

**PAJARO VALLEY COMMUNITY
HEALTH TRUST**

FINANCIAL STATEMENT

FOR THE YEAR ENDED
JUNE 30, 2018

AND INDEPENDENT AUDITORS'
REPORT

PAJARO VALLEY COMMUNITY HEALTH TRUST

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**PAJARO VALLEY COMMUNITY HEALTH TRUST
BOARD OF DIRECTORS
FISCAL YEAR 2017-2018**

Caitlin Brune, Chief Executive Officer

Shebreh Kalantari Johnson, Chair

Damian Maldonado, Vice Chair

Elsa Mendoza Jimenez, Treasurer

David Mesa, Secretary

Trina Coffman-Gomez

Lowell Hurst

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Yuliana Mendoza-Flores

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Christian Miranda

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Devon Caroselli

Suzanne Mine-Eguchi

Joe Gallagher, MD

Ron Jones

Bob Kennedy



HAYASHI | WAYLAND

INDEPENDENT AUDITORS' REPORT

**To the Board of Directors
Pajaro Valley Community Health Trust
Watsonville, California**

Report on the Financial Statements

We have audited the accompanying financial statements of *Pajaro Valley Community Health Trust* (a California nonprofit corporation), which comprise the statement of financial position as of June 30, 2018, and the related statement of activities and cash flows for the year then ended and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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



Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the **Pajaro Valley Community Health Trust** as of June 30, 2018, and the changes in its net assets and cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Report on Summarized Comparative Information

We have previously audited Pajaro Valley Community Health Trust's 2017 financial statements, and we expressed an unmodified audit opinion on these audited financial statements in our report dated October 20, 2017. In our opinion, the summarized comparative information presented herein as of and for the year ended June 30, 2017, is consistent, in all material respects, with the audited financial statements from which it has been derived.

October 31, 2018

Hayashi Wayland, LLP



PAJARO VALLEY COMMUNITY HEALTH TRUST
STATEMENT OF FINANCIAL POSITION
JUNE 30, 2018
(WITH COMPARATIVE TOTALS FOR JUNE 30, 2017)

	<u>2018</u>	<u>2017</u>
<u>ASSETS</u>		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 306,845	\$ 283,855
Accounts receivable	75,643	179,636
Pledges and grants receivable	33,000	66,000
Prepaid expenses	<u>32,803</u>	<u>30,784</u>
Total current assets	<u>448,291</u>	<u>560,275</u>
PROPERTY AND EQUIPMENT:		
Furniture and fixtures	50,490	31,393
Equipment	70,400	49,959
Leasehold improvements	<u>46,978</u>	<u>46,978</u>
Total property and equipment	167,868	128,330
Less accumulated depreciation	<u>107,701</u>	<u>97,856</u>
Total property and equipment – net	<u>60,167</u>	<u>30,474</u>
INVESTMENTS (NOTE 4)	<u>16,350,610</u>	<u>16,239,484</u>
TOTAL ASSETS	<u>\$ 16,859,068</u>	<u>\$ 16,830,233</u>

PAJARO VALLEY COMMUNITY HEALTH TRUST
STATEMENT OF FINANCIAL POSITION
JUNE 30, 2018
(WITH COMPARATIVE TOTALS FOR JUNE 30, 2017)
(Continued)

	<u>2018</u>	<u>2017</u>
<u>LIABILITIES AND NET ASSETS</u>		
CURRENT LIABILITIES:		
Accounts payable	\$ 54,429	\$ 13,799
Other accrued liabilities	117,974	101,278
Fiscal sponsorship payable (Note 5)	134,435	252,232
Deferred revenue	<u>2,100</u>	<u>2,500</u>
Total current liabilities	308,938	369,809
OTHER LIABILITIES –		
Accrued workers' compensation fund (Note 7)	<u>52,965</u>	<u>74,849</u>
Total liabilities	<u>361,903</u>	<u>444,658</u>
NET ASSETS:		
Unrestricted:		
Undesignated	14,812,196	14,867,727
Board designated (Note 8)	<u>–</u>	<u>11,395</u>
Total unrestricted net assets	14,812,196	14,879,122
Temporarily restricted (Note 9)	558,809	398,063
Permanently restricted (Note 10)	<u>1,126,160</u>	<u>1,108,390</u>
Total net assets	<u>16,497,165</u>	<u>16,385,575</u>
TOTAL LIABILITIES AND NET ASSETS	<u>\$ 16,859,068</u>	<u>\$ 16,830,233</u>

See Notes to Financial Statements.

PAJARO VALLEY COMMUNITY HEALTH TRUST
STATEMENT OF ACTIVITIES
FOR THE YEAR ENDED JUNE 30, 2018
(WITH COMPARATIVE TOTALS FOR THE YEAR ENDED JUNE 30, 2017)

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>2018 Total</u>	<u>2017 Total</u>
SUPPORT AND REVENUE:					
Grants, contributions and donations	\$ 116,276	\$ 252,328	\$ 17,770	\$ 386,374	\$ 296,937
In-kind contributions	252,711	-	-	252,711	249,448
Special event revenues	123,155	13,825	-	136,980	135,398
DHC patient fees	98,229	-	-	98,229	63,487
Net investment income (Note 4)	938,986	106,993	-	1,045,979	1,977,269
Miscellaneous revenue	7,269	-	-	7,269	28,056
Net assets released from restrictions (Note 9)	<u>212,400</u>	<u>(212,400)</u>	<u>-</u>	<u>-</u>	<u>-</u>
Total support and revenue	<u>1,749,026</u>	<u>160,746</u>	<u>17,770</u>	<u>1,927,542</u>	<u>2,750,595</u>
EXPENSES:					
Diabetes Health Center Services	775,424	-	-	775,424	694,502
Regional Diabetes Collaborative	131,314	-	-	131,314	102,763
Grant Making	379,036	-	-	379,036	385,306
Fundraising	233,590	-	-	233,590	236,999
General and administrative	<u>181,313</u>	<u>-</u>	<u>-</u>	<u>181,313</u>	<u>172,765</u>
Total expenses	<u>1,700,677</u>	<u>-</u>	<u>-</u>	<u>1,700,677</u>	<u>1,592,335</u>
Increase (decrease) in net assets from continuing operations	48,349	160,746	17,770	226,865	1,158,260
Discontinued operations – additional gain (loss) on sale of hospital assets (Note 7)	<u>(115,275)</u>	<u>-</u>	<u>-</u>	<u>(115,275)</u>	<u>84,397</u>
Increase (decrease) in net assets	(66,926)	160,746	17,770	111,590	1,242,657
NET ASSETS, BEGINNING OF YEAR	<u>14,879,122</u>	<u>398,063</u>	<u>1,108,390</u>	<u>16,385,575</u>	<u>15,142,918</u>
NET ASSETS, END OF YEAR	<u>\$14,812,196</u>	<u>\$ 558,809</u>	<u>\$ 1,126,160</u>	<u>\$16,497,165</u>	<u>\$16,385,575</u>

See Notes to Financial Statements.

PAJARO VALLEY COMMUNITY HEALTH TRUST
STATEMENT OF FUNCTIONAL EXPENSES
FOR THE YEAR ENDED JUNE 30, 2018
(WITH COMPARATIVE TOTALS FOR THE YEAR ENDED JUNE 30, 2017)

	<u>Diabetes Health Center Services</u>	<u>Regional Diabetes Collaborative</u>	<u>Grant Making</u>	<u>Fundraising</u>	<u>General and Administrative</u>	<u>2018 Total</u>	<u>2017 Total</u>
EXPENSES:							
Salaries	\$ 382,027	\$ 78,944	\$ 97,708	\$ 98,169	\$ 65,165	\$ 722,013	\$ 686,046
Payroll taxes and benefits	91,366	15,399	20,765	24,030	16,762	168,322	169,795
Professional fees	88,739	10,862	6,071	3,300	37,133	146,105	92,777
Facilities and equipment	171,816	15,593	31,185	34,026	46,777	299,397	303,510
Miscellaneous office and board expenses	9,198	1,302	9,820	6,255	4,937	31,512	20,094
Duplicating	2,433	59	188	796	834	4,310	3,920
Special events	119	6,374	69	55,295	-	61,857	73,524
Postage	1,580	294	883	870	392	4,019	5,953
Publications	3,968	760	2,286	1,330	875	9,219	8,682
Supplies	8,860	371	1,028	718	1,704	12,681	16,247
Training	3,173	30	1,339	44	2,922	7,508	4,862
Outreach	6,690	1,067	2,432	5,723	2,559	18,471	8,715
Travel	788	176	13	-	1,158	2,135	1,678
Bad debt	-	-	-	2,889	-	2,889	7,335
Grantee disbursements	-	-	205,000	-	-	205,000	185,000
Interest	433	83	249	145	95	1,005	-
Insurance	4,234	-	-	-	-	4,234	4,197
	<u>\$ 775,424</u>	<u>\$ 131,314</u>	<u>\$ 379,036</u>	<u>\$ 233,590</u>	<u>\$ 181,313</u>	<u>\$ 1,700,677</u>	<u>\$ 1,592,335</u>

See Notes to Financial Statements.

PAJARO VALLEY COMMUNITY HEALTH TRUST
STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED JUNE 30, 2018
(WITH COMPARATIVE TOTALS FOR THE YEAR ENDED JUNE 30, 2017)

	<u>2018</u>	<u>2017</u>
CASH FLOWS FROM OPERATING ACTIVITIES:		
Cash received from contributions and grants	\$ 419,374	\$ 233,133
Cash received as revenue and support	346,071	93,449
Cash paid to suppliers and employees	(1,596,695)	(1,164,137)
Grants paid	(205,000)	(185,000)
Interest and dividends received	487,134	467,142
Contributions restricted for endowment	<u>(6,375)</u>	<u>(8,075)</u>
NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES	<u>(555,491)</u>	<u>(563,488)</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of property and equipment	(39,538)	-
Cash paid to purchase investments	(486,778)	(497,204)
Proceeds from sale of investments	<u>1,098,422</u>	<u>1,151,746</u>
NET CASH PROVIDED (USED) BY INVESTING ACTIVITIES	<u>572,106</u>	<u>654,542</u>
CASH FLOWS FROM FINANCING ACTIVITIES:		
Permanently restricted contributions	6,375	8,075
Principal payments on capital leases	<u>-</u>	<u>(831)</u>
NET CASH PROVIDED (USED) BY FINANCING ACTIVITIES	<u>6,375</u>	<u>7,244</u>
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	22,990	98,298
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	<u>283,855</u>	<u>185,557</u>
CASH AND CASH EQUIVALENTS, END OF YEAR	<u>\$ 306,845</u>	<u>\$ 283,855</u>

PAJARO VALLEY COMMUNITY HEALTH TRUST
STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED JUNE 30, 2018
(WITH COMPARATIVE TOTALS FOR THE YEAR ENDED JUNE 30, 2017)
(Continued)

	<u>2018</u>	<u>2017</u>
RECONCILIATION OF CHANGE IN NET ASSETS TO NET CASH FLOWS USED BY OPERATING ACTIVITIES		
Increase (decrease) in net assets	\$ 111,590	\$ 1,242,657
Adjustments to reconcile increase (decrease) in net assets to cash provided (used) by operating activities:		
Depreciation	9,845	6,000
Net realized/unrealized (gain) loss on investments	(722,770)	(1,645,856)
Contributions for endowment purposes	(6,375)	(8,075)
(Increase) decrease in:		
Accounts receivable	103,993	(119,792)
Pledges and grants receivable	33,000	(63,804)
Prepaid expenses	(2,019)	(9,240)
Increase (decrease) in:		
Accounts payable	40,630	(13,428)
Other accrued liabilities	16,696	12,754
Fiscal sponsorship payable	(117,797)	167,535
Deferred revenue	(400)	(13,700)
Accrued workers' compensation fund	(21,884)	(118,539)
NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES	<u>\$ (555,491)</u>	<u>\$ (563,488)</u>

See Notes to Financial Statements.

PAJARO VALLEY COMMUNITY HEALTH TRUST
NOTES TO FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2018

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Business – The Pajaro Valley Community Health Trust (the Trust) is a nonprofit organization which is the successor organization to Watsonville Community Hospital. In September 1998, substantially all of the Hospital’s operating assets were sold to Community Health Systems, Inc. (“CHS”) under an asset sale agreement. Subsequent to the sale, the Hospital’s corporate name was changed to the Pajaro Valley Community Health Trust. The Trust’s obligations include receiving and disbursing the residual sales proceeds in accordance with applicable California law. Its long-range goals include the development and maintenance of endowment funds, operation of health-related programs, and the distribution of funds to health care agencies located in the Pajaro Valley to provide support for the delivery of health and human services.

Under California charitable trust law, the Trust’s net assets and income derived from the sale of the assets of Watsonville Community Hospital must be used consistently with the purposes set forth in the Trust’s Articles of Incorporation at the time the assets were obtained. The Articles permit the Trust to make medical care grants or distributions, directly provide medical care, and make health/medical education expenditures to qualified non-profit organizations in the Pajaro Valley area of California as defined in the Articles.

During 2000, the Trust received the assets of the Watsonville Community Hospital Foundation (the Foundation). Due to the sale of the hospital assets and operations to a for-profit company, the Foundation’s assets were contributed to the Trust under an action approved by the Foundation’s board of directors with local court approval.

The Trust has adopted investment and spending policies, approved by the Board of Trustees, for non-endowed funds, which includes the proceeds from the sale of the hospital assets in the approximate amount of \$13 million. Distributions from these funds are made in accordance with the current spending policy and the Articles of Incorporation with the intention of preserving the original corpus.

Basis of Presentation – The accompanying financial statements are presented using the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America. The net assets, revenues, gains and losses, and other support and expenses and other changes in the accompanying financial statements are classified based on the existence or absence of donor-imposed restrictions. Accordingly, for reporting purposes, net assets of the Trust and changes therein are classified as follows.

- **Unrestricted Net Assets** – Net assets that are not subject to donor-imposed stipulations. This includes certain amounts designated by the Board for endowment and other purposes.
- **Temporarily Restricted Net Assets** – Net assets subject to donor-imposed stipulations that may or will be met either by actions of the Trust and/or the passage of time.
- **Permanently Restricted Net Assets** – Net assets subject to donor-imposed restrictions that they be maintained permanently by the Trust. Generally, the donors of these assets permit the Trust to use all or a part of the income earned on related investments for general or specific purposes.

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Recognition of Donor Restrictions – Support that is restricted by the donor is reported as an increase in temporarily or permanently restricted net assets, depending on the nature of the restriction. When a restriction expires (that is, when a stipulated time restriction ends or purpose restriction is accomplished), temporarily restricted net assets are reclassified to unrestricted net assets and reported in the Statement of Activities as “Net assets released from restrictions.”

Revenue Recognition – Contributions, which include unconditional promises to give, are recognized as revenues in the period received or promised. Conditional contributions are recorded when the conditions have been substantially met. Contributions are considered to be unrestricted unless specifically restricted by the donor.

Gains and losses on investments and other assets and liabilities are reported as increases or decreases in unrestricted net assets unless their use is restricted by explicit donor stipulation or by law.

Cash and Cash Equivalents – For the purposes of the statements of cash flows, cash equivalents include all highly liquid debt instruments purchased with an original maturity of three months or less, except for money market funds held in investment brokerage accounts, which are classified as investments.

Accounts Receivable, Current – Accounts receivable are recorded using the allowance method and are presented net of the allowance for uncollectibility. At June 30, 2018, the allowance is estimated to be zero.

Investment Valuation and Income Recognition – Investments in marketable securities with readily determinable fair values and all investments in debt securities are valued at their fair values on the statement of financial position. Interest income is recognized when earned. Dividend income is recorded on the ex-dividend date. Realized gains and losses on investments are recognized upon the sale of the related investments. Unrealized appreciation or depreciation is recognized at period end when the carrying values of the related investments are adjusted to their estimated fair market value and are included in the change in net assets. Purchases and sales of securities are reflected on a trade-date basis.

Donated Services and Facilities – Donated services are not recorded unless such services create or enhance nonfinancial assets or require specialized skills and are so essential that they would be purchased if not provided by donation. Program service expenses for diabetes health center services include \$2,500 in donated services for the year ending June 30, 2018. A substantial number of volunteers donated hours to the Trust’s program services during the period; however, these donated services are not reflected in the financial statements since the services do not require specialized skills as specified by accounting standards for recognition. Shared expenses for the Trust also included \$3,263 of donated services related to IT assistance.

The Trust receives use of facilities for their general operations. The fair value of donated facilities is determined based on the amount of current rental fees.

Taxes on Income – As a tax-exempt not-for-profit organization, the Trust is exempt from federal income tax under Section 501(c)(3) of the Internal Revenue Code and from state franchise tax under California Revenue and Taxation Code Section 23701(d) but is subject to taxes on unrelated business income when earned.

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Management has considered its tax positions and believes that all the positions taken in its federal and state exempt organization tax returns are more likely than not to be sustained upon examination. The Trust's returns are subject to examination by federal and state taxing authorities, generally for three years and four years, respectively, after they are filed.

Property and Equipment – Property and equipment is recorded at cost, except for donated property which is recorded at fair market value on the date received. Such donations are reported as unrestricted support unless the donor has restricted the donated asset to a specific purpose. Assets donated with explicit restrictions regarding their use and contributions of cash that must be used to acquire property and equipment are reported as restricted support. Absent donor stipulations regarding how long those donated assets are to be maintained, the Trust reports expirations of donor restrictions when the donated or acquired assets are placed in service. The Trust capitalizes property if its value is greater than \$1,000 and its useful life is more than one year. Depreciation is computed using the straight-line method over the estimated useful lives of the assets ranging from three to thirty-nine years. Depreciation expense for the year ended June 30, 2018 was \$9,845.

Functional Allocation of Expenses – The costs of providing program services and other activities have been presented on a functional basis in the Statement of Activities. Accordingly, certain costs have been allocated among the programs and supporting services benefited.

Fair Value of Financial Instruments – The carrying amount of financial instruments, including cash, contributions receivable, accounts payable and accrued expenses approximate their fair values because of the relatively short maturity of these instruments.

Use of Estimates – Preparing the Trust's 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 disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Summarized Comparative Totals – The financial statements include prior-year summarized comparative information in total, but not by net asset class. Such information does not include sufficient detail to constitute a presentation in conformity with accounting principles generally accepted in the United States of America. Accordingly, such information should be read in conjunction with the Trust's financial statements for the year ended June 30, 2017, from which the summarized information was derived.

Recent Accounting Pronouncements – In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2014-09, Revenue from Contracts with Customers (Topic 606). ASU 2014-09 provides a robust framework for addressing revenue recognition issues and, upon its effective date, will replace almost all pre-existing revenue recognition guidance, including industry-specific guidance, in current U.S. generally accepted accounting principles (GAAP). Implementation for non-public entities must occur in years beginning after December 15, 2018. Early application of the amendments in this update is permitted. The Trust has no plan for early implementation of this Statement. At this time the Trust is not certain of the effect the adoption of ASU 2014-09 will have on the accompanying financial statements.

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

On February 25, 2016, the FASB issued Accounting Standards Update (ASU) 2016-02, Leases (Topic 842). Non-public entities are required to adopt the standard for reporting periods beginning after December 15, 2019. All entities may elect to early-adopt. The core principle of the new leases standard is that lessees should recognize assets and liabilities arising from all leases, except for leases with a lease term of 12 months or less. This will significantly gross-up many entities balance sheets. The Trust has no plan for early implementation of this Statement. At this time the Trust is not certain of the effect the adoption of ASU 2016-02 will have on the accompanying financial statements.

On August 18, 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2016-14, Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities, representing the first time since the mid-1990s that financial reporting for not-for-profit organizations has been addressed. While the guidance is effective for fiscal years beginning after December 15, 2017, early adoption is allowed. Key elements of the ASU include a reduction in the number of net asset categories from three to two, conforming requirements on releases of capital restrictions, several new requirements related to expense presentation and disclosure (including investment expenses), and new required disclosures communicating information useful in assessing liquidity. The Trust has no plan for early implementation of this Statement. At this time the Trust is not certain of the effect the adoption of ASU 2016-14 will have on the accompanying financial statements.

In June 2018, the FASB issued ASU 2018-08 Clarifying the Scope and the Accounting Guidance for Contributions Received and Contributions Made. The amendments in this update clarify and improve current guidance about whether a transfer of assets (or the reduction, settlement, or cancellation of liabilities) is a contribution or an exchange transaction. This standard is effective for nonpublic companies for years beginning after December 15, 2018. The Trust has no plan for early implementation of this Statement. At this time the Trust is not certain of the effect the adoption of ASU 2018-08 will have on the accompanying financial statements.

Reclassifications – Certain reclassifications have been made to prior year comparative financial statements to conform with the current year presentation.

Subsequent Events – Subsequent events have been evaluated by the Trust’s management through October 31, 2018, which is the date the financial statements were available to be issued.

NOTE 2. CONCENTRATION OF RISK

The Trust maintains cash in bank accounts at various financial institutions. The balance, at times, exceeds federally insured limits. At June 30, 2018, the Trust’s deposits were fully insured.

The Trust’s investments are exposed to various risks, such as fluctuations in the market and credit risks. Due to the level of risk associated with certain investment securities, it is at least reasonably possible that the changes in the values of investment securities will occur in the near future and that such changes could materially affect the amounts reported in the statement of activities.

NOTE 3. FAIR VALUE MEASUREMENTS

The Trust measures its assets and liabilities at fair value in accordance with the Fair Value Measurements and Disclosures Topic of the FASB Accounting Standards Codification. This guidance defines fair value as 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 and establishes a framework for measuring fair value. The guidance establishes a three-level hierarchy for fair value measurements based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. The guidance expands disclosures about instruments measured at fair value. The guidance applies to other accounting pronouncements that require or permit fair value measurements and, accordingly, the guidance does not require any new fair value measurements. As noted above, the guidance establishes a three-level valuation hierarchy for disclosure of fair value measurements. The valuation hierarchy is based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. The three levels are defined as follows:

- Level 1 – inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities in active markets.
- Level 2 – inputs to the valuation methodology include quoted prices for similar assets or liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the same term of the financial statement.
- Level 3 – inputs to the valuation methodology are unobservable and significant to the fair value measurements.

A financial instrument's categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement.

Following is a description of the Trust's valuation methodologies for assets and liabilities measured at fair value:

Fair value for Level 1 is based upon quoted market prices. Inputs are obtained from various sources including market participants, dealers, brokers and financial institutions.

Fair value for Level 2 investments are determined by reference to quoted market prices for similar investments, yield curves, and other relevant information.

The following table sets forth by level, within the fair value hierarchy, the Trust's assets at fair value as of June 30, 2018:

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Investments, at fair value:				
Money market	\$ 345,454	\$ –	\$ –	\$ 345,454
Common stocks	9,393,937	–	–	9,393,937
Corporate bonds and notes	676,349	–	–	676,349
Preferred securities	4,104	–	–	4,104
Asset backed securities	732,610	–	–	732,610
Mutual funds	1,908,115	–	–	1,908,115
Government securities	512,641	–	–	512,641
ETF Funds	2,015,212	–	–	2,015,212
Alternative investments	–	762,188	–	762,188
Total investments	<u>\$ 15,588,422</u>	<u>\$ 762,188</u>	<u>\$ –</u>	<u>\$ 16,350,610</u>

NOTE 4. INVESTMENTS

Investments were composed of the following at June 30, 2018:

	<u>Cost</u>	<u>Fair Value</u>	<u>Unrealized Gain (Loss)</u>
Money market	\$ 345,454	\$ 345,454	\$ -
Common stocks	8,057,095	9,393,937	1,336,842
Corporate bonds and notes	701,702	676,349	(25,353)
Preferred securities	4,209	4,104	(105)
Asset backed securities	758,713	732,610	(26,103)
Mutual funds	2,004,629	1,908,115	(96,514)
Government securities	515,655	512,641	(3,014)
ETF Funds	1,791,459	2,015,212	223,753
Alternative investments	770,487	762,188	(8,299)
Total investments	<u>\$ 14,949,403</u>	<u>\$ 16,350,610</u>	<u>\$ 1,401,207</u>

The following schedule summarizes investment returns and its classification in the statement of activities for the year ended June 30, 2018:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Interest/dividend income	\$ 447,358	\$ 39,776	\$ -	\$ 487,134
Realized/unrealized gains (losses) on investments	641,779	80,991	-	722,770
Investment fees	<u>(150,151)</u>	<u>(13,774)</u>	<u>-</u>	<u>(163,925)</u>
Total net investment income	<u>\$ 938,986</u>	<u>\$ 106,993</u>	<u>\$ -</u>	<u>\$ 1,045,979</u>

NOTE 5. FISCAL SPONSORSHIP

In September of 2015, the Trust entered into a fiscal sponsorship agreement with Mesa Verde Gardens (MVG). Under the terms of the agreement, an administrative fee of 8% of gross revenue is paid to the Trust with a maximum amount of \$15,000 per year. The length of the agreement was for one year with the option to renew for successive one-year terms. The Trust extended the agreement for a one-year term on May 10, 2018.

As part of the agreement, the Trust controls all revenue, accounts payable and receivable, leases and contracts, disbursement of MVG funds (including grants), and other activities to further the MVG mission. Currently, the Trust has a payable amount due to MVG for funds received in excess of expenses paid of \$134,435.

The Trust signed various lease agreements on behalf of MVG for use of land and water utilities. The amounts of these leases are for various terms and the amounts are nominal and immaterial to the financial statements as a whole and therefore are not disclosed.

NOTE 6. OPERATING LEASES

The Trust leases facilities at 85 Nielson Street in Watsonville, under a nine-year lease, which commenced September 8, 1998. The original agreement called for monthly rent of \$1,250, with a provision for a CPI increase after 5 years. It renews automatically for successive nine-year terms at the end of the initial term and at the end of every successive term, through a maximum of nine extension terms, unless terminated earlier.

The Trust occupies an additional 12,782 square feet, rent free, under an arrangement with Community Health Systems. The fair market value of this space is \$1.61 per square foot annually, totaling \$246,948. This amount is recorded both as revenue and expense in the accompanying Statement of Activities.

The Trust also leases office equipment under non-cancelable leases.

The following is a schedule by years and in the aggregate of future minimum rental payments under operating leases that have initial or remaining non-cancelable lease terms in excess of one year for the years ending June 30:

2019	\$	21,047
2020		19,318
2021		19,318
2022		19,318
2023		19,318
2024		<u>22,538</u>
Total	\$	<u>120,857</u>

Total rental expense charged to operations for the year ended June 30, 2018 was \$22,282.

NOTE 7. ADJUSTMENTS RELATED TO SALE OF HOSPITAL ASSETS

As described in Note 1, on September 1, 1998 the operating assets of Watsonville Community Hospital, consisting principally of the hospital building, furniture and equipment, and working capital, were sold to CHS under an asset sale agreement. The agreement also provided that the Trust would be liable for certain liabilities and entitled to receive certain other assets. The Trust refers to these liabilities and entitlements as "discontinued hospital business." The Trust has a workers' comp liability of \$52,965 related to discontinued operations. This liability is calculated based on actuarial assumptions on the claims outstanding.

Since the asset sale date, the Trust has actively tracked and recorded yearly discontinued hospital business activity, meeting its liability obligations under the asset sale agreement and collecting discontinued hospital business revenues as they become available.

Many of the transactions described below are estimates based on the best information currently available, and are subject to change in the near term. The reserve associated with the self-insured workers' compensation plan is subject to change according to the results of audits of outstanding claims performed by the State of California Department of Industrial Relations. The liabilities for MediCare and MediCal are subject to change according to steps taken by the Trust to resolve outstanding cases.

NOTE 7. ADJUSTMENTS RELATED TO SALE OF HOSPITAL ASSETS (Continued)

The principal transactions and adjustments made during the 2018 fiscal year are as follows:

Adjust reserve associated with self-insured workers' compensation plan	\$ 21,884
Salary and personnel related expenses	(11,908)
Workers' compensation claims and settlements, net of refunds	(9,799)
Facilities and equipment	(15,593)
Other costs	<u>(99,859)</u>
Total	<u>\$ (115,275)</u>

NOTE 8. BOARD DESIGNATED NET ASSETS

Board designated net assets consist of unrestricted funds received from donors that are to be used for future use in operations in accordance with a board approved plan of action. Prior to establishing the Rather Endowment Fund, gifts received in memory of Mr. Phil Rather were treated as board designated, but they were actually intended for the Phil Rather Endowment. There has never been a motion and vote of the board to formally move these funds into the Phil Rather Endowment. In February 2018, the Board voted to move board designated assets of \$11,395 to the Rather Endowment fund, per the donor's intentions.

NOTE 9. TEMPORARILY RESTRICTED NET ASSETS

For the year ended June 30, 2018, activity in temporarily restricted net assets was as follows:

	Balance <u>6/30/2017</u>	Additions	Satisfied	Balance <u>6/30/2018</u>
Diabetes Health Center	\$ 28,330	\$ 167,680	\$ (182,123)	\$ 13,887
Regional Diabetes Collaborative	-	115,350	(18,355)	96,995
Dental Health Center Services	8,548	6,350	(840)	14,058
General	<u>361,185</u>	<u>83,766</u>	<u>(11,082)</u>	<u>433,869</u>
	<u>\$ 398,063</u>	<u>\$ 373,146</u>	<u>\$ (212,400)</u>	<u>\$ 558,809</u>

NOTE 10. ENDOWMENT

At June 30, 2018, the Trust had four permanently restricted endowment funds totaling \$1,126,160, which were established for a variety of purposes.

The Founders' Fund was contributed by the Watsonville Community Hospital Foundation (see Note 1). Under the terms of the contribution the original donation must be kept in perpetuity and the earnings are available to fund health programs for seniors and children (temporarily restricted). These permanently restricted net assets totaled \$687,953.

The General Endowment Fund totaled \$193,720 as of June 30, 2018 and is composed of a bequest from the Frank F. Orr and Zoe Ann Orr Fund and individual contributions. The original donations must be kept in perpetuity and the earnings are available for the unrestricted use of the Trust.

In 2005, the Phil Rather Endowment Fund was established with an initial contribution of \$2,125. Under the terms of the contribution the earnings are available to fund the Diabetes Health Center. At June 30, 2018, the Phil Rather Endowment Fund totaled \$77,644.

In 2010, the Ralph Flood "Healthy lifestyles" Fund was established with a contribution of \$100,000. Under the terms of the contribution the original donation must be kept in perpetuity and the earnings are available to fund services that help prevent obesity and diabetes in Pajaro Valley children. At June 30, 2018, the Ralph Flood Endowment Fund totaled \$100,000.

In 2011, the Dental Health Fund was established with an initial contribution of \$5,000. Under the terms of the contribution the original donation and earnings for the first five years must be kept in perpetuity. After the first five years, the earnings are available as prescribed by the endowment spending policy to support dental health programs and projects approved by the Health Trust Board of Directors and for the benefit of low-income Pajaro Valley Residents. At June 30, 2018, the Dental Health Fund totaled \$66,843.

As required by GAAP, net assets associated with endowment funds are classified and reported based on the existence or absence of donor-imposed restrictions.

Interpretation of Relevant Law

The trust's Board of Directors has interpreted the Uniform Prudent Management of Institutional Funds Act (UPMIFA) as requiring the preservation of the fair value of the original gift as of the date of the donor-restricted endowment funds absent explicit donor stipulations to the contrary. As a result of this interpretation, the Trust classifies as permanently restricted net assets (a) the original value of gifts donated to the permanent endowment, (b) the original value of subsequent gifts to the permanent endowment and (c) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund. The remaining portion of the donor restricted endowment fund that is not classified as permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by the Trust in a manner consistent with

NOTE 10. ENDOWMENT (Continued)

the standard of prudence prescribed by UPMIFA. In accordance with UPMIFA, the Trust considers the following factors in making a determination to appropriate or accumulate donor restricted endowment funds:

- (1) The duration and preservation of the fund
- (2) The purposes of the Trust and the donor-restricted endowment fund
- (3) General economic conditions
- (4) The possible effect on inflation and deflation
- (5) The expected total return from income and the appreciation of investments
- (6) Other resources of the Trust
- (7) The investment policies of the Trust

Spending/Investment Policies

The Trust has adopted investment and spending policies, approved by the Board of Trustees, for endowment assets that attempt to provide a predictable stream of funding to programs supported by its endowment while seeking to maintain the purchasing power of these endowment assets over the long-term. The Trust spending and investment policies work together to achieve this objective. The investment policy establishes a goal of the aggregate endowment assets to equal or exceed an absolute rate of return of 8.0%. Actual returns in any given year may vary from this amount. To satisfy its long-term rate-of-return objectives, the Trust relies on a total return strategy in which investment returns are achieved through both capital appreciation and dividend and interest income. The Trust targets a diversified asset allocation that places emphasis on equity-based and government securities to achieve its long-term objectives within prudent risk parameters.

Unless specified by the original gift, the spending policy calculates the amount of money annually distributed from the Trust's various endowed funds, for grant making and administration. The current spending policy is to distribute an amount equal to 4% calculated based on a 12-quarter moving average of the fair value of the endowment funds. Accordingly, over the long term, the Trust expects its current spending policy to allow its endowment assets to grow at an average rate of 4% annually. If a particular fund has no accumulated earnings at the time of the spending policy calculation, that fund will not be able to participate in grant making or appropriations for the upcoming year.

Asset Allocation Limitations – Domestic equities 40% – 60%, target 45%; International Equities 10% – 25%, target 25%; Fixed Income Intermediate 25% – 50%, target 25%; Liquid Alternatives 0% – 20%, target 5%.

NOTE 10. ENDOWMENT (Continued)**Endowment Net Asset Composition**

Endowment net asset composition as of June 30, 2018:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Donor restricted endowments:				
Founders Fund	\$ —	\$ 342,261	\$ 687,953	\$ 1,030,214
Frank Ann Orr	—	91,607	193,720	285,327
Rather Fund	—	—	77,644	77,644
Ralph Flood	—	650	100,000	100,650
Dental Health Fund	—	14,058	66,843	80,901
Total donor restricted	—	448,576	1,126,160	1,574,736
Board designated endowment	—	—	—	—
Total endowments	<u>\$ —</u>	<u>\$ 448,576</u>	<u>\$ 1,126,160</u>	<u>\$ 1,574,736</u>

Changes in Endowment Net Assets

Changes in endowment net assets for the year ended June 30, 2018:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Balance at Beginning of Year	\$ 11,395	\$ 398,063	\$ 1,108,390	\$ 1,517,848
Investment return:				
Investment income	—	39,775	—	39,775
Realized gain (loss)	—	45,441	—	45,441
Unrealized gain (loss)	—	35,552	—	35,552
Total donor restricted	—	120,768	—	120,768
Contributions	—	—	17,770	17,770
Financial advisor fees	—	(13,775)	—	(13,775)
Transfer of board designated endowment	(11,395)	—	—	(11,395)
Appropriation of endowment assets for expenditure	—	(56,480)	—	(56,480)
Total endowments	<u>\$ —</u>	<u>\$ 448,576</u>	<u>\$ 1,126,160</u>	<u>\$ 1,574,736</u>

NOTE 11. DEFINED CONTRIBUTION RETIREMENT PLAN

The Pajaro Valley Community Health Trust Retirement Plan is a tax-sheltered annuity plan under Section 403(b) of the Internal Revenue Code. It has been established for all employees of the Trust as a Trust-paid benefit. Employees of the Trust, if not covered by another plan, become eligible after three months of employment. Employee accounts are 100% vested after one year of employment.

The Trust contributes between five to eight percent of each eligible employee's gross wages on a monthly basis. Eligible employees may contribute any amount up to the legal limit on a voluntary payroll deduction basis, although no voluntary contribution is required. Contributions made by the Pajaro Valley Community Health Trust for the year ended June 30, 2018, on behalf of eligible employees, totaled \$33,552.