1,107		(376)	731	313
Total long-term debt	$ 1,135,151	$ 21,020	$ (4,436)	$ 1,151,735	$ 16,555

	Beginning Balance Fiscal Year 2014	Additions	Reductions	Ending Balance Fiscal Year 2014	Amounts Due within One Year
Bonds payable:					
Series 2010 certificates of participation	$ 159,449	$ 198	$ -	$ 159,647	$ -
Series 2010A general obligation bonds	65,721		(32)	65,689	
Series 2009 certificates of participation	228,724	246		228,970	
Series 2009A general obligation bonds	114,402		(222)	114,180	
Series 2007A general obligation bonds	243,778		(1,786)	241,992	2,002
Series 2006 certificates of participation	171,673	58		171,731	
Series 2005A general obligation bonds	65,626		(1,453)	64,173	1,380
Series 1999 insured refunding revenue bonds	15,227		(15,227)		
Accrued interest on capital appreciation bonds	68,047	19,518		87,565	855
Note Payable		97		97	
Capital leases	1,388		(281)	1,107	364
Total long-term debt	$ 1,134,035	$ 20,117	$ (19,001)	$ 1,135,151	$ 4,601

The terms and due dates of PH's long-term debt as of June 30, 2015 and 2014, are as follows:

- Series 2010 Certificates of Participation (COP), interest at 5.25% to 6% due semiannually, principal due in annual amounts ranging from $2,255 in fiscal 2016 to $20,725 in fiscal 2042, net of unamortized original issue discount of $3,521 and $3,718 at June 30, 2015 and 2014, respectively, collateralized by PH revenues as defined in the indenture agreement.

- Series 2010A G.O. Bonds, accreted interest compounds at 6.84% to 7.85% on $14,917 Capital Appreciation Bonds (CABs) with the first payment to bondholders on August 1, 2034. Accreted interest compounds at 6.75% on $49,999 Convertible CABs with the first payment to bondholders also due on August 1, 2034. Principal amounts due in annual amounts ranging from $1,476 in fiscal 2038 to $33,159 in fiscal 2041, net of unamortized premium of $742 and $773 at June 30, 2015 and 2014, respectively.

- Series 2009 COP, interest at 4.50% to 6.75% due semiannually, principal due in annual amounts ranging from $3,515 in fiscal 2016 to $28,730 in fiscal 2040, net of unamortized original issue discount of $4,123 and $4,370 at June 30, 2015 and 2014, respectively, collateralized by PH revenues as defined in the indenture agreement.

- Series 2009A G.O. Bonds, accreted interest compounds at 6.84% to 9% on $50,001 CABs with the first payment to bondholders on August 1, 2019. Accreted interest compounds at 7% on $59,999 Convertible CABs with the first payment to bondholders on August 1, 2033. Principal amounts due in annual amounts ranging from $327 in fiscal 2021 to $18,868 in fiscal 2039, net of unamortized premium of $3,958 and $4,180 at June 30, 2015 and 2014, respectively.

- Series 2007A G.O. Bonds, interest at 4.5% to 5.125% is due semiannually on $175,000 of Current Interest Bonds. Interest on the $66,083 CABs is compounded at 3.67% to 4.92% with the first payment to bondholders on August 1, 2011. Principal amounts due in annual amounts ranging from $557 in fiscal 2012 to $21,585 in fiscal 2038, net of unamortized premium of $3,799 and $4,050 at June 30, 2015 and 2014, respectively.

- Series 2006 COP, a portion of which refunded the Series 1993 Insured Refunding Revenue Bonds. In addition, PH entered into an interest rate agreement with Citibank, N.A., New York, with respect to the Series 2006 COP in a notional amount of $180,000 (the "Swap Agreement") (see Note 9). Interest on the Series 2006 COP is 3.218%, which is the fixed rate to be paid by PH under the Swap Agreement, due semiannually, principal due in amounts ranging from $2,775 in fiscal 2009 to $12,350 in fiscal 2037, net of unamortized loss on refunding of $219 and $269 at June 30, 2015 and 2014, respectively, collateralized by PH revenues as defined in the indenture agreement.

- Series 2005A G.O. Bonds, interest at 3% to 5% due semiannually, principal due in annual amounts ranging from $945 in fiscal 2009 to $5,115 in fiscal 2035, net of unamortized premium of $2,033 and $2,208 at June 30, 2015 and 2014, respectively.

- In May 2014, PH legally defeased the remaining $7,855 of outstanding Series 1999 Insured Refunding Revenue Bonds. As a result, the liability for these bonds has been removed from the consolidated statement of net position as of June 30, 2014.

All the G.O. Bonds represent the general obligation of PH, in an amount sufficient to service the obligation, and PH has the power and is obligated to cause to be levied and collected by the County of San Diego annual ad valorem taxes upon all property within PH's boundaries subject to taxation by PH for payment of the principal of and interest on the bonds when due. However, PH is legally required to repay the G.O. Bonds if collected ad valorem taxes are insufficient.

PH is required to maintain certain debt covenants (Days Cash on Hand, Maximum Annual Debt Service, and Cushion Ratio) under its indenture agreements for COP. The covenant stipulates that in the event of underachievement, the Insurers may require PH to call in mutually agreed-upon consultants to perform mutually agreed-upon scope of services to assist PH in achieving the covenants. As of June 30, 2015 and 2014, PH was in compliance with all required debt covenants.

At June 30, 2015 and 2014, long-term capital leases, net of current portion, amounted to $418 and $743, respectively. Related net book value of leased equipment totaled $675 and $981, and depreciation expense totaled $367 and $343 for the years ended June 30, 2015 and 2014, respectively.

The estimated fair value of PH's long-term debt was approximately $1,306,726 and $1,205,255 as of June 30, 2015 and 2014, respectively, based on quotations from independent third parties.

Estimated future principal and interest payments on long-term debt, including capital leases, as of June 30, 2015, are as follows:

Years Ending June 30	Principal	Interest	Total
2016	$ 15,315	$ 43,145	$ 58,460
2017	16,297	42,994	59,291
2018	17,209	42,879	60,088
2019	18,164	45,320	63,484
2020–2024	114,471	286,507	400,978
2025–2029	160,230	315,368	475,598
2030–2034	257,869	315,399	573,268
2035–2039	310,158	240,162	550,320
2040–2043	131,176	64,055	195,231
Total	$ 1,040,889	$ 1,395,829	$ 2,436,718

9. INTEREST RATE SWAP

In 2006, PH entered into the Swap Agreement as a means to lower its borrowing costs on the Series 2006 COP (see Note 8) when compared against fixed-rate bonds at the time of issuance. The agreement was effective December 28, 2006, with a notional amount of $180,000 for the Series 2006 COP and terminates on November 1, 2036, simultaneously with the maturity of the 2006 COP.

The Series 2006 COP were issued as auction rate securities, whereby the interest rate for each series is generally determined during successive seven-day auction periods.

Under the Swap Agreement, PH pays the swap provider amounts based on a fixed interest rate of 3.218%, and the swap provider pays to PH amounts based on 56% of the British Banker's Association 30-day LIBOR, plus 0.23%.

The significant terms of the swap are as follows:

Corresponding bond series	Series 2006 Certificate of Participation bonds
Swap type	Fixed income
Notional amount	$180,000
Effective date	December 28, 2006
Termination date	November 1, 2036
Final bond maturity	November 1, 2036
PH pays	3.218 %
Cash payments remitted by PH for year ended June 30, 2015	$4,960
PH receives	56% of 30-day LIBOR + 0.23%
Swap fair value—June 30, 2015	$(28,664)
Change in fair value for the year ended June 30, 2015	$(2,136)
Classification	Liability

Fair Value—As of June 30, 2015 and 2014, the swap had a negative fair value of $28,664 and $26,528, respectively, developed by a mark-to-market pricing service using the zero-coupon method. This method calculates the future net settlement payments required by the swap, assuming that the current forward rates implied by the yield curve correctly anticipate future spot interest rates. These payments are then discounted using the spot rates implied by the current yield curve for hypothetical zero-coupon bonds due on the date of each future net settlement of the swap. The negative fair value of the swap is reported in the accompanying consolidated statements of net position as a long-term liability. The change in the fair value of the swap is reported in the accompanying consolidated statements of revenue, expenses, and changes in net position as unrealized loss on interest rate swap.

Credit Risk—PH seeks to limit its counterparty risk by contracting only with highly rated entities. As of June 30, 2015, the counterparty of the interest rate swap was rated “A1” by Moody’s, “A” by S&P, and “A+” by Fitch Investor Services (Fitch). To mitigate the potential for credit risk, under the terms of the Swap Agreement, if the counterparty’s credit quality falls below (1) Moody’s rating of Baa2, (2) S&P’s rating of BBB, or (3) Fitch’s rating of BBB, the fair value of the swap will be collateralized by the counterparty with cash and/or treasury securities.

Basis Risk—PH is exposed to basis risk on its Swap Agreement because the variable rate payments received by PH on the instruments are based on a rate or index other than the interest rate paid on its variable rate debt.

Termination Risk—The swap uses the International Swap Dealers Association Master Agreement (the “Master Agreement”), which includes standard termination events such as failure to pay and bankruptcy. The Master Agreement also includes an “additional termination event.” The Master Agreement can be terminated if, at any time, a relevant credit rating with respect to a party declines below the termination level or is withdrawn, or if any party has no relevant rating but was previously rated by such rating agency. The termination levels are, with respect to Moody’s, Baa2; S&P, BBB; and Fitch, BBB-.

The negative swap fair value in the accompanying consolidated statements of net position approximates the termination payment that would be owed by PH to the swap counterparty if the swap was terminated. The payments from PH to the swap counterparty are insured by Assured Guaranty. This insurance provides protection to the swap counterparty in the event PH fails to make payments due under the swap. Under the terms of the Swap Agreement, an “insurer event” will occur if both Moody’s and S&P’s ratings for Assured Guaranty fall below the A category. If an insurer event happens, PH would be required to post collateral by a first priority perfected security interest in the gross revenues of PH. Assured Guaranty was rated A2 by Moody’s with a stable outlook effective July 2, 2014.

10. OPERATING LEASES

PH leases certain office space and equipment under operating leases. Lease expense on all such leases for the years ended June 30, 2015 and 2014, totaled $17,350 (including $402 in nonoperating expense) and $16,006 (including $130 in nonoperating expense), respectively. PH also leases office space to others under operating leases. Future minimum lease payments and receipts under office space and equipment leases as of June 30, 2015, are as follows:

Years Ending June 30	Lease Payments	Lease Receipts
2016	$ 9,107	$ 414
2017	9,125	175
2018	9,061	93
2019	9,168	49
2020	9,383	51
2021–2025	32,948	44
2026–2030	14,991	230
2031–2035	8,529	257
2036–2081	29,339	175
Total	$ 131,651	$ 1,488

11. DEFERRED ANNUITY CONTRACTS

PH offers its employees a deferred compensation plan, which has an employer-match component created in accordance with Internal Revenue Code (“IRC”) Section 457. Employees who elect to participate in the plan make contributions through a reduction in salary. All participating employees manage their contribution and investment choices through a funding agency selected by PH.

The investments of PH’s IRC Section 457 plan and earnings thereon are held in trust for the exclusive benefit of the plan participants and their beneficiaries. The IRC Section 457 plan and earnings are not subject to claims of PH’s general creditors. Accordingly, the accompanying consolidated statements of net position do not include the funds deposited with financial institutions pursuant to deferred annuity contracts.

12. RETIREMENT PLAN

PH sponsors a defined contribution retirement plan under which benefits are limited to amounts accumulated from total contributions by PH and by participating employees, plus earnings thereon. Generally, all employees with one year of service are eligible to participate. Contributions under the retirement plan by PH for the years ended June 30, 2015 and 2014, were 5% and 4% (6% prior to January 1, 2014), respectively, of covered employees’ basic compensation. Contributions are funded as accrued. Total PH contributions expensed for the years ended June 30, 2015 and 2014, were $14,374 and $12,997, respectively.

13. POSTEMPLOYMENT HEALTHCARE PLAN

The Company accounts for its postemployment healthcare plan under GASB Codification Section P50, *Postemployment Benefits Other Than Pensions—Employer Reporting*. As of June 30, 2015 and 2014, the annual required contribution was $282 and $282, respectively, and is included in accrued compensation and related liabilities in the accompanying consolidated statements of net position.

Plan Description and Funding Policy—PH's Postemployment Healthcare Plan (the "Plan") is a single-employer defined benefit healthcare plan administered by Tri-Ad Actuaries, Inc. The Plan provides medical and dental insurance benefits to qualified postemployment participants on a gap coverage basis. Coverage is limited to those employees who have provided 10 years of consecutive service, are below the age of 65, and do not receive coverage from other sources. The contribution requirements of the Plan members and PH are established and may be amended by the Board of Directors. The required contribution is based on estimated pay-as-you-go financing requirements. For the years ended June 30, 2015 and 2014, PH contributed $102 and $88, respectively, to the Plan, which consisted entirely of current premiums and included no additional contribution to prefund benefits.

Annual Cost—PH's annual cost of the Plan is calculated based on its annual required contribution and the amount actuarially determined in accordance with the guidelines of GASB Codification Section P50.

Actuarial Methods and Assumptions—Projections of benefits for financial reporting purposes are based on the substantive plan (the Plan as understood by the employer and the Plan members) and include the types of benefits provided at the time of each valuation and the historical pattern of sharing the benefit costs between the employer and the Plan members to that point. The actuarial methods and assumptions used include techniques that are designed to reduce the effects of short-term volatility in actuarial accrued liabilities and the actuarial value of assets, consistent with the long-term perspective of the calculations. The actuarial valuations are effective for the years ended June 30, 2015 and 2014.

For the years ended June 30, 2015 and 2014, the actuarial assumptions included a 3% discount rate, which approximates PH's own rate of return on investments, and a healthcare cost trend rate of 7% declining by 1% annually to stabilize at 3% per year for the year ended June 30, 2016, and thereafter. The unfunded actuarial accrued liability (UAAL) of $2,478 is being amortized over the maximum permissible amortization period of 30 years on an open basis. The actuarial valuation uses the projected unit credit and the entry-age normal actuarial cost methods.

Actuarial valuations involve estimates of the value of reported amounts and assumptions about the probability of events far into the future, and actuarially determined amounts are subject to continual revision as actual results are compared to past expectations and new estimates are made about the future.

Funded Status and Funding Progress—As of June 30, 2014, the most recent actuarial valuation date, the plan was unfunded. The actuarial accrued liability for benefits was $2,478 and the actuarial value of assets was $0, resulting in an UAAL of $2,478. The estimated covered payroll was $179,505 and the ratio of the UAAL to the covered payroll was 1%.

14. COMMITMENTS AND CONTINGENCIES

Legal Matters—The health care industry is subject to numerous laws and regulations of federal, state, and local governments. Compliance with these laws and regulations, specifically those relating to the Medicare and Medi-Cal programs, is subject to government review and interpretation, as well as regulatory actions. Claims for payment for services rendered to Medicare and Medi-Cal beneficiaries must meet applicable billing laws and regulations, which, among other things, require that the services are medically necessary, accurately coded, and sufficiently documented in the beneficiaries' medical records. Allegations concerning possible violations of regulations can result in the imposition of significant fines and penalties, as well as significant repayment of previously billed and collected revenues for patient services.

PH has ongoing efforts to comply with laws and regulations and to assess its prior compliance and the potential impact of noncompliance. PH with its ongoing compliance program will continue to monitor, investigate, and correct any potential areas of noncompliance. No regulatory action has been asserted against PH to date, although such action could occur in the future.

PH is a party to certain other legal actions arising in the ordinary course of business. In the opinion of PH management, the liability, if any, under these claims is adequately covered by insurance. PH is insured for medical malpractice under a claims-made and reported policy.

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

Workers' Compensation Program—PH is a participant in the Association of California Healthcare Districts ALPHA Fund ("ALPHA Fund") that administers a self-insured workers' compensation plan for participating districts and other qualifying nonprofit entities. PH pays premiums to the ALPHA Fund that are adjusted annually. Effective July 1, 2008, PH changed its participation in the ALPHA Fund from self-insured retention to a guaranteed loss/zero deductible. At June 30, 2015 and 2014, estimated claims liabilities for workers' compensation recorded is $878 and $1,016, respectively.

If the ALPHA Fund were terminated, PH would be liable for its share of any additional premiums necessary for final disposition of claims and losses covered by the ALPHA Fund. If PH were to withdraw from the ALPHA Fund, it would be required to fund its share of a deficit as defined under the joint powers agreement. From fiscal year 2007 onwards, the ALPHA Fund has been in a surplus position. PH accounts for its investment in the ALPHA Fund under the equity method and has recorded its share of $2,177 and $1,948 as of June 30, 2015 and 2014, respectively, as an asset within investment in and amounts due from affiliated entities in the accompanying consolidated statements of net position.

Comprehensive Liability Insurance Coverage—PH is insured for comprehensive liability (professional liability, bodily injury and property damage liability, personal injury, advertising injury and discrimination liability, and employee benefit liability) under a claims-made policy, which covers asserted claims and incidents reported to the insurance carrier, and has a per-claim deductible of $50 for professional liability. PH's comprehensive liability insurance was renewed effective July 1, 2015, and the current policy expires on June 30, 2016. PH has reserved for estimated claims through 2015, including an estimate of IBNR. Such reserves totaled $1,755 and $1,963 as of June 30, 2015 and 2014, respectively, and are recorded as other accrued liabilities in the accompanying consolidated statements of net position.

Medicare Recovery Audit Contractor (RAC) Program—PH is subject to the Medicare RAC Program, which is a program designed to identify improper Medicare payments—both underpayments and overpayments. RAC auditors are contracted by the Centers for Medicare and Medicaid Services on a contingent fee basis, receiving a percentage of the improper overpayments and underpayments they recover from or return to providers. There are currently no RAC audits in process nor any reserves recorded at June 30, 2015 or 2014. PH will establish a reserve to account for potential negative settlements when improper payments are identified by RAC.

Seismic Compliance—California Senate Bill ("SB") 1953 requires hospital acute care buildings to meet more stringent seismic guidelines by 2020. PH's buildings are compliant with an SPC-2 rating and are eligible to render acute inpatient care until 2030.

15. CONDENSED COMBINING INFORMATION

A summary of the condensed combining information for PH and Arch for the years ended June 30, 2015 and 2014, is as follows:

CONDENSED COMBINING STATEMENT OF NET POSITION
AS OF JUNE 30, 2015
($ in thousands)

	PH	Arch	Elimination	Total
ASSETS				
Current assets	$ 350,864	$ 4,521	$ -	$ 355,385
Capital assets—net	1,149,305	4,972		1,154,277
Noncurrent assets	71,502			71,502
Other receivables		502	(502)	
Line of Credit and note receivable—PH	52,563		(52,563)	
TOTAL	$ 1,624,234	$ 9,995	$ (53,065)	$ 1,581,164
LIABILITIES AND NET POSITION				
Current liabilities	$ 126,563	$ 10,585	$ -	$ 137,148
Long-term liabilities	1,165,687	87		1,165,774
Other payables	502		(502)	
Line of Credit and note payable—ARCH		52,563	(52,563)	
Total liabilities	1,292,752	63,235	(53,065)	1,302,922
Deferred Inflow of resources—deferred revenue and deferred rent liability	8,277	2,874		11,151
Total liabilities and deferred inflow of resources	1,301,029	66,109	(53,065)	1,314,073
Invested in capital assets—net of related debt	49,173			49,173
Restricted	22,409			22,409
Unrestricted	251,623	(56,114)		195,509
Total net position	323,205	(56,114)	-	267,091
TOTAL	$ 1,624,234	$ 9,995	$ (53,065)	$ 1,581,164

CONDENSED COMBINING STATEMENT OF REVENUE, EXPENSES, AND CHANGES IN NET POSITION
FOR THE YEAR ENDED JUNE 30, 2015
($ in thousands)

	PH	Arch	Elimination	Total
OPERATING REVENUE:				
Net patient service revenue	$ 591,916	$ 27,720	$ -	$ 619,636
Net premium revenue	50,662	2,184		52,846
Other revenue	16,189	1,016		17,205
PH Program revenue		2,950	(2,950)	
Total operating revenue	658,767	33,870	(2,950)	689,687
OPERATING EXPENSES	598,854	56,759	(2,950)	652,663
DEPRECIATION AND AMORTIZATION	50,779	1,758		52,537
LOSS FROM OPERATIONS	9,134	(24,647)		(15,513)
NONOPERATING INCOME (EXPENSE):				
Investment income	2,968		(1,134)	1,834
Unrealized loss on interest rate swap	(2,136)			(2,136)
Interest expense	(66,270)	(1,142)	1,134	(66,278)
Property tax revenue	32,033			32,033
Other—net	4,689			4,689
Total nonoperating expense—net	(28,716)	(1,142)		(29,858)
DEFICIENCY OF REVENUE OVER EXPENSES	(19,582)	(25,789)		(45,371)
INTERFUND	(1,507)	1,507		
DECREASE IN NET POSITION	(21,089)	(24,282)		(45,371)
NET POSITION—Beginning of year	344,294	(31,832)		312,462
NET POSITION—End of year	$ 323,205	$ (56,114)	$ -	$ 267,091

CONDENSED COMBINING STATEMENT OF CASH FLOW
FOR THE YEAR ENDED JUNE 30, 2015
($ in thousands)

	PH	Arch	Elimination	Total
CASH FLOWS FROM:				
Operating activities	$ 69,754	$ (15,708)	$ -	$ 54,046
Noncapital financing activities	15,142	1,507		16,649
Capital and related financing activities	(25,994)	14,906	(16,400)	(27,488)
Investing activities	(61,293)		16,400	(44,893)
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(2,391)	705		(1,686)
CASH AND CASH EQUIVALENTS—Beginning of year	46,574	395		46,969
CASH AND CASH EQUIVALENTS—End of year	$ 44,183	$ 1,100	$ -	$ 45,283

CONDENSED COMBINING STATEMENT OF NET POSITION
AS OF JUNE 30, 2014
($ in thousands)

ASSETS	PH	Arch	Elimination	Total
Current assets	$ 307,364	$ 6,683	$ -	$ 314,047
Capital assets—net	1,203,540	5,244		1,208,784
Noncurrent assets	70,017			70,017
Other receivables	881	549	(1,430)	
Line of Credit and note receivable—PH	33,343		(33,343)	
TOTAL	$ 1,615,145	$ 12,476	$ (34,773)	$ 1,592,848
LIABILITIES AND NET POSITION				
Current liabilities	$ 103,333	$ 7,627	$ -	$ 110,960
Long-term liabilities	1,158,580	97		1,158,677
Other payables	549	881	(1,430)	
Line of Credit and note payable—ARCH		33,343	(33,343)	
Total liabilities	1,262,462	41,948	(34,773)	1,269,637
Deferred Inflow of resources—deferred revenue and deferred rent liability	8,389	2,360		10,749
Total liabilities and deferred inflow of resources	1,270,851	44,308	(34,773)	1,280,386
Invested in capital assets—net of related debt	120,027			120,027
Restricted	23,521			23,521
Unrestricted	200,746	(31,832)		168,914
Total net position	344,294	(31,832)		312,462
TOTAL	$ 1,615,145	$ 12,476	$ (34,773)	$ 1,592,848

CONDENSED COMBINING STATEMENT OF REVENUE, EXPENSES, AND CHANGES IN NET POSITION
FOR THE YEAR ENDED JUNE 30, 2014
($ in thousands)

	PH	Arch	Elimination	Total
OPERATING REVENUE:				
Net patient service revenue	$ 555,664	$ 27,952	$ -	$ 583,616
Net premium revenue	45,489	9,624		55,113
Other revenue	13,047	915		13,962
PH Program revenue		3,166	(3,166)	
Total operating revenue	614,200	41,657	(3,166)	652,691
OPERATING EXPENSES	563,769	61,156	(3,166)	621,759
DEPRECIATION AND AMORTIZATION	56,711	1,671		58,382
LOSS FROM OPERATIONS	(6,280)	(21,170)		(27,450)
NONOPERATING INCOME (EXPENSE):				
Investment income	2,591		(649)	1,942
Unrealized loss on interest rate swap	(185)			(185)
Interest expense	(64,861)	(658)	649	(64,870)
Property tax revenue	29,868			29,868
Other—net	7,183			7,183
Total nonoperating expense—net	(25,404)	(658)		(26,062)
DEFICIENCY OF REVENUE OVER EXPENSES	(31,684)	(21,828)		(53,512)
INTERFUND	(1,982)	1,982		
DECREASE IN NET POSITION	(33,666)	(19,846)		(53,512)
NET POSITION—Beginning of year	377,960	(11,986)		365,974
NET POSITION—End of year	$ 344,294	$ (31,832)	$ -	$ 312,462

CONDENSED COMBINING STATEMENT OF CASH FLOW
FOR THE YEAR ENDED JUNE 30, 2014
($ in thousands)

	PH	Arch	Elimination	Total
CASH FLOWS FROM:				
Operating activities	$ 58,847	$ (18,761)	$ -	$ 40,086
Noncapital financing activities	13,781	1,982		15,763
Capital and related financing activities	(43,893)	16,858	(16,400)	(45,545)
Investing activities	(1,193)		16,400	17,317
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	27,542	79		27,621
CASH AND CASH EQUIVALENTS—Beginning of year	19,032	316		19,348
CASH AND CASH EQUIVALENTS—End of year	$ 46,574	$ 395	$ -	$ 46,969

16. SUBSEQUENT EVENTS

PH evaluated events or transactions through November 25, 2015, the date the consolidated financial statements were available to be issued, and concluded that except as disclosed in Note 1, no subsequent events have occurred that would require recognition in the consolidated financial statements or disclosure in the notes to the consolidated financial statements.

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