Audited Financial Statements
and Other Financial Information

PAJARO VALLEY
HEALTH CARE DISTRICT

December 31, 2023

JWT & Associates, LLP
Advisory Assurance Tax

Pajaro Valley Health Care District

Audited Financial Statements and Other Financial Information

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Report of Independent Auditors

The Board of Directors
Pajaro Valley Health Care District
Watsonville, California

Opinion

We have audited the accompanying combined financial statements of Pajaro Valley Health care District (the District) and Pajaro Valley Health Care District Hospital Corporation dba Watsonville Community Hospital (the Hospital), collectively referred to as the "Combined Unit," as of December 31, 2023 and 2022, which comprise the combined statements of net position as of December 31, 2023 and 2022, and the related combined statements of revenues, expenses, and changes in net position, and cash flows for the years then ended, and the related notes to the combined financial statements.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial positions of the business-type activities and the discretely presented component unit of the District, as of December 31, 2023 and 2022, and the respective changes in financial position, and, where applicable, cash flows thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Basis for Opinion

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of the District, and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audits. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

Responsibilities of Management for the Financial Statements

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

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the District's ability to continue as a going concern for twelve months beyond the financial statement date, including any currently known information that may raise substantial doubt shortly thereafter.

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinions. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with generally accepted auditing standards will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.

In performing an audit in accordance with generally accepted auditing standards, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the District's internal control. Accordingly, no such opinion is expressed.
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about the District's ability to continue as a going concern for a reasonable period of time.

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal control-related matters that we identified during the audit.

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis be presented to supplement the basic financial statements. Such information is the responsibility of management and, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audits of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Emphasis of Matter – Going Concern

The accompanying financial statements have been prepared assuming that the District will continue as a going concern. As discussed in Note 10 to the financial statements, the Hospital has reduced the annual losses since emerging from bankruptcy in 2022, however it has suffered significant losses from operations and has experienced cash flow difficulties. These conditions raise substantial doubt about the District's ability to continue as a going concern. Management's plans regarding these matters are also described in Note 10 and in the Management's Discussion and Analysis. The financial statements do not include any adjustments that might result from the outcome of this uncertainty. Our opinion is not modified with respect to this matter.

JWT & Associates, LLP

Fresno, California
March 27, 2024

Pajaro Valley Health Care District

Management's Discussion and Analysis

For the Year Ended December 31, 2023

Management of the Pajaro Valley Health Care District (the District) has prepared this annual discussion and analysis in order to provide an overview of performance for the fiscal year ended December 31, 2023, in accordance with the Governmental Accounting Standards Board Statement No. 34, Basic Financials Statements; Management's Discussion and Analysis for State and Local Governments. The District wholly owns the Pajaro Valley Health Care District Hospital Corporation dba Watsonville Community Hospital (the Hospital). Together they are referenced as the Combined Unit. The intent of this document is to provide additional information on the Combined Unit's financial performance as a whole and a prospective look at revenue, operating expenses, and capital development plans. This discussion should be reviewed in conjunction with the audited financial statements for the fiscal year ended December 31, 2023, and accompanying notes to the financial statements to enhance one's understanding of the Combined Unit's financial performance. Being the first full year of operation, the prior comparison year is a 4-month period.

Introduction

The Combined Unit offers readers of our financial statements this narrative overview and analysis of our financial activities for the year ended December 31, 2023. We encourage readers to consider the information presented here in conjunction with the Combined Unit's financial statements, including the notes thereto.

The Combined Unit is governed by a five-member elected board of directors. Day-to-day operations are managed by the Chief Executive Officer. The Combined Unit employed 663 employees on December 31, 2023, and had monthly payroll of approximately $5.85M, not including benefits.

Required Financial Statements

The Combined Unit's financial statements offer short-term and long-term information about its activities. The statement of net position includes all of the Combined Unit's assets and liabilities at December 31, 2023 and provides information about the nature and amounts of investments in resources (assets) and the obligations to Combined Unit creditors (liabilities). The statement of net position also provides the basis for evaluating the capital structure of the Combined Unit and assessing the liquidity and financial flexibility of the Combined Unit.

All revenue and expenses for the years ended December 31, 2023, and 2022 are accounted for in the statement of revenue, expenses, and changes in net position. The statement can be used to determine whether the Combined Unit has successfully recovered all its costs through its patient service revenue and other revenue sources. Revenue and expenses are reported on an accrual basis, which means the related cash could be received or paid in a subsequent period.

The final required statement is the statement of cash flows. This statement reports cash receipts, cash payments and net changes in cash resulting from operations, investing and financial activities for the years ended December 31, 2023, and 2022. They also provide answers to such questions as where cash came from, what was cash used for and what was the change in the cash balance during the reporting period.

Pajaro Valley Health Care District

Management's Discussion and Analysis

For the Year Ended December 31, 2023

Financial Analysis of the Combined Unit

The Combined Unit's net position, the difference between assets and liabilities, is a way to measure financial health or financial position. Over time, sustained increases or decreases in the Combined Unit's net position are one indicator of whether its financial health is improving or deteriorating. However, other nonfinancial factors such as changes in economic conditions, population growth and new or revised government regulations and legislation should also be considered. In 2023, the Combined Unit's net position decreased by approximately $13.2M (see footnotes).

Financial Summary

- Total assets ended at $64.6 million being largely comprised of net patient AR $15.2M) and lease assets ($33.5M). Total cash and cash equivalents at year end were $6.6 million (see the Statements of Cash Flows for changes).

- Current assets ended at $27.9M compared to current liabilities which ended at $21M. The current ratio for this year was 1.33.

- Net operating revenues were $134.5M and operating expenses were $148.3M. There was an operating loss of $13.8M

- The decrease in net position was $13.2M See footnotes for more information.

Items Affecting Operations

The challenges facing the Combined Unit this fiscal period were largely similar, although varying in degree of intensity, to those issues facing the health care industry in general and for rural health care facilities in particular. Where the immediate environment and circumstances uniquely influence the Combined Unit, these areas are also highlighted in the discussion below:

- Reimbursement: Medicare and Medi-Cal programs continue to look for ways to reduce reimbursement.

- Labor: Physician positions continue to be difficult to recruit in rural areas.

- The Hospital emerged from bankruptcy and was purchased by The District on September 1, 2022, with limited working capital. The District continues to work to stabilize operations.

- The District has secured multiple funding sources to address the cashflow challenges.

Items Affecting Operations (continued)

- The Hospital renegotiated all major payor contracts to improve reimbursement. As of December 31, 2023, all were implemented.

- The Hospital faces challenges recruiting staff due to the high cost of living in the area and thus relies on contracted resources to supplement staffing. These resources come at a slightly higher cost.

- The District leases hospital real estate from Medical Properties Trust. The Hospital operations must cover this lease payment along with all deficits of The District.

In summary, the external environment continues to challenge rural healthcare providers in particular, with continuing declines in reimbursement, increases in uncompensated care and ongoing labor and health insurance issues. The Combined Unit strives to improve relationships within our community through collaboration with community leaders and service groups, outreach to neighboring healthcare facilities, improving access to care and recruitment of quality medical providers.

The Combined Unit's employees are working together to continue to find ways to make progress on improving how the Combined Unit organizes and processes work in such a way that it continues to improve patient care and service to its patients and community, while striving to improve its financial position and overall fiscal performance.

The Hospital received Distressed Hospital loan proceeds of $8,300,000 on November 1, 2023. These funds were used to maintain operations and in support of some Hospital projects to stabilize operations. The six-year loan is zero interest and has an 18-month grace period before repayment. The legislation behind the Distressed Hospital Loan allows for the possibility of loan forgiveness, however that has not been confirmed as of 12/31/23.

The District placed Measure N on the March 2024 ballot. Measure N is a $116M general obligation bond program intended to renovate the Hospital and improve services to our community. Measure N will allow the Hospital to modernize and expand our facility. It will also allow us to purchase the Hospital building and land through the locally controlled accountable Pajaro Valley Health Care District. The purchase would eliminate the current $3.0M annual lease payments to the third-party owner, allowing those funds to be reinvested in supporting staff and patient care.

The District obtained a $3.0 million line of credit with Santa Cruz County Bank, secured by community guarantors. As of 12/31/23, the District had not drawn on the credit line. The Pajaro Valley Healthcare District Philanthropy Foundation is a newly formed non-profit 501(c)3 corporation in existence to raise funds and secure grants for Watsonville Community Hospital activities and services. In 2023 they were able to secure a $250K grant for the purchase of anesthesia machines. Additionally, they secured $60K in grants to support translation services to support patient care for non-English speaking patients.

Management has implemented a cash management plan and is actively managing its revenue cycle (collections) activities. Additionally, the District (Hospital) is opening a Cath Lab in Q2 2024 which will provide new revenue generating opportunities. Other expense initiatives are also planned for 2024.

Pajaro Valley Healthcare District

Combined Statement of Net Position

	December 31	
	2023	2022
Assets		
Current Assets		
Cash and cash equivalents	$ 6,639,515	$ 8,660,568
Patient accounts receivable, net of allowances	15,195,777	21,266,511
Other accounts receivable	-	1,498,921
Inventories	3,841,424	2,158,403
Prepaid expenses and other current assets	2,260,013	2,510,580
Total current assets	27,936,729	36,094,983
Capital assets, net of accumulated depreciation	3,138,796	3,015,808
Lease assets	33,549,419	34,759,953
Total assets	$ 64,624,944	$ 73,870,744
Liabilities and Net Position		
Current liabilities		
Current maturities of debt borrowings	$ 3,120,987	$ 1,702,035
Accounts payable and accrued expenses	6,531,695	6,922,004
Accrued payroll and related liabilities	9,014,485	8,641,862
Estimated third party payor settements	728,871	1,597,184
IBNR self funded health benefits	1,706,135	2,787,581
Total current liabilities	21,102,173	21,650,666
Debt borrowings, net of current maturities	12,408,100	7,478,951
Lease liabilities	34,559,114	35,023,963
Total liabilities	68,069,387	64,153,580
Net position		
Invested in capital assets, net of related debt	3,138,796	2,891,822
Restricted	2,600,000	2,600,000
Unrestricted	(9,183,239)	4,225,342
Total net position	(3,444,443)	9,717,164
Total liabilities and net position	$ 64,624,944	$ 73,870,744

See accompanying notes to the financial statements

Pajaro Valley Healthcare District

Combined Statement of Revenues, Expenses and Changes in Net position

	Year Ended December 31	
	2023	2022
Operating revenues		
Net patient service revenues	$ 129,114,224	$ 33,308,250
Other operating revenues	5,367,526	532,944
Total operating revenues	134,481,750	33,841,194
Operating expenses		
Salaries & wages	70,156,726	17,381,952
Employee benefits	21,460,602	6,100,838
Contract labor	6,931,655	2,414,616
Supplies	8,319,794	3,688,032
Medical specialist fees	7,751,461	2,876,058
Purchased services	13,458,807	5,579,962
Lease cost and rent	1,914,944	1,649,758
Repairs & maintenance	1,359,867	316,371
Utilities	2,466,097	712,745
Depreciation and amortization	1,979,831	384,786
Other operating expenses	6,190,016	2,906,562
Property taxes & insurance	2,444,845	731,821
Interest	3,841,925	320,538
Total operating expenses	148,276,570	45,064,039
Operating income (loss)	(13,794,820)	(11,222,845)
Nonoperating revenues		
Rental income	529,666	277,387
Interest income	103,547	-
Total nonoperating revenues (expenses)	633,213	277,387
Net income/(loss) before extraordinary item	(13,161,607)	(10,945,458)
Gain from acquisition of hospital	-	20,662,622
Increase/(decrease) in net position	(13,161,607)	9,717,164
Net position, beginning of the year	9,717,164	-
Net position, end of year	$ (3,444,443)	$ 9,717,164

See accompanying notes to the financial statements

Pajaro Valley Healthcare District

Combined Statement of Cash Flows

	Year Ended December 31	
	2023	2022
Cash flows from operating activities		
Cash received for operations	$ 137,341,168	$ 12,352,408
Cash payments to suppliers and contractors	(52,660,249)	(18,622,904)
Cash payments to employees and benefit programs	(92,326,152)	(12,053,347)
Net cash (used in) operating activities	(7,645,233)	(18,323,843)
Cash flows from noncapital financing activities		
Gain from acquisition of hospital	-	20,662,622
Net cash provided by noncapital financing activities	-	20,662,622
Cash flows from investing activities		
Purchases of property, plant & equipment	(1,357,134)	(3,136,584)
Interest income	103,547	-
Rental income	529,666	277,387
Net cash (used in) investing activities	(723,921)	(2,859,197)
Cash flows from financing activities		
Proceeds from debt borrowings	9,095,000	
Prepayments of debt borrowings	(2,746,899)	9,180,986
Net cash provided by financing activities	6,348,101	9,180,986
Increase in cash and cash equivalents	(2,021,053)	8,660,568
Cash and cash equivalents at beginning of year	8,660,568	-
Cash and cash equivalents at end of year	$ 6,639,515	$ 8,660,568

See accompanying notes to the financial statements

Pajaro Valley Healthcare District

Combined Statement of Cash Flows (continued)

	Year Ended December 31	
	2023	2022
Reconciliation of operating income (loss) to net cash provided by operating activities		
Operating income	$ (13,794,821)	$ (11,222,845)
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	1,979,831	384,786
Changes in operating assets and liabilities		
Receivables	7,569,656	(22,765,432)
Inventories	(1,683,021)	(2,158,403)
Prepaid expenses and other current assets	295,812	(2,510,580)
Accounts payable and accrued expenses	(435,554)	6,922,004
Accrued payroll and related expenses	372,623	8,641,862
Estimated third party payor settements	(868,313)	1,597,184
IBNR self funded health benefits	(1,081,446)	2,787,581
Net cash (used in) operating activities	$ (7,645,233)	$ (18,323,843)

See accompanying notes to the financial statements

Pajaro Valley Health Care District

Notes to the Financial Statements

For the Year Ended December 31, 2023

NOTE 1 - ORGANIZATION AND ACCOUNTING POLICIES

Organization: Pajaro Valley Health Care District, (the District) is a public entity organized under Local District Law as set forth in the Health and Safety Code of the State of California. The District is a political subdivision of the State of California and is generally not subject to federal or state income taxes. The District is governed by a five-member Board of Directors, elected from within the district to specified terms of office. The District is located in Watsonville, California. The District wholly owns the Pajaro Valley Health Care District Hospital Corporation dba Watsonville Community Hospital (the Hospital). The Hospital is a 501(c)(3) component unit of the District and operates a 106 -bed acute care hospital and other patient services. The District's mission is to provide health care services primarily to individuals who reside in the local geographic area. A combining statement presenting both District and Hospital operations is presented in the supplementary information to these combined financial statements.

The District and the Hospital were both created to purchase the operations and certain assets of the Watsonville Community Hospital (WCH) and operate the hospital facility. WCH assets were acquired in September of 2022.

The District has a Professional Services Agreement (PSA) with Coastal Health Partners (CHP). CHP is incorporated under the laws of the State of California and operates as a corporation. This agreement calls for CHP to provide physicians to the District 1206(b) clinic. The District provides support staff to CHP through the Hospital and passes those expenses onto the District Clinic.

The Combined Unit (the District and the Hospital) maintains its financial records in conformity with guidelines set forth by the Local Health Care District Law and the Office of Statewide Health Planning and Development of the state of California.

Basis of Preparation: The accounting policies and financial statements of the Combined Unit generally conform with the recommendations of the audit and accounting guide, *Health Care Organizations*, published by the American Institute of Certified Public Accountants. The financial statements are presented in accordance with the pronouncements of the Governmental Accounting Standards Board (GASB). For purposes of presentation, transactions deemed by management to be ongoing, major or central to the provision of health care services are reported as operational revenues and expenses.

The Combined Unit uses proprietary fund accounting. Revenues and expenses are recognized on the accrual basis using the economic resources measurement focus. Based on GASB Statement Number 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, as amended, the District has elected to apply the provisions of all relevant pronouncements of the Financial Accounting Standards Board (FASB), including those issued after November 30, 1989, that do not conflict with or contradict GASB pronouncements.

NOTE 1 - ORGANIZATION AND ACCOUNTING POLICIES (continued)

Financial Statement Presentation: The Combined Unit applies the provisions of GASB 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments* (Statement 34), as amended by GASB 37, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments: Omnibus*, and Statement 38, *Certain Financial Statement Note Disclosures*. Statement 34 established financial reporting standards for all state and local governments and related entities. Statement 34 primarily relates to presentation and disclosure requirements. The impact of this change was related to the format of the financial statements; the inclusion of management's discussion and analysis; and the preparation of the statement of cash flows on the direct method. The application of these accounting standards had no impact on the total net assets.

Management's Discussion and Analysis: Statement 34 requires that financial statements be accompanied by a narrative introduction and analytical overview of the Combined Unit's financial activities in the form of "management's discussion and analysis" (MD&A). This analysis is similar to the analysis provided in the annual reports of organizations in the private sector.

Use of Estimates: The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amount of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Cash and cash equivalents: Cash and cash equivalents include deposits with financial institutions and investments in highly liquid debt instruments with an original maturity of three months or less. Cash and cash equivalents exclude amounts whose use is limited by board designation or by legal restriction.

Patient Accounts Receivable: Patient accounts receivable consists of amounts owed by various governmental agencies, insurance companies and private patients. The Combined Unit manages its receivables by regularly reviewing the accounts, inquiring with respective payors as to collectability and providing for allowances on their accounting records for estimated contractual adjustments and uncollectible accounts. Significant concentrations of patient accounts receivable are discussed further in the footnotes.

Supplies: Inventories are consistently reported from year to year at cost determined by average costs and replacement values which are not in excess of market. The Combined Unit does not maintain levels of inventory values such as those under a first-in, first out or last-in, first out method.

NOTE 1 - ORGANIZATION AND ACCOUNTING POLICIES (continued)

Capital Assets: Capital assets consist of property and equipment and are reported on the basis of cost, or in the case of donated items, on the basis of fair market value at the date of donation. Routine maintenance and repairs are charged to expense as incurred. Expenditures which increase values, change capacities, or extend useful lives are capitalized. Depreciation of property and equipment and amortization of property under capital leases are computed by the straight-line method for both financial reporting and cost reimbursement purposes over the estimated useful lives of the assets, which range from 10 to 30 years for buildings and improvements, and 3 to 15 years for equipment. The Combined Unit periodically reviews its capital assets for value impairment. As of December 31, 2023 the Combined Unit has determined that no capital assets are impaired.

Compensated Absences: The employees of the Combined Unit earn vacation, paid time off, holiday and float benefits at varying rates. These accrual rates are determined based on the employee's years of service, full time equivalent (FTE) status, and union affiliation. This benefit can accumulate up to specified maximum levels. Accumulated vacation, paid time off, holiday, and float benefits are paid to an employee upon either termination or retirement. The combined liability for vacation, paid time off, holiday, and float liabilities as of December 31, 2023 and 2022 totaled $4,279,528 and $4,137,292, respectively.

Some employees also have a Legacy bank of hours that can be utilized, once they have exhausted all other accruals, and is payable at one half of their hourly rate of pay upon termination or retirement. The liability for these hours as of December 31, 2023 and 2022 totaled $902,141 and $982,045, respectively.

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

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

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

NOTE 1 - ORGANIZATION AND ACCOUNTING POLICIES (continued)

Net Patient Service Revenues: Net patient service revenues are reported in the period at the estimated net realized amounts from patients, third-party payors and others including estimated retroactive adjustments under reimbursement agreements with third-party programs. Normal estimation differences between final reimbursement and amounts accrued in previous years are reported as adjustments of current year's net patient service revenues.

Financial Assistance: The Hospital offers a financial assistance policy for its patients. The financial assistance policy describes the Hospital's policy for both charity care (free care) and discounted care, and the process for patients who need help paying for their emergency and medically necessary care. The intent of this policy is to satisfy the requirements of Section 501(r) of the Internal Revenue Code and California Health and Safety Code sections 127400 to 127446. Because the Combined Unit does not pursue collection of amounts determined to qualify as charity care, they are not reported as net patient service revenues. Services provided are recorded as gross patient service revenues and then written off entirely as an adjustment to net patient service revenues.

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

Income taxes: The District operates under the purview of the Internal Revenue Code, Section 115, and corresponding California Revenue and Taxation Code provisions. As such, it is not subject to state or federal taxes on income. However, income from the unrelated business activities of the District may be subject to income taxes.

The Hospital is exempt from income taxes under Section 501(c)(3) of the Internal Revenue Code (IRC). Thus, no provision for income taxes is included in the accompanying financial statements. The Hospital follows the accounting guidance for accounting for uncertainty in income taxes. The Hospital is subject to federal and state income taxes to the extent it has unrelated business income. In accordance with the guidance for uncertainty in income taxes, management has evaluated its material tax positions and determined that there are no income tax effects with respect to its financial statements. The Hospital is subject to examination by federal or state authorities within the three-year statute of limitations applied to tax filings. The Hospital management has not been notified of any impending examination and no examinations are currently in process.

NOTE 1 - ORGANIZATION AND ACCOUNTING POLICIES (continued)

Recently Adopted Accounting Pronouncement: In June 2017 the Governmental Accounting Standards Board released GASB 87 regarding changes in the way leases are accounted for. GASB 87 superseded GASB 13 and GASB 62 and more accurately portrays lease obligations by recognizing lease assets and lease liabilities on the statement of net position and disclosing key information about leasing arrangements. GASB 87 increases the usefulness of financial statements by requiring recognition of certain operating lease obligations to recognize the inflows of resources based upon the provisions of the lease contracts. The Combined Unit has adopted GASB 87 effective September 1, 2022, in accordance with the timetable established by GASB 87.

Other new GASB pronouncements recently issued were GASB's 84 (Fiduciary Activities) 88 (Certain Disclosures Related to Debt, including Direct Borrowings and Direct Placements) 89 (Accounting for Interest Cost Incurred Before the End of a Construction Period) and 91 (Conduit Debt Obligation) have been analyzed by Combined Unit management and have been determined to have no impact upon the financial statements.

Revenue Recognition: As previously stated, net patient service revenues are reported at amounts that reflect the consideration to which the Combined Unit expects to be entitled in exchange for patient services. These amounts are due from patients, third-party payors (including health insurers and government programs), and others and include variable consideration for retroactive revenue adjustments due to settlement of third-party payor audits, reviews, and investigations. Generally, the Combined Unit bills the patients and third-party payors several days after the patient receives healthcare services at the Combined Unit. Revenue is recognized as services are rendered.

The Combined Unit has agreements with third-party payors that provide for payments to the Combined Unit at amounts different from its established rates. Payment arrangements include prospectively determined rates per day, discharge or visit, reimbursed costs, discounted charges and per diem payments. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined.

NOTE 2 – CASH AND CASH EQUIVALENTS

As of December 31, 2023 and 2022, the Combined Unit had deposits in a financial institution of $6,639,515 and $8,660,568, respectively. $2,600,000 of these funds are restricted and not available for use to the Combined Unit. All of these funds are in the form of cash and cash equivalents, which were collateralized in accordance with the California Government Code ("CGC"), except for $250,000 per account that is federally insured.

Under the provisions of the CGC, California banks and savings and loan associations are required to secure the Combined Unit's deposits by pledging government securities as collateral. The market value of pledged securities must equal at least 110% of the Combined Unit's deposits.

NOTE 2 – CASH AND CASH EQUIVALENTS (continued)

California law also allows financial institutions to secure Combine Unit deposits by pledging first trust deed mortgage notes having a value of 150% of the Combined Unit's total deposits. The pledged securities are held by the pledging financial institution's trust department in the name of the Combined Units.

Combined Unit investment policies allow investments in U.S. Government securities and state and local agency funds which invest in U.S. Government securities. These investments, when present, are stated at quoted market values. Changes in market value between years are reflected as a component of investment income in the accompanying statement of revenues, expenses, and changes in net position.

NOTE 3 - NET PATIENT SERVICE REVENUES AND REIMBURSEMENT PROGRAMS

The Combined Unit renders services to patients under contractual arrangements with the Medicare and Medi-Cal programs, commercial insurance companies, health maintenance organizations (HMOs) and preferred provider organizations (PPOs). Patient service revenues from these programs approximate 86.6% of gross patient service revenues for the year ended December 31, 2023.

The Medicare Program reimburses the Hospital on a cost basis payment system for inpatient and outpatient hospital services. The cost-based reimbursement is determined based on filed Medicare cost reports. Clinic services are reimbursed based on fee schedules.

The Combined Unit contracts to provide services to Medi-Cal, HMO and PPO inpatients on negotiated rates. Certain outpatient reimbursement is subject to a schedule of maximum allowable charges for Medi-Cal and to a percentage discount for HMOs and PPOs.

Both the Medicare and Medi-Cal program's administrative procedures preclude final determination of amounts due to the Combined Unit for services to program patients until after patients' medical records are reviewed and cost reports are audited or otherwise reviewed by and settled with the respective administrative agencies. The Medicare and Medi-Cal cost reports are subject to audit and possible adjustment. Management is of the opinion that no significant adverse adjustment to the recorded settlement amounts will be required upon final settlement.

Medicare and Medi-Cal revenue accounted for approximately 56% of the Combined Unit’s net patient revenues for the year ended December 31, 2023. Laws and regulations governing the Medicare and Medi-Cal programs are extremely complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term.

NOTE 4 - CONCENTRATION OF CREDIT RISK

The Combined Unit grants credit without collateral to its patients and third-party payors. Patient accounts receivable from government agencies represent the only concentrated group of credit risk for the Combined Unit and management does not believe that there is any credit risk associated with these governmental agencies. Contracted and other patient accounts receivable consist of various payors including individuals involved in diverse activities, subject to differing economic conditions and do not represent any concentrated credit risks to the Combined Unit. Concentration of patient accounts receivable at December 31, 2023 and 2022, were as follows:

	2023	2022
Medicare	$ 34,412,365	$ 33,608,188
Medi-Cal	43,776,399	45,145,391
Other third party payors	50,431,841	59,234,298
Self pay and other	22,023,987	11,100,868
Gross patient accounts receivable	150,644,592	149,088,745
Less allowances for contractual adjustments and bad debts	(135,448,815)	(127,822,234)
Net patient accounts receivable	$ 15,195,777	$ 21,266,511

NOTE 5 - CAPITAL ASSETS

Capital assets as of December 31, 2023 were comprised of the following:

	Balance at 12/31/2022	Transfers & Additions	Transfer & Retirements	Balance at 12/31/2023
CIP	$ 965,266	$ 24,700	$ -	$ 989,966
Equipment	1,738,255	1,057,188	-	2,795,443
Software	1,038,183	33,549	-	1,071,732
Totals at historical cost	3,741,704	1,115,437	-	4,857,141
Less accumulated depreciation	(725,896)	(992,449)	-	(1,718,345)
Capital assets, net	$ 3,015,808	$ 122,988	$ -	$ 3,138,796

NOTE 6 - DEBT BORROWINGS

Long-term debt consists of a note payable, a line of credit, and finance lease agreements as follows:

	2023	2022
District debt		
Santa Cruz County	$ 1,700,000	$ 2,700,000
Mako Surgical	795,000	-
Total District debt:	2,495,000	2,700,000
Hospital debt		
David and Lucille Packard Foundation	4,715,253	6,357,000
Distressed Hospital Loan	8,300,000	-
Multiple finance leases; imputed interest ranging from 10-11%; monthly lease payments ending in August of 2024:	18,834	123,986
Total Hospital debt:	13,034,087	6,480,986
Total debt borrowings	15,529,087	9,180,986
Less current maturities	(3,120,987)	(1,702,035)
Debt borrowings, net of current maturities	$ 12,408,100	$ 7,478,951

Santa Cruz County: The District has a note payable with the County of Santa Cruz, for the purpose of funding a Letter of Credit with the Santa Cruz County Bank, which is a requirement of the Hospital lease agreement. Interest at 0% with principal payments in the amount of $500,000 due bi-annually on June 30th and December 31st. The first payment is due on June 30, 2023, with final payment due on December 31st, 2025.

Mako Surgical: The District assumed an agreement to purchase a surgical robotic arm and related systems for hip and knee applications. The interest rate is 0%. At the time, there were four remaining principal payments of $120k, $200k, $280k, and $315k. The agreement includes an annual supply rebate program, which has the potential to fully offset these payments. The final payment, less supply rebates, is due in March of 2026.

David and Lucille Packard Foundation: The Hospital is a co-borrower on a note payable collateralized by community pledges to the Pajaro Valley Healthcare District Project (the Project). As community pledges are received, the Project will make annual principal payments, with the first payment due on March 31, 2023, and the final payment due on January 31, 2026. The Hospital will relieve the debt and recognize revenue as principal payments are made by the Project. Interest at 0.5% will be paid by the Hospital bi-annually on March 31st and September 30th, with the final payment due on January 31, 2026.

NOTE 6 - DEBT BORROWINGS (continued)

Distressed Hospital Loan: The Hospital received Distressed Hospital loan proceeds of $8,300,000 on November 1, 2023. These funds were used to maintain operations and in support of some Hospital projects to stabilize operations. The six-year loan is zero interest and has an 18-month grace period before repayment. The legislation behind the Distressed Hospital Loan allows for the possibility of loan forgiveness, however that has not been confirmed as of 12/31/23.

The District also obtained a $3.0 million line of credit with Santa Cruz County Bank, secured by community guarantors. The LOC has an interest rate of 1% plus prime and matures on November 5, 2026. Accrued interest on any outstanding principal is due monthly. As of December 31, 2023, the District had not drawn on the credit line.

NOTE 7 - RETIREMENT PLANS

The Hospital sponsors two 401(a) defined contribution retirement plans for employer contributions: one for service and maintenance employees payable on a calendar year-end that contributes 6% or higher depending on years of service of gross annual earnings; the second 401(a) plan covers other non-management, non-highly compensated employees and contributes 6% of gross earnings bi-weekly. The Hospital also sponsors a 457(b) deferred compensation plan for employee contributions, withheld from bi-weekly earnings.

Accrued payroll and related liabilities include $154,208 of 401(a) employer liabilities, calculated from the final two pay period of the year and contributed to the plan in January of 2024. 401(a) liabilities for SEIU Service & Maintenance employees was $552,800 as of December 31, 2023.

NOTE 8 - COMMITMENTS AND CONTINGENCIES

Construction-in-Progress: As of December 31, 2023, the Combined Unit had $989,966 in construction-in-progress for the Cardio Cath Lab. Approximately $52,400 in remobilization fees are remaining to complete construction. Funds for these fees will come from earnings.

Litigation: The Combined Unit may from time-to-time be involved in litigation and regulatory investigations which arise in the normal course of doing business. As of December 31, 2023, management is not aware of any legal matters or potential regulatory investigations.

Medical Malpractice Insurance: The Combined Unit maintains commercial malpractice liability insurance coverage under a claims made and reported policy covering losses up to $15 million per claim and $25 million in the aggregate for all claims, subject to a deductible of $150,000 Indemnity & Expense each claim. The District plans to maintain the insurance coverage by renewing its current policy, or by replacing it with equivalent insurance.

NOTE 8 - COMMITMENTS AND CONTINGENCIES (continued)

Workers Compensation Program: The Hospital workers compensation policy is through travelers and renews in Oct 2024. Annual premium is $1,188,473. The district workers compensation policy is through travelers and renews in Oct 2024. The annual premium is $20,898.

Health Insurance Portability and Accountability Act: The Health Insurance Portability and Accountability Act (HIPAA) was enacted August 21, 1996, to ensure health insurance portability, reduce health care fraud and abuse, guarantee security and privacy of health information, and enforce standards for health information. Organizations are subject to significant fines and penalties if found not to be compliant with the provisions outlined in the regulations. Management believes the Combined Unit is in compliance with HIPAA as of December 31, 2023 and 2022.

Regulatory Environment: The Combined Unit is subject to several laws and regulations. These laws and regulations include matters such as licensure, accreditation, government health care program participation requirements, reimbursement for patient services, and Medicare and Medi-Cal fraud and abuse. Government activity has increased with respect to possible violations of statues and regulations by health care providers. Violations of these laws and regulations could result in expulsion from government health care programs together with the imposition of significant fines and penalties, as well as significant repayments for patient services previously billed. Management believes that the Combined Unit is in compliance with all applicable government laws and regulations and is not aware of any future actions or unasserted claims at this time.

NOTE 9 - LEASES

The Combined Unit has multiple equipment and building leases. The District leases the building and land for the Hospital from Medical Properties Trust, Inc with a remaining term of 319 months and an estimated annual increase to base rent of 2% based on CPI. The District also leases office space for a urology center near the Hospital. This lease has 79 months remaining and a fixed monthly payment during the term. All other lease arrangements are either immaterial or have a term of 12 months or less.

Neither lease has a readily determinable discount rate. The estimated borrowing rate for the Hospital building and land and for the urology center is 9.5%. The urology center lease requires payment of common area maintenance, which represent the majority of variable lease costs. Variable lease costs are excluded from the present value of lease obligations. The District's lease agreements do not contain any material restrictions, covenants, or any material residual value guarantees.

NOTE 9 – LEASES (continued)

Lease related assets and liabilities as of December 31, 2023 and 2022 consist of the following:

Lease assets:	2023	2022
MPT	$ 32,414,776	$ 33,042,270
Urology center	502,704	554,503
Other	631,939	1,163,180
Total lease assets	$ 33,549,419	$ 34,759,953

Lease liabilities:	2023	2022
MPT	$ 33,446,113	$ 33,300,104
Urology center	507,764	557,177
Other	605,237	1,166,684
Total lease liabilities	$ 34,559,114	$ 35,023,965

Total operating lease expense for the year ended December 31, 2023, was $1,914,944. Future minimum rental payments required under operating lease obligations as of December 31, 2023, are summarized as follows:

Years ending December 31,	
2024	$ 3,544,634
2025	3,385,886
2026	3,192,676
2027	3,239,280
Thereafter	85,982,188
Total	99,344,664
Less imputed interest	(64,785,550)
Present value of lease liabilities	$ 34,559,114

The weighted average reamining lease term for these leases is 25 years and the weighted average discount rate is 9.5%.

NOTE 10 – GOING CONCERN

The accompanying financial statements have been prepared assuming that the Combined Unit will continue as a going concern. The Hospital has reduced its annual losses since emerging from bankruptcy in 2022, however it has suffered significant losses from operations and has experienced cash flow difficulties since the District acquired them in September 2022. These conditions raise substantial doubt about the Hospital's ability to continue as a going concern. Management's plans regarding these matters are described above and in the Management's Discussion and Analysis. The financial statements do not include any adjustments that might result from the outcome of this uncertainty. In view of these matters, continuation as a going concern is dependent on continued operations of the District and the Hospital, which in turn is dependent on the District's and the Hospital's ability to increase collections, decrease expenses, and raise additional capital.

The Combined Unit's management is working to continue to find ways to make progress on improving how the Combined Unit organizes and processes work in such a way that it continues to improve patient care and service to its patients and community, while striving to improve its financial position and overall fiscal performance.

The Hospital received Distressed Hospital loan proceeds of $8,300,000 on November 1, 2023. These funds were used to maintain operations and in support of certain Hospital projects to further stabilize operations. The six-year loan is at 0.0% interest and has an 18-month grace period before repayment begins. The legislation behind the Distressed Hospital Loan allows for the possibility of loan forgiveness, however that has not been confirmed as of December 31, 2023.

The District has placed Measure N on the March 2024 ballot. Measure N is a $116M general obligation bond program intended to renovate the Hospital and improve services to the community. Measure N will allow the hospital to modernize and expand the facility. It will also allow the District to purchase the hospital building and land. The purchase would eliminate the current $3.0M annual lease payments to the third-party owner, allowing those funds to be reinvested in supporting staff and patient care.

The District obtained a $3.0 million line of credit with Santa Cruz County Bank, secured by community guarantors. The LOC has an interest rate of 1% plus prime and matures on November 5, 2026. Accrued interest on any outstanding principal is due monthly. As of December 31, 2023, the District had not drawn on the credit line. The Pajaro Valley Healthcare District Philanthropy Foundation is a newly formed non-profit 501(c)3 corporation in existence to raise funds and secure grants for Hospital activities and services. In 2023, they were able to secure a $250K grant for the purchase of anesthesia machines. Additionally, they secured $60K in grants to support translation services to support patient care for non-English speaking patients.

Management has implemented a cash management plan and is actively managing its revenue cycle (collections) activities. Additionally, the District (Hospital) is opening a Cath Lab in Q2 2024 which will provide new revenue generating opportunities. Other expense initiatives are also planned for 2024.

NOTE 11 – SUBSEQUENT EVENTS

Management evaluated the effect of subsequent events on the combined financial statements through March 27, 2024, the date the combined financial statements are issued, and determined that there are no material subsequent events that have not been disclosed.

SUPPLEMENTARY SCHEDULES

Pajaro Valley Healthcare District

Combining Statement of Net Position

December 31, 2023

	District	Hospital	Eliminations	Total
Assets				
Current Assets				
Cash and cash equivalents	$ 2,784,641	$ 3,854,874	$ -	$ 6,639,515
Patient accounts receivable, net of allowances	34,066	15,161,711	-	15,195,777
Other accounts receivable	-	-	-	-
Inventories	20,859	3,820,565	-	3,841,424
Prepaid expenses and other current assets	765,157	1,494,856	-	2,260,013
Total current assets	3,604,723	24,332,006	-	27,936,729
Capital assets, net of accumulated depreciation	3,090,877	47,919	-	3,138,796
Lease assets	32,940,084	609,335	-	33,549,419
Due from district	-	9,160,814	(9,160,814)	-
Total assets	$ 39,635,684	$ 34,150,074	$ (9,160,814)	$ 64,624,944
Liabilities and Net Position				
Current liabilities				
Current maturities of debt borrowings	$ 1,200,000	$ 1,920,987	$ -	$ 3,120,987
Accounts payable and accrued expenses	(106,224)	6,637,919	-	6,531,695
Accrued payroll and related liabilities	274,306	8,740,179	-	9,014,485
Estimated third party payor settements	-	728,871	-	728,871
IBNR self funded health benefits	-	1,706,135	-	1,706,135
Total current liabilities	1,368,082	19,734,091	-	21,102,173
Debt borrowings, net of current maturities	1,295,000	11,113,100	-	12,408,100
Lease liabilities	33,967,426	591,688	-	34,559,114
Due to hospital	9,160,814	-	(9,160,814)	-
Total liabilities	45,791,322	31,438,879	(9,160,814)	68,069,387
Net position				
Invested in capital assets, net of related debt	3,090,877	47,919	-	3,138,796
Restricted	2,600,000	-	-	2,600,000
Unrestricted	(11,846,515)	2,663,276		(9,183,239)
Total net position	(6,155,638)	2,711,195	-	(3,444,443)
Total liabilities and net position	$ 39,635,684	$ 34,150,074	$ (9,160,814)	$ 64,624,944

See accompanying notes to the financial statements

Pajaro Valley Healthcare District

Combining Statement of Revenues, Expenses and Changes in Net position

For The Year Ended December 31, 2023

	District	Hospital	Eliminations	Total
Operating revenues				
Net patient service revenues	$ 2,488,045	$ 126,626,179	$ -	$ 129,114,224
Other operating revenues	932,754	5,085,425	(650,653)	5,367,526
Total operating revenues	3,420,799	131,711,604	(650,653)	134,481,750
Operating expenses				
Salaries & wages	2,977,295	67,179,431	-	70,156,726
Employee benefits	557,809	20,902,793	-	21,460,602
Contract labor	-	6,931,655	-	6,931,655
Supplies	27,227	8,292,567	-	8,319,794
Medical specialist fees	178,908	7,572,553	-	7,751,461
Purchased services	224,819	13,233,988	-	13,458,807
Lease cost and rent	270,683	1,644,261	-	1,914,944
Repairs & maintenance	295	1,359,572	-	1,359,867
Utilities	13,239	2,452,858	-	2,466,097
Depreciation and amortization	1,979,831	-	-	1,979,831
Other operating expenses	35,062	6,154,954	-	6,190,016
Property taxes & insurance	99,492	2,345,353	-	2,444,845
Interest	3,773,502	68,423	-	3,841,925
Total operating expenses	10,138,162	138,138,408	-	148,276,570
Operating income (loss)	(6,717,363)	(6,426,804)	(650,653)	(13,794,820)
Nonoperating revenues (expenses)				
Rental income	529,666	-	-	529,666
Interest income		103,547		103,547
Management fees	(650,653)	-	650,653	-
Total nonoperating revenues (expenses)	(120,987)	103,547	650,653	633,213
Increase/(decrease) in net position	(6,838,350)	(6,323,257)	-	(13,161,607)
Net position, beginning of the year	682,713	9,034,451	-	9,717,164
Net position, end of year	$ (6,155,637)	$ 2,711,194	$ -	$ (3,444,443)

See accompanying notes to the financial statements

JWT & Associates, LLP

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Independent Auditors Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards

The Board of Directors
Pajaro Valley Health Care District
Watsonville, California

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards issued by the Comptroller General of the United States, the combined financial statements of the business-type activities of the Pajaro Valley Health Care District (the District) as of and for the year ended December 31, 2023, and the related notes to the combined financial statements, which collectively comprise the District's combined financial statements, and have issued our report thereon dated March 27, 2024.

Internal Control over Financial Reporting

In planning and performing our audit of the combined financial statements, we considered the District's internal control over financial reporting (internal control) as a basis for designing audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the combined financial statements, but not for the purpose of expressing an opinion on the effectiveness of the District's internal control. Accordingly, we do not express an opinion on the effectiveness of the District's internal control.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's combined financial statements will not be prevented or detected and corrected on a timely basis. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given those limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the District's combined financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the combined financial statement. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under Government Auditing Standards.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the District's internal control or on compliance. This report is an integral part of an audit performed in accordance with Government Auditing Standards in considering the District's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

JWT & Associates, LLP

Fresno, California
March 27, 2024

Pajaro Valley Health Care District

Schedule of Findings and Questioned Costs

For the Year Ended December 31, 2023

I. Summary of Auditor's Results

Type of auditor's report issued:	Unmodified	
Internal Control over financial reporting:		
Material weakness identified?	___yes	_X_no
Significant deficiency(ies) identified that are not considered to be material weaknesses?	___yes	_X_no
Noncompliance material to financial statements noted?	___yes	_X_no

II. Current Year Audit Findings and Questioned Costs

Financial Statement Findings

None reported

III. Prior Year Audit Findings and Questioned Costs

None reported