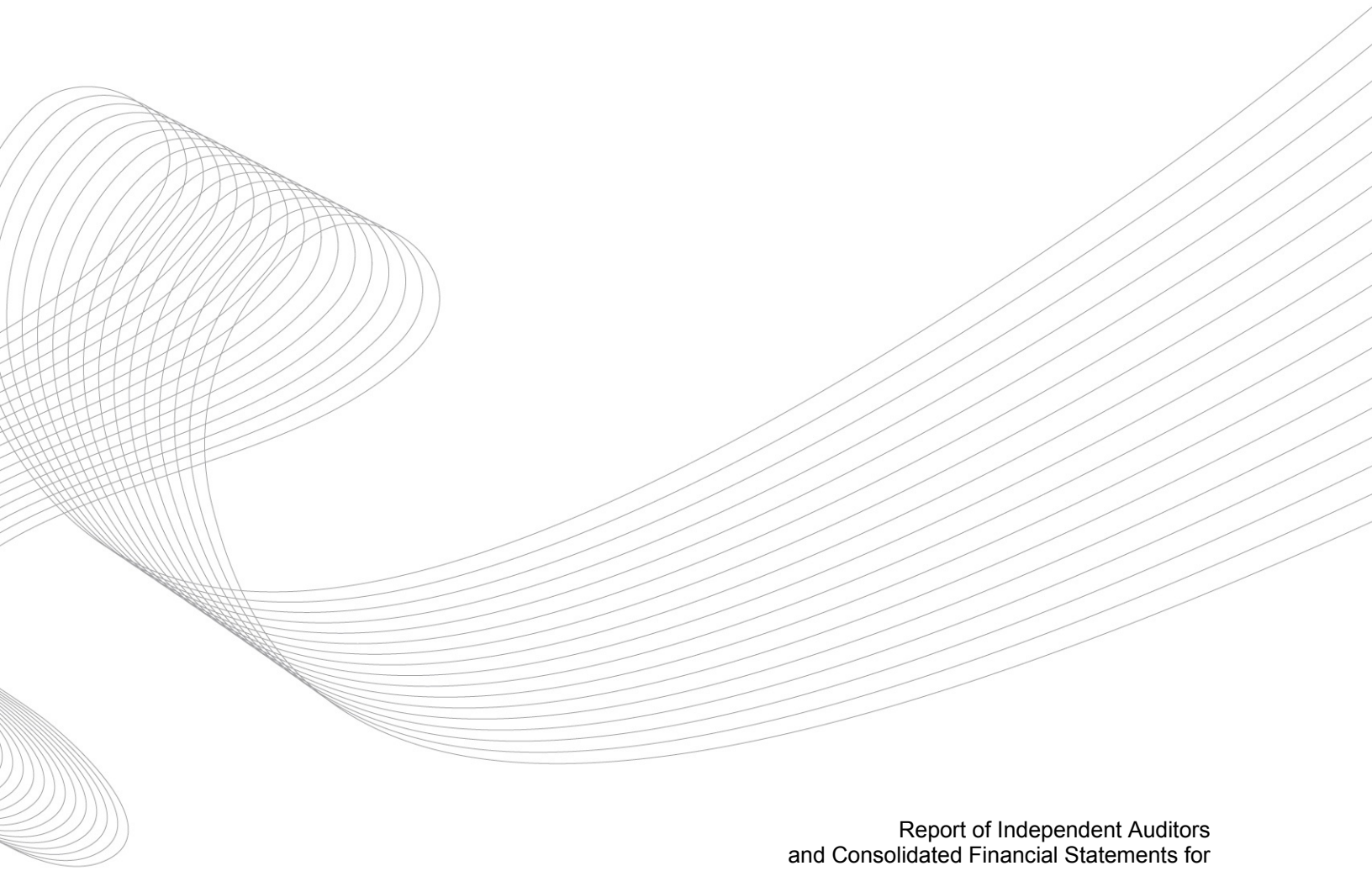

Report of Independent Auditors
and Consolidated Financial Statements for

Antelope Valley Healthcare District

June 30, 2013 and 2012

MOSS-ADAMS LLP

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REPORT OF INDEPENDENT AUDITORS

The Board of Directors
Antelope Valley Healthcare District

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of Antelope Valley Healthcare District (the "District") as of and for the years ended June 30, 2013 and 2012, and the related notes to the consolidated financial statements, which collectively comprise the District's basic consolidated financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express opinions on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. 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 District'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 opinions.

Opinions

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Antelope Valley Healthcare District as of June 30, 2013 and 2012, and the changes in financial position and cash flows thereof for the years then ended in accordance with accounting principles generally accepted in the United States of America.

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Emphasis of Matter

As discussed in Note 1 to the financial statements, for the year ended June 30, 2013, the District adopted new accounting guidance that reflects certain changes to the presentation and the reclassification of certain accounts due to the implementation of Governmental Accounting Standards Board Statement No. 61, *The Financial Reporting Entity: Omnibus—an amendment of GASB Statements No. 14 and No. 34.* Our opinions are not modified with respect to these matters.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that management's discussion and analysis on pages 4 through 10 and the schedules of funding progress for the District's defined benefit pension plan and postretirement health plan on page 44 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Information

Our audit was conducted for the purpose of forming opinions on the financial statements that comprise Antelope Valley Healthcare District's basic financial statements. The consolidating schedules on pages 45 through 50 and schedule of expenditures of federal awards as required by Office of Management and Budget Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations, and other information, such as the schedule of charity care and community benefit, are presented for purposes of additional analysis and are not a required part of the basic financial statements.

The consolidating schedules and schedule of expenditures of federal awards is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the consolidating schedules and schedule of expenditures of federal awards is fairly stated, in all material respects, in relation to the basic financial statements as a whole.

The schedule of charity care and community benefit on page 51 has not been subjected to the auditing procedures applied in the audit of the basic financial statements, and accordingly, we do not express on opinion or provide any assurance on it.

MOSS-ADAMS LLP

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated November 26, 2013 on our consideration of Antelope Valley Healthcare District's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering Antelope Valley Healthcare District's internal control over financial reporting and compliance.

Moss Adams LLP

Los Angeles, California
November 26, 2013

This section of Antelope Valley Healthcare District's (the District) financial statements presents management's discussion and analysis of the financial activities of the District for the fiscal years ended June 30, 2013, 2012, and 2011. We encourage the reader to consider the information presented here in conjunction with the financial statements as a whole.

Introduction to the Financial Statements

This discussion and analysis is intended to serve as an introduction to the District's audited financial statements. This annual report is prepared in accordance with the Governmental Accounting Standards Board (GASB) Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments*. The required financial statements include the Statement of Net Position; the Statement of Revenues, Expenses, and Changes in Net Position; and the Statement of Cash Flows. Notes to the financial statements, supplementary detail and/or statistical information, and this summary support these statements. All sections must be considered together to obtain a complete understanding of the financial picture of the District.

Statement of Net Position

This statement includes all assets and liabilities using the accrual basis of accounting as of the statement date. The difference between the two classifications is represented as "Net Position"; this section of the statement identifies major categories of restrictions on these assets and reflects the overall financial position of the District as a whole.

Statement of Revenues, Expenses, and Changes in Net Position

This statement presents the revenues earned and the expenses incurred during the year using the accrual basis of accounting. Under the accrual basis, all increases or decreases in net position are reported as soon as the underlying event occurs, regardless of the timing of the cash flow. Consequently revenues and/or expenditures reported during this fiscal year may result in changes to cash flows in a future period.

Statement of Cash Flow

This statement reflects inflows and outflows of cash, summarized by operating, capital, financing, and investing activities. The direct method was used to prepare this information, which means gross rather than net amounts were presented for the year's activities.

Notes to the Financial Statements

This additional information is essential to a full understanding of the data reported in the financial statements.

The District is a political subdivision of the state of California organized and existing under the provisions of the Local Health Care District Law of the state of California. The District is located in Lancaster, California, and is governed by a five-member Board of Directors elected by voters within the District. Unless otherwise indicated, in the management's discussion and analysis section, amounts are in thousands.

The District's Net Position

The District's net position represents the difference between its assets and liabilities reported in the statements of net position. The District's net position increased by $3,597 or 3.1% in 2013 over 2012, and increased by $3,610 or 3.3% in 2012 over 2011 as shown in Table 1.

Table 1: Assets, Liabilities and Net Position as of June 30 (in thousands):

	2013	2012	2011
ASSETS			
Patient accounts receivable, net	$ 48,954	$ 39,128	$ 38,867
Other current assets	78,150	68,017	75,443
Capital assets, net	169,273	160,581	141,847
Other noncurrent assets	73,626	98,480	98,952
Total assets	$ 370,003	$ 366,206	$ 355,109
LIABILITIES			
Long-term debt (including current portion)	$ 135,684	$ 141,113	$ 144,249
Other current and noncurrent liabilities	116,564	110,935	100,312
Total liabilities	252,248	252,048	244,561
NET POSITION			
Net investment in capital assets	53,044	47,440	37,062
Restricted, expendable	690	838	855
Restricted, nonexpendable	561	982	1,155
Unrestricted	63,460	64,898	71,476
Total net position	$ 117,755	$ 114,158	$ 110,548

The following is an explanation of the significant changes between fiscal years as show in Table 1:

Changes from fiscal 2012 to 2013

Patient accounts receivable, net increased $9,826 or 25.1% from 2012 to 2013 mainly due to a shift in payor mix, specifically related to an increase in patients qualifying for governmental programs in 2013 as compared to 2012 as evidenced by a decline in charity care write offs of $13,058 from 2012 to 2013, and an increase in net patient service revenue, exclusive of other supplemental funding and changes in cost report settlement estimates, of $4,855 from 2012 to 2013.

Other current assets increased $10,133 or 14.9% from 2012 to 2013 mainly due to funding from the Intergovernmental Transfer (IGT) program and increased cost report settlement amounts receivable resulting from Budget Neutrality appeals with the Centers for Medicare and Medicaid Services (CMS). As of June 30, 2013, amounts receivable for IGT funding and Budget Neutrality settlements totaled $5,673 and $3,306, respectively. As of June 30, 2012, amounts related to IGT funding were received prior to June 30, 2012 and as such, no accrual was recorded. No amounts were received in 2012 related to Budget Neutrality.

The District's Net Position (continued)

Capital assets, net increased $8,692 or 5.4% from 2012 to 2013. This was due to the District's Master Plan renovation and other projects. *Other noncurrent assets* decreased $24,854 or 25.2% from 2012 to 2013. This was due to use of bond funds of $8,517 for the District's Master Plan renovation projects, and $16,100 in expenditures for hospital operations.

Changes from fiscal 2011 to 2012

Other current assets decreased $7,426 or 9.8% from 2011 to 2012 mainly due a decrease in short-term investments and corresponding increase in long-term investments of $6,170 (included in other noncurrent assets). The increase in long-term investments was offset by a decrease in trustee held funds used for capital projects, resulting in a net decrease in *other noncurrent assets* of $472 from 2011 to 2012.

Capital assets, net increased $18,734 or 13.2% from 2011 to 2012. This was mainly due to Master Plan Projects of $13,631, land purchase of $3,004 and equipment purchases of $2,000.

Operating Results and Changes in the District's Net Position

Table 2: Operating Results and Changes in Net Position for the years ended June 30 (in thousands)

	2013	2012	2011
OPERATING REVENUE			
Net patient service revenue	$ 350,481	$ 345,341	$ 353,959
Other	4,344	4,666	6,063
Total operating revenues	354,825	350,007	360,022
OPERATING EXPENSES			
Salaries and wages and employee benefits	207,689	214,622	214,164
Purchased services and professional fees	50,310	41,192	40,226
Other operating expenses	79,626	78,264	74,007
Depreciation and amortization	12,679	12,524	11,860
Total operating expenses	350,304	346,602	340,257
OPERATING INCOME	4,521	3,405	19,765
NONOPERATING REVENUES (EXPENSES)			
Grant revenue and contributions	4,054	4,125	4,885
Investment income	506	1,316	1,445
Interest expense	(5,486)	(5,236)	(5,209)
Total nonoperating expenses, net	(926)	205	1,121
CAPITAL CONTRIBUTIONS	-	-	344
Change in net position	$ 3,595	$ 3,610	$ 21,230

Operating Results and Changes in the District's Net Position (continued)

The following is an explanation of the significant changes between fiscal years as show in Table 2:

The first component of the overall change in the District's net position is its operating income that is generally the result of the difference between net patient service revenue and other operating revenues and the expenses incurred to perform those services. Operating income increased by $1,116 or 32.8% in 2013 as compared to 2012 and decreased $16,360 or 82.8% from 2011 to 2012. The primary components of the changes in operating income are as follows:

Changes from fiscal 2012 to 2013

Net patient service revenue for the District increased by $5,140 or 1.5% in 2013 as compared to 2012. While the District reported a net decrease in acute patient days of 0.3% from 2013 as compared to 2012, the District realized a 1.6% increase in net patient service revenue per adjusted patient day. The District recognized revenue from various supplemental funding sources including the IGT Program, Disproportionate Share funding, and the Hospital Fee Program totaling $28,121 and $32,288 in 2013 and 2012, respectively. The decrease in supplemental funding and acute patient days was primarily offset by changes in estimates on estimated third party payor settlements in 2013 of $5,400, resulting in an overall increase in net patient service revenue.

Operating expenses increased $3,702 or 1.1% in 2013 as compared to 2012. The District paid $5,621 into the IGT Program in 2013 compared to $7,963 in 2012 which is included in other operating expenses in Table 2. S*alaries and wages and employee benefits* decreased by $6,933 or 3.2% from 2012 to 2013 primarily due to decreased volumes although the decrease included union representation for which annual increases were negotiated. Also, an annual increase in compensation levels was approved for employees not represented by the unions. *Purchased services and professional fees* increased $9,118 or 22.1% in 2013 as compared to 2012 due to an increase of $5,954 in contract labor (including registry), an increase of $971 in professional fees (including on-call fees paid to physicians), an increase in legal fees of $832 (including fees associated with union negotiations) and $328 for other contracts.

Changes from fiscal 2011 to 2012

Operating income decreased by $16,360 or 82.8% in 2012 as compared to 2011. The primary components of the decrease in operating income are:

A decrease in *operating revenues* for the District of $10,358 or 2.9% in 2012 as compared to 2011. In 2012 the District received additional funds from the IGT Program of $15,990 and an additional $1,927 in Hospital Fee Program funds. This was an $8,953 decrease from amounts received 2011, in which the District received $18,908 in Hospital Fee Program funds. No IGT Program funds were received in 2011.

An increase in *operating expenses* for the District of $6,395 or 1.9% in 2012 as compared to 2011. In 2012 the District paid $7,963 into the IGT Program which was recorded to other operating expenses. No such payments were made in 2011.

Formatting Differences to Consider When Comparing the District's Statement of Revenues, Expenses, and Changes in Net Position to Other Nongovernment Hospitals

The Governmental Accounting Standards Board ("GASB") requires a grouping on the statements of revenues, expenses, and changes in net position, which grouping differs from other non-governmental hospitals as follows: non-operating revenues, net includes interest expense, which, in non-governmental hospitals is grouped as an operating expense. This GASB grouping requirement makes District hospitals conform to other government entities, such as cities and counties. Because of this difference, the District's published statements of revenues, expenses, and changes in net position is not readily comparable to other non-governmental hospitals because the GASB grouping requirement does not apply to non-governmental hospitals. This must be considered in order to compare the District to other non-governmental hospitals.

The District's Cash Flows

Net cash provided by operating activities decreased $25,124 or 87.9% from 2012 to 2013 mainly due to the increase in net patient accounts receivable and changes in estimated third party payor settlements. See Note 16, Hospital Fee Program. In 2012, net cash provided by operating activities increased mainly due to the decrease in patient accounts receivable and the increase in accounts payable and accrued expenses. In 2011, net cash provided by operating activities increased mainly due to the increased operating income, decrease in patient accounts receivable and the increase in accounts payable and accrued expenses.

Capital Asset and Debt Administration Capital Assets

At the end of 2013, 2012 and 2011, respectively, the District had $169,273, $160,581 and $141,847 in capital assets, net of accumulated depreciation, as detailed in Note 6 to the consolidated financial statements. The District purchased new equipment, particularly for information technology and related infrastructure, costing $1,697 in 2013, $5,483 in 2012 and $5,412 in 2011. Also during 2013, 2012 and 2011, $19,403, $25,463 and $10,284, respectively, was expended on land, buildings and improvements for the District Master Plan renovation, which includes upgrades to the Central Plant, Catheterization Lab expansion, Canopy addition and new parking lot redesign.

Debt

The District had $135,684, 141,113 and $144,249 at June 30, 2013, 2012 and 2011, respectively, in revenue bonds outstanding, notes payable and capital lease obligations outstanding, as detailed in Note 10 to the consolidated financial statements. The District entered into new capital lease obligations totaling $407 in 2013, and new notes payable, capital lease obligations and revenue bonds totaling $2,631 in 2012 and $44,764 in 2011. The District's formal debt issuances are subject to limitations imposed by state law. In July 2013, Moody's affirmed the District's Baa3 rating with an outlook of negative.

Economic Factors on the Fiscal Year 2013 Budget and Beyond

The next two to five years will see additional significant capital expenditures on the seismic retrofits and building of new facilities, necessary purchase and upgrading of the District's Information Systems to meet Meaningful Use requirements, and continued need to replace outdated equipment.

The challenge of meeting these capital needs becomes more difficult as reimbursement for services continues to decline. On the federal level, the provisions of the Affordable Care Act have already begun and cuts from the sequestration were experienced in fiscal year 2013. Penalties and loss of Medicare reimbursement for re-admissions and value based purchasing will continue to increase each year. Other penalties and loss of reimbursement for poor quality measures and patient experience are on the horizon.

On the State level, the California legislature continues to change reimbursement laws and regulations to create continued uncertainty over future healthcare reimbursement. Medi-Cal reimbursement has been reduced significantly with across-the-board rate cuts and the State is moving to several new methods of reimbursement in 2014 which will further reduce reimbursement on a go-forward basis. The effects of these reductions are considered particularly troublesome with the expected Medi-Cal expansion from the introduction of the State exchanges.

A long standing challenge for the District is a weak local economy and challenging payer mix. Unfunded legislation mandated by the state of California relative to staffing ratios, and increased clinical quality and safety standards that are tied to government reimbursement contributes to higher staffing costs, increased uncompensated care expense, and lower reimbursement. Statutory regulations applied to workers' compensation insurance benefits in the state of California over the past few years continue to adversely affect the District's workers' compensation costs despite the District's continued focus on overall employee health and safety. Growing medical costs has resulted in increased employee medical insurance expense, although the District has tried to mitigate some of the costs by moving to a self-insured plan.

Health Insurance Portability and Accountability Act

Beginning in 2001, the District made the conversion to comply with the Health Insurance Portability and Accountability Act (HIPAA) enacted by the federal government. The District has successfully made the appropriate changes in forms, processes and operations to fully comply with the Regulations. The broad categories of HIPAA regulation compliance include: Privacy, Security, and Electronic Transactions. The process also includes education at various levels throughout the organization on the importance of patient privacy and protection of the patient health information.

Upgrades to our patient information system have already been installed to meet privacy and security requirements. Contracts have been negotiated to install upgrades to meet the transaction code set requirements. The information systems infrastructure has been updated and will continue to be reviewed to ensure continuing compliance of the HIPAA law. Organizations are subject to significant fines and penalties if found not to be compliant with the provisions outlined in the regulations.

Contacting the District's Financial Management

This financial report is designed to provide the District's patients, suppliers, community members and creditors with a general overview of the District's finances and to show the District's accountability for the money it receives. Questions about this report and requests for additional financial information should be directed to the District's administration by telephoning 661.949.5533.

ANTELOPE VALLEY HEALTHCARE DISTRICT
CONSOLIDATED STATEMENTS OF NET POSITION

	June 30, 2013	June 30, 2012
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	$ 10,520,648	$ 9,677,332
Short-term investments	45,172,239	43,301,821
Restricted cash and investments, current	3,207,016	3,500,557
Patient accounts receivable, net of estimated uncollectible accounts of $39,933,623 in 2013 and $30,340,781 in 2012	48,953,512	39,127,540
Other receivables, net of estimated uncollectible accounts of $739,701 in 2013 and $431,403 in 2012	4,655,423	4,276,469
Supplies	5,241,785	4,850,647
Prepaid expenses and other assets	2,437,045	2,410,983
Estimated third-party payor settlements	6,915,885	-
Total current assets	127,103,553	107,145,349
NONCURRENT CASH AND INVESTMENTS		
Held by trustee for debt service	19,454,601	27,971,624
Less amounts required to meet current obligations	2,378,511	2,456,557
	17,076,090	25,515,067
Other long-term investments	54,291,004	70,309,957
Total noncurrent cash and investments	71,367,094	95,825,024
CAPITAL ASSETS, net	169,273,284	160,581,098
OTHER ASSETS, net	2,259,026	2,654,858
Total noncurrent assets	242,899,404	259,060,980
TOTAL ASSETS	$ 370,002,957	$ 366,206,329

See accompanying notes.

ANTELOPE VALLEY HEALTHCARE DISTRICT
CONSOLIDATED STATEMENTS OF NET POSITION (CONTINUED)

	June 30, 2013	June 30, 2012
LIABILITIES AND NET POSITION		
CURRENT LIABILITIES		
Accounts payable and accrued liabilities	$ 18,325,012	$ 13,981,450
Accrued payroll and related expenses	20,915,382	19,755,874
Current maturities of long-term debt	6,692,560	6,677,466
Accrued workers' compensation and professional liability claims, current portion	5,515,000	5,399,000
Accrued interest payable	2,378,511	2,456,557
Estimated third-party payor settlements	-	4,542,591
Total current liabilities	53,826,465	52,812,938
LONG-TERM DEBT, net of current portion	128,991,607	134,435,124
ACCRUED WORKERS' COMPENSATION AND PROFESSSIONAL LIABILITY CLAIMS, net of current portion	14,521,142	15,546,141
PENSION AND OPEB LIABILITIES	54,909,160	49,253,322
Total liabilities	252,248,374	252,047,525
NET POSITION		
Net investment in capital assets	53,043,718	47,440,132
Restricted, expendable for:		
Workers' compensation collateral	44,133	44,000
Specific operating activities	645,564	794,348
Restricted, non-expendable for minority interests	561,346	982,495
Unrestricted	63,459,822	64,897,829
Total net position	$ 117,754,583	$ 114,158,804

See accompanying notes.

ANTELOPE VALLEY HEALTHCARE DISTRICT
CONSOLIDATED STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET POSITION

	Years Ended June 30,	
	2013	2012
OPERATING REVENUES		
Net patient service revenue, net of provision for uncollectible accounts of $34,794,160 in 2013 and $31,907,201 in 2012	$ 350,481,189	$ 345,341,111
Other revenue	4,343,933	4,665,873
Total operating revenues	354,825,122	350,006,984
OPERATING EXPENSES		
Salaries and wages	158,413,694	162,523,775
Employee benefits	49,275,357	52,098,298
Fees to individuals and organizations	29,270,246	21,558,724
Purchased services	21,039,935	19,633,725
Supplies and other expenses	79,625,065	78,262,748
Depreciation and amortization	12,679,331	12,524,256
Total operating expenses	350,303,628	346,601,526
OPERATING INCOME	4,521,494	3,405,458
NONOPERATING REVENUES (EXPENSES)		
Grant revenue and contributions	4,054,380	4,125,214
Investment income	505,753	1,316,136
Interest expense	(5,485,848)	(5,236,199)
Total nonoperating expenses, net	(925,715)	205,151
Change in net position	3,595,779	3,610,609
NET POSITION, Beginning of year, as adjusted (Note 1)	114,158,804	110,548,195
NET POSITION, End of year, as adjusted	$ 117,754,583	$ 114,158,804

See accompanying notes.

ANTELOPE VALLEY HEALTHCARE DISTRICT
CONSOLIDATED STATEMENTS OF CASH FLOWS

	Years Ended June 30,	
	2013	2012
CASH FLOWS FROM OPERATING ACTIVITIES		
Receipts from and on behalf of patients	$ 328,981,160	$ 348,777,657
Payments to suppliers and contractors	(178,176,734)	(168,687,300)
Payments to employees	(151,598,348)	(156,122,664)
Other receipts and payments, net	4,253,392	4,615,814
Net cash provided by operating activities	3,459,470	28,583,507
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Receipts from grants and contributions	4,007,007	4,262,158
Net cash provided by noncapital financing activities	4,007,007	4,262,158
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Acquisition and construction of capital assets	(17,018,400)	(25,561,719)
Principal repayments on long-term debt	(5,835,153)	(5,768,275)
Interest payments on long-term debt	(7,156,414)	(6,629,752)
Net cash used in capital and related financing activities	(30,009,967)	(37,959,746)
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchases of investments	(152,369,536)	(65,575,421)
Proceeds from sale of investments	175,250,589	61,478,654
Interest and dividends received on investments	505,753	1,316,135
Net cash provided by (used in) investing activities	23,386,806	(2,780,632)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	843,316	(7,894,713)
CASH AND CASH EQUIVALENTS, Beginning of year	9,677,332	17,572,045
CASH AND CASH EQUIVALENTS, End of year	$ 10,520,648	$ 9,677,332

See accompanying notes.

ANTELOPE VALLEY HEALTHCARE DISTRICT
CONSOLIDATED STATEMENTS OF CASH FLOWS (CONTINUED)

	Years Ended June 30, 2013	2012
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	$ 4,521,494	$ 3,405,458
Adjustments to reconcile operating income to net cash provided by operating activities:		
Provision for bad debts	34,794,160	31,907,201
Depreciation and amortization	12,679,331	12,524,256
(Gain) loss on disposal of assets	90,541	50,059
Changes in assets and liabilities:		
Patient accounts receivable, net	(44,620,132)	(32,167,540)
Other receivables, net	(331,581)	1,385,716
Supplies and prepaid expenses	(417,200)	1,365,197
Other assets	(56,638)	799,071
Accounts payable and accrued liabilities	2,351,624	(1,271,455)
Accrued payroll and related expenses	1,159,508	868,364
Accrued workers' compensation and professional liability claims	(908,999)	3,672,264
Pension and OPEB liabilities	5,655,838	5,532,747
Estimated third-party payor settlements	(11,458,476)	512,169
Net cash provided by operating activities	$ 3,459,470	$ 28,583,507
NONCASH INVESTING, CAPITAL, AND FINANCING ACTIVITIES		
Capital expenditures included in accounts payable	$ 1,021,765	$ 173,405
Capital assets acquired through capital leases	$ 406,730	$ 2,631,477
Accrued capital expenditures	$ 970,173	$ 854,541

See accompanying notes.

Note 1 - Nature of Operations and Reporting Entity

Antelope Valley Healthcare District (the "District") is a health care district and political subdivision of the state of California organized and existing under the provisions of the Local Health Care District Law of the state of California. The District is located in Lancaster, California, and is governed by a five-member Board of Directors elected by voters within the District.

The District primarily earns revenues by providing inpatient, outpatient and emergency care services to patients in the Antelope Valley, High Desert and eastern Sierra areas. It also operates a home health agency in the same geographic areas.

Effective July 1, 2013, the District adopted GASB Statement No. 61, *The Financial Reporting Entity: Omnibus—an amendment of GASB Statements No. 14 and No. 34.* Significant impacts include modified criteria for evaluating component units and reclassifying the presentation of equity interests for minority participants in a blended component unit as a component of restricted net position, nonexpendable which had previously been reported as a liability on the statements of net position. The retroactive effects for implementing the change in reporting resulted in a change in beginning net position as set forth below:

	2012	
	Net Position	Minority Interests
As previously reported	$ 113,176,309	$ 982,495
Adjustment to recognize minority interests as a component of restricted net position	982,495	(982,495)
As adjusted	$ 114,158,804	$ -

	2011	
	Net Position	Minority Interests
As previously reported	$ 109,393,090	$ 1,155,105
Adjustment to recognize minority interests as a component of restricted net position	1,155,105	(1,155,105)
As adjusted	$ 110,548,195	$ -

Note 1 - Nature of Operations and Reporting Entity (continued)

These financial statements present the District and the following blended component units:

- The Gift Foundation of the Antelope Valley Health Care District d/b/a Antelope Valley Hospital Foundation (AVHF) is a 501(c)(3) tax exempt organization and is legally separate from the District and operates with a June 30 fiscal year end. Although the District does not appoint a voting majority of the AVHF's Board of Directors nor is the District financially accountable for the organization, the District has determined that AVHF meets the criteria of a blended component unit in accordance with GASB No. 61 as the economic resources earned and held by AVHF have historically been used for the direct benefit of the District.

- The Antelope Valley Outpatient Imaging Center, LLC (AVOIC) is a legally separate entity that operates two diagnostic imaging centers located in Lancaster, California and Palmdale, California with a December 31 year end. The District owns 70% of AVOIC and can unilaterally make operating decisions such as establishing a budget or issuing debt. The District has determined that AVOIC meets the criteria of a blended component unit under GASB No. 61 as the governing bodies are substantially the same and because the operations are managed by the District similar to other hospital departments.

- The Desert Hills Sleep Disorder Center, LLC (DHSDC) is a legally separate entity that operates a sleep diagnostic facility in Lancaster, California with a December 31 year end. The District owns 60% of the DHSDC and can unilaterally make operating decisions such as establishing a budget or issuing debt. The District has determined that DHSDC meets the criteria of a blended component unit under GASB No. 61 as the governing bodies are substantially the same and because the operations are managed by the District similar to other hospital departments.

The other members' interest in AVOIC and DHSDC is accounted for as a minority interest in the District's financial statements. All significant intercompany accounts and transactions have been eliminated.

Note 2 - Summary of Significant Accounting Policies

Basis of accounting and presentation - The accompanying financial statements have been prepared using the economic resource measurement focus and the accrual basis of accounting, in accordance with U.S. generally accepted accounting principles for healthcare organizations, and are presented in accordance with the reporting model as prescribed in Governmental Accounting Standards Board (GASB) Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments,* as amended by GASB Statement No. 37, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments: Omnibus*; and GASB Statement No. 38, *Certain Financial Statement Note Disclosures*; and GASB Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflow of Resource, and Net Position*. The District follows the business-type activities' requirements of GASB Statement No. 34 and No. 63. This approach requires the following components of the District's financial statements:

Management's discussion and analysis - Basic financial statements, including statements of net position, statements of revenues, expenses, and changes in net position, and statements of cash flows using the direct method for the District as a whole.

GASB Statement No. 34 and subsequent amendments including GASB Statement No. 63 as discussed below, established standards for external financial reporting and requires that resources be classified for accounting and reporting purposes into the following net position categories:

Net investment in capital assets - Capital assets, net of accumulated depreciation and outstanding principal balances of debt attributable to the acquisition, construction, or improvement of those assets.

Restricted net position - Expendable - Assets whose use by the District are subject to externally imposed constraints that can be fulfilled by actions of the District pursuant to those constraints or that expire by the passage of time. Restricted resources are used in accordance with the District's policies. When both restricted and unrestricted resources are available for use, the determination to use restricted or unrestricted resources is made on a case-by-case basis.

Restricted net position – Nonexpendable – Assets whose use by the District are not available as they represent the net position of minority interests of AVOIC and DHSDC.

Unrestricted net position - This amount represents the amount of net position that is not subject to externally imposed constraints. Unrestricted net position may be designated for specific purposes by action of the Board of Directors or may otherwise be limited by contractual agreements with outside parties.

Note 2 - Summary of Significant Accounting Policies (continued)

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 amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Reclassifications - Certain prior year amounts were reclassified to conform to the current year presentation.

Cash and cash equivalents - The District considers all liquid investments with original maturities of three months or less to be cash equivalents. At June 30, 2013 and 2012, cash equivalents consisted primarily of money market accounts with brokers.

Risk management - The District 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 employee health, dental and accident benefits. Commercial insurance coverage is purchased for claims arising from such matters other than medical malpractice and workers' compensation claims. Settled claims have not exceeded this commercial coverage in any of the three preceding years.

The District is self-insured for a portion of its exposure to risk of loss from workers' compensation, malpractice claims, and employee health, dental and accident benefits. Annual estimated provisions are accrued based on actuarially determined amounts or management's estimate and includes an estimate of the ultimate costs for both reported claims and claims incurred but not yet reported.

Investments and investment income - The District's investments are carried at fair value. Fair value is determined using quoted market prices. Investment income includes dividend and interest income, realized gains and losses on investments and the net change for the year in the fair value of investments carried at fair value. Amounts required to meet current debt service obligations are classified within short-term investments.

Supplies - Supply inventories are stated at the lower of cost, determined using the first-in, first-out method, or market.

Patient accounts receivable - The District reports patient accounts receivable for services rendered at net realizable amounts from third-party payers, patients and others. The District provides an allowance for uncollectible accounts based upon a review of outstanding receivables, historical collection information and existing economic conditions. As a service to the patient, the District bills third-party payers directly and bills the patient when the patient's liability is determined. Patient accounts receivable are due in full when billed. Accounts are considered delinquent and subsequently written off as bad debts based on individual credit evaluation and specific circumstances of the account.

Note 2 - Summary of Significant Accounting Policies (continued)

Capital assets - Capital assets are recorded at cost at the date of acquisition, or fair value at the date of donation if acquired by gift. The capitalization threshold (the dollar value above which asset acquisitions are added to the capital asset accounts) is $2,500 for all asset classifications and for items with a useful life of more than two years.

Depreciation is computed using the straight-line method over the estimated useful life of each asset.

Assets under capital lease obligations and leasehold improvements are depreciated over the shorter of the lease term or their respective estimated useful lives. The following estimated useful lives are being used by the District:

Land improvements	2-25 years
Buildings and leasehold improvements	5-50 years
Equipment	3-30 years

The District capitalizes interest costs as a component of construction in progress, based on the weighted-average rates paid for long-term borrowings. Total interest capitalized and incurred during fiscal years ended June 30, 2013 and 2012 was:

	2013	2012
Interest capitalized	$ 1,592,520	$ 2,529,468
Interest charged to expense	5,485,848	5,236,199
Total interest incurred	$ 7,078,368	$ 7,765,667

Capital assets are reviewed for impairment when events or changes in circumstances suggest that the service utility of the capital asset may have significantly and unexpectedly declined. Capital assets are considered impaired if both the decline in service utility of the capital asset is large in magnitude and the event or change in circumstance is outside the normal life cycle of the capital asset. Such events or changes in circumstances that may be indicative of impairment include evidence of physical damage, enactment or approval of laws or regulations or other changes in environmental factors, technological changes or evidence of obsolescence, changes in the manner or duration of use of a capital asset, and construction stoppage. The determination of the impairment loss is dependent upon the event or circumstance in which the impairment occurred. Impairment losses, if any, are recorded in the statements of revenues, expenses, and changes in net position. There were no impairment losses recorded in the years ended June 30, 2013 and 2012.

Deferred financing costs - Deferred financing costs represent costs incurred in connection with the issuance of long-term debt. Such costs are being amortized over the term of the respective debt using a method that approximates the effective interest rate method and are included in other assets on the statements of net position. Deferred financing costs approximated $6,199,000 at June 30, 2013 and 2012, with accumulated amortization of approximately $4,148,000 and $3,786,000 as of June 30, 2013 and 2012, respectively.

Note 2 - Summary of Significant Accounting Policies (continued)

Compensated absences - District policies permit most employees to accumulate vacation and sick leave benefits that may be realized as paid time off or, in limited circumstances, as a cash payment. Expense and the related liability are recognized as vacation benefits are earned whether the employee is expected to realize the benefit as time off or in cash. Expense and the related liability for sick leave benefits are recognized when earned to the extent the employee is expected to realize the benefit in cash determined using the termination payment method. Compensated absence liabilities are computed using the regular pay and termination pay rates in effect at the statement of net position date plus an additional amount for compensation-related payments such as Social Security and Medicare taxes computed using rates in effect at that date.

Net patient service revenue - The District has agreements with third-party payers that provide for payments to the District at amounts different from its established rates. Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payers and others for services rendered and include estimated retroactive revenue adjustments and a provision for uncollectible accounts. Retroactive adjustments are considered in the recognition of revenue on an estimated basis in the period the related services are rendered and such estimated amounts are revised in future periods as adjustments become known.

During fiscal 2013, the District reduced its estimated amounts due to third-party payers and increased net patient service revenue by approximately $5.4 million due to changes in accounting estimates related to prior periods. During fiscal 2012, the District increased its estimated amounts due to third-party payers and reduced net patient service revenue by approximately $3.5 million due to a change in accounting estimate related to prior periods. Normal estimation differences between subsequent cash collections on patient accounts receivable and net patient accounts receivable estimated in the prior year are reported as adjustments to net patient service revenue in the current period. These differences decreased net patient service revenue by approximately $2.2 million for the year ended June 30, 2013 and increased net patient service revenue by approximately $3.2 million for the year ended June 30, 2012.

Charity care - The District provides care without charge or at amounts less than its established rates to patients meeting certain criteria under its charity care policy. Because the District does not pursue collection of amounts determined to qualify as charity care, these amounts are not reported as net patient service revenue.

Income taxes - The District is generally exempt from federal and state income taxes under Section 115 of the Internal Revenue Code and a similar provision of state law. However, the District is subject to federal income tax on any unrelated business taxable income.

Note 2 - Summary of Significant Accounting Policies (continued)

Grant and contribution income - During 2013 and 2012, the District received approximately $3,001,000 and $3,165,000 respectively in grant revenues from the federal government. These funds were recognized as other operating revenue when the funds were expended for the purpose specified by the grantee. In addition, during 2013 and 2012 the District received approximately $13,000 and $972,000, respectively, in other grant and contribution income. Revenues from grants and contributions (including contributions of capital assets) are recognized when all eligibility requirements, including time requirements, are met. Grants and contributions may be restricted for either specific operating purposes or for capital purposes.

Operating revenues and expenses - The statements of revenues, expenses and changes in net position distinguishes between operating and non-operating revenues and expenses. Operating revenues result from exchange transactions associated with providing health care services, the District's principal activity. Non-exchange revenues, including grants, contributions and income (losses) from investments, are reported as non-operating revenues. Operating expenses are all expenses incurred to provide health care services, other than financing costs.

Adoption of Accounting Pronouncements in Current Year - As described in Note 1, effective July 1, 2013, the District adopted GASB Statement No. 61, *The Financial Reporting Entity: Omnibus—an amendment of GASB Statements No. 14 and No. 34.*

Additionally, effective July 1, 2012, the District adopted GASB Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflow of Resources, and Net Position*. This statement had minimal impact on the District's financial statements or related accounting and financial reporting. The primary effects of implementing these statements were to change all previous references from "net assets" to "net position," change the line item for "invested in capital assets, net of related debt" to "net investment in capital assets," and to classify certain assets and liabilities as "deferred inflows" and "deferred outflows." At June 30, 2013, the District had no items meeting the criteria of "deferred inflows" or "deferred outflows."

Accounting Pronouncements Impacting Future Years - GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities*, is required to be implemented effective July 1, 2013, and thus will be adopted by the District next fiscal year. The statement establishes accounting and financial reporting standards that reclassify, as deferred outflows of resources or deferred inflows of resources, certain items that were previously reported as assets and liabilities, and recognizes, as outflows of resources or inflows of resources, certain items that were previously reported as assets and liabilities. Among the more significant impacts of this statement to the District, debt issuance costs are expensed as incurred rather than capitalized and amortized under previous guidance. Changes required by this statement are required to be applied retroactively by restating financial statements for all periods presented, and thus in the next year's financial statements, the District will restate net position effective July 1, 2012 to record the impact of expensing bond issuance costs. Management is currently evaluating other impacts of this standard on the District's financial statements.

Note 2 - Summary of Significant Accounting Policies (continued)

In March 2012, the GASB issued statement No. 66, *Technical Corrections - 2012*. GASB 66 amends Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, by modifying the specific guidance on accounting for operating lease payments that vary from a straight-line basis. The guidance is effective for fiscal years beginning after December 15, 2012. The implementation of the guidance will not have a significant impact on the District.

In June 2012, the GASB issued GASB Statement No. 67, *Financial Reporting for Pension*, which is effective for financial statements for period years beginning after June 15, 2013. GASB 67 replaces the requirements of GASB Statement No. 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans* and GASB Statement No. 50 as they relate to pension plans that are administered through trusts or similar arrangements meeting certain criteria. GASB 67 builds upon the existing framework for financial reports of defined benefit pension plans, which includes a statement of fiduciary net position (the amount held in a trust for paying retirement benefits) and a statement of changes in fiduciary net position. GASB 67 enhances note disclosures and required supplementary information ("RSI") for both defined benefit and defined contribution pension plans. GASB 67 also requires the presentation of new information about annual money-weighted rates of return in the notes to the financial statements and in 10-year RSI schedules. The District is reviewing the impact of the adoption of GASB 67 for the year ending June 30, 2014.

In June 2012, the GASB issued GASB Statement No. 68, *Accounting and Financial Reporting for Pensions*, which is effective for financial statements for periods beginning after June 15, 2014. The statement replaces the requirements of GASB Statement No. 27, *Accounting for Pensions by State and Local Governmental Employers* and GASB Statement No. 50, *Pension Disclosures*, as they relate to governments that provide pensions through pension plans administered as trusts or similar arrangements that meet certain criteria. GASB 68 requires governments providing defined benefit pensions to recognize their long-term obligation for pension benefits as a liability for the first time, and to more comprehensively and comparably measure the annual costs of pension benefits. The statement also enhances accountability and transparency through revised and new note disclosures and required supplementary information. The District is reviewing the impact of the adoption of GASB 68 for the year ending June 30, 2015.

Note 3 - Net Patient Service Revenue

The District has agreements with third-party payers that provide for payments to the District at amounts different from its established rates. These payment arrangements include:

Medicare - Inpatient acute care services and substantially all outpatient services rendered to Medicare program beneficiaries are paid at prospectively determined rates. These rates vary according to a patient classification system that is based on clinical, diagnostic, acuity and other factors. The District is reimbursed for certain services at tentative rates with final settlement determined after submission of annual cost reports by the District and audits thereof by the Medicare administrative contractor. The Medicare administrative contractor has audited the District's cost reports through June 30, 2010.

Medi-Cal - Inpatient services are paid on a per diem basis depending on the Medi-Cal program. Outpatient services rendered to Medi-Cal program beneficiaries are primarily reimbursed under a fee schedule reimbursement methodology. The District is reimbursed at tentative rates with final settlement determined after submission of annual cost reports by the District and audits thereof by the Medi-Cal fiscal intermediary. The Medi-Cal fiscal intermediary has audited the District's cost reports through June 30, 2010.

Approximately 65% and 59% of net patient service revenue is from participation in the Medicare and state-sponsored Medi-Cal programs for the year ended June 30, 2013, respectively. Approximately 58% and 63% of net patient service revenue is from participation in the Medicare and state-sponsored Medi-Cal programs for the year ended June 30, 2012, respectively. Laws and regulations governing the Medicare and Medi-Cal programs are complex and subject to interpretation and change. As a result, it is reasonably possible that recorded estimates will change materially in the near term.

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

Note 4 - Deposits, Investments and Investment Income

Cash and investments as of June 30 consist of the following:

	2013	2012
Cash on hand	$ 8,805	$ 8,805
Deposits	21,581,979	29,757,266
Investments	108,676,213	122,538,663
Total cash and investments	$ 130,266,997	$ 152,304,734

Note 4 - Deposits, Investments and Investment Income (continued)

The carrying values of deposits and investments shown above are included in the statements of net position as follows:

	2013	2012
Cash and cash equivalents	$ 10,520,648	$ 9,677,332
Short-term investments	45,172,239	43,301,821
Restricted cash and investments — current	3,207,016	3,500,557
Noncurrent cash and investments	71,367,094	95,825,024
Total cash and investments	$ 130,266,997	$ 152,304,734

Deposits - Custodial credit risk is the risk that, in the event of a bank failure, an entity's deposits may not be returned to it. The District's deposit policy for custodial credit risk requires compliance with the provisions of state law which requires collateralization of all deposits with federal depository insurance and other acceptable collateral in specific amounts.

At June 30, 2013 and 2012 approximately $9,621,000 and $0 of the District's bank balances respectively, were uninsured or uncollateralized. These amounts exclude deposits held by the District's blended component units with carrying values of approximately $2,994,000 and $4,060,000 at June 30, 2013 and 2012, respectively. As nongovernmental entities, the blended component units are not subject to the collateralization requirements. At June 30, 2013 and 2012, the blended component units' cash accounts are uncollateralized and exceeded federally insured limits by approximately $1,668,000 and $1,322,000, respectively.

Investments - Under provisions of the California Government Code, the District's investments are limited to certain types of investments. In general, the District may legally invest in direct obligations of and other obligations guaranteed as to principal by the U.S. Treasury, U.S. agencies and instrumentalities, California agencies, negotiable certificates of deposit and in bank repurchase agreements. It may also invest to a limited extent in commercial paper, corporate and depository institution debt securities and mortgage-backed securities.

Note 4 - Deposits, Investments and Investment Income (continued)

At June 30, 2013, the District had the following investments and maturities:

		Investment Maturities (In Years)		
Investment Type	Fair Value	Less Than 1	1-5	More Than 5
External investment pool - LAIF	$ 28,014,266	$ 28,014,266	$ -	$ -
U.S. instrumentalities	44,716,276	10,223,486	34,492,790	-
Corporate bonds	15,361,245	4,525,599	10,835,646	-
U.S. Treasury	9,120,118	-	9,120,118	-
Commercial paper	1,998,290	1,998,290	-	-
Held with trustee	9,055,419	2,901,525	6,153,894	-
		$ 47,663,166	$ 60,602,448	$ -
Accrued interest receivable	410,599			
	$ 108,676,213			

At June 30, 2012, the District had the following investments and maturities:

		Investment Maturities (In Years)		
Investment Type	Fair Value	Less Than 1	1-5	More Than 5
External investment pool - LAIF	$ 41,937,753	$ 41,937,753	$ -	$ -
U.S. instrumentalities	49,004,825	5,058,134	43,946,691	-
Corporate bonds	11,259,694	5,580,430	5,679,264	-
U.S. Treasury	10,671,641	1,503,282	9,168,359	-
Municipal bonds	9,228,770	3,789,629	5,439,141	-
		$ 57,869,228	$ 64,233,455	$ -
Accrued interest receivable	435,980			
	$ 122,538,663			

Interest rate risk - As a means of limiting its exposure to fair value losses arising from rising interest rates, the District's investment policy generally limits its investment portfolio to maturities of less than ten years unless approved by the Board of Directors. The external investment pool is presented as an investment with a maturity of less than one year because such investments are redeemable in full immediately.

Note 4 - Deposits, Investments and Investment Income (continued)

Credit risk - Credit risk is the risk that the issuer or other counterparty to an investment will not fulfill its obligations. The District's investment policy generally limits its investments to a credit rating of A or the equivalent by a nationally recognized statistical rating organization. At June 30, 2013 and 2012 the District's investments not directly guaranteed by the U.S. government were rated as follows:

Investment Type	Moody's	S&P
External investment pool - LAIF	Not Rated	Not Rated
U.S. instrumentalities	Aaa	AA+
Corporate bonds	A1 to Aaa	AAA to A-
U.S. Treasury	Aaa	AA+
Commercial paper	P-1	A-1

Custodial credit risk - For an investment, custodial credit risk is the risk that, in the event of the failure of the counterparty, the District will not be able to recover the value of its investment or collateral securities that are in the possession of an outside party. All of the District's investments as disclosed in the table above at June 30, 2013 and 2012 are held by custodians in other than the District's name. The District's investment policy for custodial credit risk requires compliance with the provisions of state law.

Concentration of credit risk - The District places no limit on the amount that may be invested in any one issuer. At June 30 the following investments exceeded 5% of the total fair value of all investments:

	2013		2012	
Investment Type	Fair Value	Percentage of Total Investments	Fair Value	Percentage of Total Investments
Federal National Mortgage Association	$ 16,014,613	16%	$ 24,164,803	20%
Federal Home Loan Mortgage Corporation	18,556,054	19%	16,752,549	14%
U.S. Treasury Securities	9,120,118	9%	10,671,641	9%
Federal Home Loan Bank	5,753,961	5%	6,722,166	6%

Investment Income - Investment income for the years ended June 30 consisted of:

	2013	2012
Interest, dividends and realized gains on sales of investments	$ 1,032,749	$ 1,443,353
Net decrease in fair value of investments	(526,996)	(127,217)
	$ 505,753	$ 1,316,136

Note 4 - Deposits, Investments and Investment Income (continued)

Investment in state investment pool - The District is a voluntary participant in the Local Agency Investment Fund (LAIF) that is regulated by California Government Code Section 16429 under the oversight of the Treasurer of the State of California. The fair value of the District's investment in this pool is reported in the accompanying financial statements at amounts based upon the District's pro-rata share of the fair value provided by LAIF for the entire LAIF portfolio (in relation to the amortized cost of that portfolio). The balance available for withdrawal is based on the accounting records maintained by LAIF, which are recorded on an amortized cost basis.

Note 5 - Patient Accounts Receivable

The District grants credit without collateral to its patients, many of whom are area residents and are insured under third-party payer agreements. Gross patient accounts receivable at June 30 consisted of:

	2013	2012
Medicare	24 %	21 %
Medi-Cal	41	38
Other third-party and commercial payor	23	29
Self pay	12	12
Total	100 %	100 %

Note 6 - Capital Assets

Capital assets activity for the years ended June 30 was as follows:

	Beginning Balance June 30, 2012	Additions	Deletions	Transfers	Ending Balance June 30, 2013
Land	$ 9,869,241	$ -	$ -	$ -	$ 9,869,241
Land improvements	12,396,278	109,848	-	481,432	12,987,558
Buildings and leasehold improvements	128,207,932	82,173	(795,466)	4,399,160	131,893,799
Equipment	167,867,531	1,696,977	(2,054,776)	1,234,523	168,744,255
Construction in progress	35,418,541	19,211,131	-	(6,115,115)	48,514,557
	353,759,523	21,100,129	(2,850,242)	-	372,009,410
Less accumulated depreciation:					
Land improvements	8,071,032	595,596	-	-	8,666,628
Buildings and leasehold improvements	58,292,473	3,381,166	(723,864)	-	60,949,775
Equipment	126,814,920	8,340,640	(2,035,837)	-	133,119,723
	193,178,425	12,317,402	(2,759,701)	-	202,736,126
	$ 160,581,098	$ 8,782,727	$ (90,541)	$ -	$ 169,273,284

	Beginning Balance June 30, 2011	Additions	Deletions	Transfers	Ending Balance June 30, 2012
Land	$ 6,865,474	$ 3,003,767	$ -	$ -	$ 9,869,241
Land improvements	12,371,494	-	-	24,784	12,396,278
Buildings and leasehold improvements	127,244,639	173,128	(6,458)	796,623	128,207,932
Equipment	155,217,637	5,482,801	(662,892)	7,829,985	167,867,531
Construction in Progress	21,783,501	22,286,432	-	(8,651,392)	35,418,541
	323,482,745	30,946,128	(669,350)	-	353,759,523
Less accumulated depreciation:					
Land improvements	7,485,997	585,035	-	-	8,071,032
Buildings and leasehold improvements	55,543,292	2,755,167	(5,986)	-	58,292,473
Equipment	118,606,100	8,822,125	(613,305)	-	126,814,920
	181,635,389	12,162,327	(619,291)	-	193,178,425
	$ 141,847,356	$ 18,783,801	$ (50,059)	$ -	$ 160,581,098

Construction commitments for various construction projects totaled approximately $75,645,000 and $41,787,000 as of June 30, 2013 and 2012, respectively.

Note 7 - Workers' Compensation Claims

The District is self-insured for the first $1,000,000 per occurrence of workers' compensation risks. The District purchases commercial insurance coverage above the self-insurance limits. Losses from asserted and unasserted claims identified under the District's incident reporting system are actuarially determined based on the District's past experience as well as other considerations, including the nature of each claim or incident and relevant trend factors. These unpaid claim liabilities were discounted at 4% in 2013 and in 2012 to account for the time value of money to determine the current estimated liabilities as reflected below. It is reasonably possible that the District's estimate of losses will change by a material amount in the near term. Activity in the District's accrued workers' compensation claims liability during 2013 and 2012 is summarized as follows:

	2013	2012
Balance, beginning of the year	$ 13,444,141	$ 10,016,111
Current year claims incurred and changes in estimates for claims incurred in the prior year	1,355,686	5,939,833
Claims and expenses paid	(1,650,685)	(2,511,803)
Balance, end of year	$ 13,149,142	$ 13,444,141

Note 8 - Medical Malpractice Claims

Effective July 1, 2007, the District changed its insurance program for medical malpractice coverage. The District increased their self-insured retention for medical malpractice claims to $500,000 per incident, $3,000,000 annual aggregate with an excess liability coverage for claims in excess of $20,000,000. Insurance coverage is on a claims-made basis. Effective July 1, 2010, the District increased their self-insured retention for medical malpractice claims to $750,000 per incident and $3,500,000 for annual aggregate. Effective July 1, 2011, the District increased their insured retention for medical malpractice claims to $4,000,000 for annual aggregate.

Accounting principles generally accepted in the United States of America require a health care provider to accrue the expense of its share of malpractice claim costs, if any, for any reported and unreported incidents of potential improper professional service occurring during the year by estimating the probable ultimate costs of the incidents. Annual estimated provisions are accrued based on the District's did past experience as well as other considerations, including the nature of the claim or incident and relevant trend factors. Losses from asserted and unasserted claims identified under the District's incident reporting system are actuarially determined based on the District's past experience as well as other considerations, including the nature of each claim or incident and relevant trend factors. These unpaid claim liabilities were discounted at 4% in 2013 and in 2012 to account for the time value of money to determine the current estimated liabilities as reflected below. It is reasonably possible that this estimate could change materially in the near term.

Note 8 - Medical Malpractice Claims (continued)

Activity in the District's accrued medical malpractice claims liability during 2013 and 2012 is summarized as follows:

	2013	2012
Balance, beginning of the year	$ 7,501,000	$ 7,256,766
Current year claims incurred and changes in estimates for claims incurred in the prior years	2,225,332	2,106,693
Claims and expenses paid	(2,839,332)	(1,862,459)
Balance, end of year	$ 6,887,000	$ 7,501,000

Note 9 - Accrued Medical Claims

The District provides certain health and dental benefits to enrollees that serve under contract to the hospital. The cost of medical services provided to these enrollees is accrued in the period that the services are rendered. A provision has been made for claims in process of review and for claims incurred but not reported at year-end. The amount of this liability is computed using historical claims payment experience, and a review of experience for similar plans. Amounts accrued totaled approximately $1,169,000 and $1,147,000 at June 30, 2013 and 2012, respectively, and are included in accounts payable and other accrued liabilities.

Estimates are adjusted based upon changes in experience and such adjustments are reflected in current operations. Although considerable variability is inherent in such estimates, there is at least a possibility that recorded estimates will change by a material amount in the near term.

Note 10 - Long-Term Obligations

The following is a summary of long-term obligation transactions for the District for the years ended June 30:

2013	Beginning Balance	Additions	Payments	Ending Balance	Due Within 1 Year
Series 2002A District Revenue Bonds (A)	$ 55,000,000	$ -	$ -	$ 55,000,000	$ -
Series 1997A District Insured Refunding Revenue Bonds (B)	23,360,000	-	(2,080,000)	21,280,000	2,185,000
Series 1997B District Insured Revenue Bonds (C)	13,970,000	-	(640,000)	13,330,000	670,000
Series 2010A Fixed Rate Revenue Bonds (D)	23,403,426	-	(318,802)	23,084,624	1,210,474
Series 2011A Fixed Rate Revenue Bonds (E)	18,425,000	-	(300,000)	18,125,000	300,000
Notes payable	1,799,749	-	(1,175,001)	624,748	530,720
Capital lease obligations	5,154,415	406,730	(1,321,350)	4,239,795	1,796,366
Total long-term debt	$ 141,112,590	$ 406,730	$ (5,835,153)	$ 135,684,167	$ 6,692,560

2012	Beginning Balance	Additions	Payments	Ending Balance	Due Within 1 Year
Series 2002A District Revenue Bonds (A)	$ 55,000,000	$ -	$ -	$ 55,000,000	$ -
Series 1997A District Insured Refunding Revenue Bonds (B)	23,360,000	-	-	23,360,000	2,080,000
Series 1997B District Insured Revenue Bonds (C)	14,575,000	-	(605,000)	13,970,000	640,000
Series 2010A Fixed Rate Revenue Bonds (D)	24,610,048	-	(1,206,622)	23,403,426	372,669
Series 2011A Fixed Rate Revenue Bonds (E)	18,493,000	-	(68,000)	18,425,000	300,000
Notes payable	3,303,197	-	(1,503,448)	1,799,749	1,175,001
Capital lease obligations	4,908,143	2,631,477	(2,385,205)	5,154,415	2,109,796
Total long-term debt	$ 144,249,388	$ 2,631,477	$ (5,768,275)	$ 141,112,590	$ 6,677,466

Revenue bonds payable

A. Due September 1, 2017; principal payable at maturity plus interest at a rate of 5.25%; secured by a pledge of the District's gross revenues and trustee-held assets. The agreement is subject to certain financial covenants, including net income to annual debt service ratio.

B. Due January 1, 2020; principal payable annually beginning January 1, 2013 plus semiannual interest payments at interest rates from 5.00% to 5.20%; secured by pledge of the District's gross revenues and trustee-held assets. The agreement is subject to certain financial covenants, including minimum liquidity, net income to annual debt service ratio and indebtedness ratio and a minimum medical malpractice insurance coverage.

C. Due January 1, 2027; principal payable annually plus semiannual interest payments at a fixed rate of 5.20%; secured by pledge of the District's gross revenues and trustee-held assets. The agreement is subject to certain financial covenants, including minimum liquidity, net income to annual debt service ratio and indebtedness ratio and a minimum medical malpractice insurance coverage.

Note 10 - Long-Term Obligations (continued)

D. Due December 1, 2020; private placement bond issuances of $25,000,000. Principal and interest payable monthly at fixed interest rates 4.82%; secured by pledge of the District's gross revenue and trustee-held assets. The agreement is subject to certain financial covenants, including minimum liquidity, net income to annual debt service ratio and indebtedness ratio and a minimum medical malpractice insurance coverage. A portion of the proceeds in the amount of $10,000,000 was used to pay the Series 1997A District Insured Refunding Revenue Bonds.

E. Due March 1, 2036; the agreement was executed via three separate bond issuances of $10,000,000, $3,620,000, and $5,105,000. Principal payable annually plus semiannual interest payment at fixed interest rates from 6.875% to 7.25%, respectively; secured by pledge of the District's gross revenue and trustee-held assets. The agreement is subject to certain financial covenants, including minimum liquidity, net income to annual debt service ratio and indebtedness ratio and a minimum medical malpractice insurance coverage.

The indenture agreements for the Series 2002A Bonds, the Series 1997A and 1997B Bonds and the Series 2010A and Series 2011A Bonds require that certain funds be established with the trustees. Accordingly, these funds are included as assets held by the trustee for debt service and capital acquisitions in the statements of net position. The indenture agreements for the Series 2002A Bonds, the Series 1997A and 1997B Bonds and the Series 2010A and Series 2011A Bonds also place certain limits on the incurrence of additional borrowings and require that the District satisfy certain measures of financial performance as long as the bonds are outstanding.

The bond service requirements as of June 30, 2013, are as follows:

Years Ending June 30	Total to be Paid	Principal	Interest
2014	$ 11,351,145	$ 4,365,474	$ 6,985,671
2015	12,109,611	5,379,024	6,730,587
2016	12,183,947	5,738,527	6,445,420
2017	65,094,807	61,355,667	3,739,140
2018	11,560,895	8,677,753	2,883,142
2019 - 2023	36,954,252	28,723,179	8,231,073
2024 - 2028	13,299,270	9,160,000	4,139,270
2029 - 2033	6,262,852	4,145,000	2,117,852
2034 - 2038	3,761,113	3,275,000	486,113
Total	$ 172,577,892	$ 130,819,624	$ 41,758,268

Note 10 - Long-Term Obligations (continued)

Notes payable - The District has multiple notes payable agreements with varying principal due dates and interest rates. The notes are secured by equipment and currently have due dates during fiscal year 2014 and 2015. Each note's principal balance is due monthly with varying interest rates ranging from 3.64% to 5.80%. The debt service requirements as of June 30, 2013, are as follows:

Years Ending June 30	Total to be Paid	Principal	Interest
2014	$ 544,575	$ 530,720	$ 13,855
2015	94,794	94,028	766
Total	$ 639,369	$ 624,748	$ 14,621

Capital lease obligations - The District is obligated under leases for equipment that are accounted for as capital leases. The carrying value of assets under capital leases totaled approximately $15,112,000 and $14,063,000, at June 30, 2013 and 2012, respectively, net of accumulated depreciation of approximately $9,604,000 and $7,348,000 at June 30, 2013 and 2012, respectively.

The following is a schedule by year of future minimum lease payments under the capital leases, including interest at rates of 2.36% to 8.65% together with the present value of the future minimum lease payments as of June 30, 2013:

Years Ending June 30	
2014	$ 1,937,156
2015	1,393,422
2016	1,002,927
2017	142,099
Total minimum lease payments	4,475,604
Less amount representing interest	235,809
Present value of future minimum lease payments	$ 4,239,795

Note 11 - Restricted Net Position

At June 30, 2013 and 2012 restricted expendable net position was available for the following purposes:

	2013	2012
Workers' compensation collateral	$ 44,133	$ 44,000
Specific operating activities	645,564	794,348
Total restricted expendable net position	$ 689,697	$ 838,348

Note 12 - Pension Plans

403(b) defined contribution plan - The District contributes to a defined contribution pension plan covering substantially all employees. Pension expense is recorded for the amount of the District's required contributions determined in accordance with the terms of the plan. The plan is administered by a board of trustees appointed by the District's governing body. The plan provides retirement and death benefits to plan members and their beneficiaries. Benefit provisions are contained in the plan document and were established and can be amended by action of the District's governing body. Contribution rates for plan members, expressed as a percentage of covered payroll, were 5.5% and 5.1% for 2013 and 2012, respectively. Contributions made by the District were approximately $7,584,000 and $6,879,000 during 2013 and 2012, respectively. There were no plan member contributions during 2013 or 2012.

Defined benefit pension plan - The District's defined benefit pension plan is a single-employer defined benefit pension plan administered by the plan's board of trustees who are appointed by the District's governing body. The plan provides retirement, disability and death benefits to plan members and beneficiaries. The authority to establish and amend benefit provisions is vested in the District's governing body. The plan issues publicly available financial statements and required supplementary information for the plan. The report may be obtained by writing to the plan at 1600 West Avenue J, Lancaster, California 93534, or by calling 661.949.5533.

Funding policy - The authority to establish and amend obligations of plan members and the District is set forth in the plan document and is vested in the District's Board of Directors. Plan members are not required to contribute any of their annual covered salary. The District contributes such amounts, if any, as it determines to be appropriate each year.

Note 12 - Pension Plans (continued)

Annual pension cost and net pension obligation **-** The District's annual pension cost and net pension obligation to the plan were as follows:

	2013	2012
Annual required contribution	$ 16,717,000	$ 15,110,012
Interest on net pension obligation	3,810,221	3,385,469
Adjustments to annual required contribution	(7,098,027)	(6,363,894)
Annual pension cost	13,429,194	12,131,587
Contributions made	(8,079,588)	(6,879,315)
Increase in net pension obligation	5,349,606	5,252,272
Net pension obligation at beginning of year	47,628,755	42,376,483
Net pension obligation at end of year	$ 52,978,361	$ 47,628,755

The annual required contributions for 2013 and 2012 were determined as part of actuarial valuations on July 1, 2012 and July 1, 2011, respectively, using the projected unit credit actuarial cost method. The actuarial assumptions included (a) an 8% investment rate of return in both 2013 and 2012 and (b) projected salary increases of up to 7.5% per year in both 2013 and 2012.

The District has voluntarily opted for a funding policy under which it contributes the normal cost plus the amount necessary to amortize the unfunded target actuarial liability over 10 years. The objective is to maintain the Plan's funded ratio at 100% of the actuarially determined accrued liability. As of June 30, 2013, the Plan is approximately 62% funded based on the actuarial value of assets. As of June 30, 2012, the Plan was approximately 65% funded based on the actuarial value of assets. The annual pension cost is approximately $13,429,000 for the year ended June 30, 2013 and was approximately $12,132,000 for the year ended June 30, 2012. The annual required contribution is approximately $16,717,000 for the year ended June 30, 2013 and was approximately $15,110,000 for the year ended June 30, 2012.

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

Note 12 - Pension Plans (continued)

Trend information:

Years Ending June 30	Annual Pension Cost (APC)	Percentage of APC Contributed	Net Pension Obligation
2013	$ 13,429,194	60.16%	$ 52,978,361
2012	$ 12,131,587	56.71%	$ 47,628,755
2011	$ 10,086,771	71.78%	$ 42,376,483

Funding status and funding progress - The following is funded status information as of July 1, 2012, the most recent actuarial valuation date.

Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Unfunded AAL (UAAL) (b - a)	Funded Ratio (a / b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll (b - a) / c
$ 102,307,703	$ 163,941,625	$ 61,633,922	62.4%	$ 138,940,618	44.4%

The schedule of funding progress, presented as required supplementary information following the notes to the financial statements, presents multiyear trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the AAL for benefits.

Note 13 - Other Benefit Plans

Postretirement health plan - The District's postretirement health care plan is a single-employer plan administered by the District's governing body. The authority to establish and amend benefit provisions, subject to collective bargaining agreements, is vested in the District's governing body. Under certain collective bargaining agreements (C.N.A. union contract), effective with retirements on or after July 1, 2006, the District provides health care coverage to eligible retirees. A retiree is eligible to receive these benefits if they earned at least 15 years of Benefited Service (as defined in the agreements) as a nurse with the District, including five years of continuous Benefited Service on the date of retirement, and they retired from active service with the District while eligible to receive a pension benefit from the District.

Retirees under age 65 are eligible to participate in the least expensive medical plan offered by the District to its nurses. This coverage ceases for retirees upon attainment of age 65. The District contributes a percentage of the premiums for the retiree based on years of Benefited Service, and the District's contribution level is frozen as of the date of retirement and does not increase with postretirement medical trend increases.

Note 13 - Other Benefit Plans (continued)

Funding policy **-** The plan is a pay-as-you-go plan and, therefore, is not funded. The District funds the plan on a cash basis as benefits are paid. No assets have been segregated or restricted to provide plan benefits.

Annual OPEB cost and net OPEB obligation - The District's annual other postemployment benefit (OPEB) cost (expense) is calculated based on the annual required contribution (ARC) of the employer, an amount actuarially determined in accordance with the parameters of GASB Statement No. 45. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost each year and amortize any unfunded actuarial accrued liabilities (UAAL) (or funding excess) over a period not to exceed 30 years. The following table shows the components of the District's annual OPEB cost for the years ended June 30, 2013 and 2012, the amount actually contributed to the plan and changes in the District's net OPEB obligation to the plan:

	2013	2012
Normal cost	$ 222,410	$ 210,616
Amortization of UAAL	134,528	115,626
Annual required contribution	356,938	326,242
Interest on prior year net OPEB obligation	64,983	53,755
Adjustment to annual required contribution	(110,403)	(91,328)
Annual OPEB cost	311,518	288,669
Benefits paid	(5,286)	(7,965)
Increase in net OPEB obligation	306,232	280,704
Net OPEB obligation at beginning of year	1,624,567	1,343,863
Net OPEB obligation at end of year	$ 1,930,799	$ 1,624,567

The District provides health insurance benefits for C.N.A. retirees who are age 55 or older and earned at least 15 years of benefitted service on the date of retirement. Retirees under the age of 65 are entitled to receive health care benefits until age 65 under the Plan. In addition, the District contributes a percent of the medical premiums based upon the employee's years of Benefited Service at retirement.

As of July 1, 2012, the most recent actuarial valuation date, the plan was unfunded. The OPEB obligation as of June 30, 2013 and 2012 is approximately $1,931,000 and $1,625,000, respectively. The annual obligation cost for the years ended June 30, 2013 and 2012 is approximately $312,000 and $289,000, respectively. The ARC for the years ended June 30, 2013 and 2012 is approximately $357,000 and $326,000, respectively.

Note 13 - Other Benefit Plans (continued)

The ARC for 2013 was determined as part of an actuarial valuation on July 1, 2012. The ARC for 2012 was determined as part of an actuarial valuation on July 1, 2010. For measurement purposes, a 7.75% and 7% annual rate of increase in the per capita cost of covered health care was assumed for 2013 and 2012, respectively, with such annual rate of increase gradually declining to 5.5% in the 13th year and after. The expected long-term annual investment return discount rate used in estimating the accumulated postretirement benefit obligation was 3.75% at June 30, 2013 and 4% at June 30, 2012. The actuarial cost method used was Projected Unit Credit. The amortization method used was Level Dollar over a remaining amortization period of 15 years.

Trend information - The District's annual OPEB cost, the percentage of annual OPEB cost contributed to the plan and the net OPEB obligation for the last three years were as follows:

Years Ending June 30	Annual OPEB Cost	Percentage of OPEB Cost Contributed	Net OPEB Obligation
2013	$ 311,518	1.70%	$ 1,930,799
2012	288,669	2.76%	1,624,567
2011	267,115	0.00%	1,343,863

Funded status and funding progress - The following is funded status information as of July 1, 2012, the most recent actuarial valuation date.

Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Unfunded AAL (UAAL) (b - a)	Funded Ratio (a / b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll (b - a) / c
$ -	$ 3,095,719	$ 3,095,719	0.00%	$ 1,774,716	174.4%

The schedule of funding progress, presented as required supplementary information following the notes to the financial statements, presents multiyear trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the AAL for benefits.

Note 14 - Contingencies

Litigation - In the normal course of business, the District is, from time to time, subject to allegations that may or do result in litigation. Some of these allegations are in areas not covered by the District's self-insurance program or by commercial insurance; for example, allegations regarding employment practices or performance of contracts. The District evaluates such allegations by conducting investigations to determine the validity of each potential claim. Based upon the advice of legal counsel, management records an estimate of the amount of ultimate expected loss, if any, for each potential claim. Events could occur that would cause the estimate of ultimate loss to differ materially in the near term.

Labor agreements - A substantial portion of the District's staff is covered by two collective bargaining agreements, one of which expired in June 2013 while the other expires in July 2015. Negotiations are currently in process on the expired collective bargaining agreement, though the ultimate outcome is not known at this time.

Operating leases - The District leases certain office space under operating lease agreements. Total lease expense amounted to approximately $1,951,000 and $2,229,000 in the fiscal years ended June 30, 2013 and 2012, respectively. Minimum future lease payments on existing non-cancelable leases as of June 30, 2013 are as follows:

Minimum Lease payments for Operating Leases:	
2014	$ 1,490,847
2015	1,023,519
2016	766,655
2017	599,567
2018	513,488
Thereafter	707,266
Total minimum lease payments	$ 5,101,342

Marketable securities - The District invests in various investment securities (see Note 4). Investment securities are exposed to various risks such as interest rate, market and credit risks. Due to the level of risk associated with certain investment securities, it is at least reasonably possible that changes in the values of investment securities will occur in the near term and that such change could materially affect the amounts reported in the accompanying statements of net position.

Note 14 - Contingencies (continued)

Regulatory matters - The health care industry is subject to numerous laws and regulations of federal, state and local governments. These laws and regulations include, but are not necessarily limited to, matters such as licensure, accreditation, governmental health care program requirements and reimbursements for patient services. Government activity has continued with respect to investigations and allegations concerning possible violations of fraud and abuse statutes 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 District is in compliance with fraud and abuse, as well as other applicable government laws and regulations. Compliance with such laws and regulations can be subject to future government review and interpretation as well as regulatory action unknown or unasserted at this time.

To ensure accurate payments to providers, the Tax Relief and Healthcare Act of 2006 mandated the Centers for Medicare & Medicaid Services (CMS) to implement a Recovery Audit Contractor (RAC) program on a permanent and nationwide basis. The program uses RACs to search for potentially improper Medicare payments that may have been made to health care providers that were not detected through existing CMS program integrity efforts, which have occurred at least one year ago but not longer than three years ago. RAC assessments against the District began in fiscal 2011; as of June 30, 2013 approximately $1,584,000 was accrued and for the year ended June 30, 2013 approximately $1,817,000 was repaid. As of June 30, 2012, approximately $1,172,000 was accrued and for the year ended June 30, 2013 approximately $1,752,000 was repaid.

Note 15 - Construction and Seismic Standards

Under current California laws, the District's facilities must comply with specific provisions related to structural and nonstructural seismic standards. These laws will generally require the District to retrofit, remodel or upgrade several buildings before 2013, subject to legislative changes and certain available exemptions. The District received an extension to comply by January 1, 2015. The District is currently working on improvements to noncompliant buildings in order to receive exemptions available under current legislation through 2030. The cost estimates associated with this compliance have not been completed but will likely be significant.

Note 16 - Hospital Fee Program

The California Hospital Fee Program (the "Program") was signed into law by the Governor of California and became effective on January 1, 2010. Amending legislation to conform to changes requested by the Centers for Medicare and Medicaid Services ("CMS"), the approval process was signed into law on September 8, 2010 by the Governor of California. The Program required a "hospital fee" or "Quality Assurance Fee" ("QA Fee") to be paid by certain hospitals to a State fund established to accumulate the assessed QA Fees and receive matching federal funds. QA Fees and corresponding matching federal funds are then paid to participating hospitals in two supplemental payment methodologies: a fee-for-service methodology and a managed care plan methodology.

The period covered by the Program included a substantial retroactive federal matching component, including all or a portion of the 2008-2009 and 2009-2010 federal fiscal years. CMS approved California's State Plan Amendment and Waiver as of October 7, 2010 allowing the State to implement the QA Fee and the fee-for-service supplemental payment methodology of the legislation. Final approval of the Program was effective December 30, 2010. The QA Fee assessment and fee-for-service supplemental payments for approved periods were assessed and paid in installments through December 2010. Managed care supplemental payments were paid through March 2011.

The District, as a non-designated public hospital in California, was not subject to the QA Fee assessments according to the legislation but rather received net supplemental payments.

During 2012 and 2013, the District received funding through the Non-designated Public Intergovernmental Transfer Program (Program) created by AB113 to allow non-designated public hospitals to access additional federal funds. Under this legislation, the District recognized $10,200,000 and $16,000,000 in net patient service revenue during the years ended June 30, 2013 and 2012, respectively. Fees paid by the District into the Program totaled $5,600,000 and $8,000,000 during the years ended June 30, 2013 and 2012, respectively, and are included in purchased services and other expense. Total net revenue recognized from the Program totaled $4,600,000 and $8,000,000 during the years ended June 30, 2013 and 2012, respectively.

Additional legislation ("SB335") extended the Program for the period from July 1, 2011 through December 31, 2013. Again, the Program included only private hospitals but did allow for direct grants to non-designated public hospitals. The District recognized net patient service revenue of $6,400,000 and $1,900,000 related to the Program in fiscal years 2013 and 2012, respectively. Legislation in September 2012 ("SB290") increased the amount of direct grant funds available to non-designated hospitals and will accordingly increase the District's allocation of direct grant income related to fiscal year 2014 which will be recognized in fiscal year 2014, the year that the enabling legislation is approved. The Program is scheduled to end December 31, 2013.

Note 17 - Meaningful Use Incentives

The American Recovery and Reinvestment Act of 2009 ("ARRA") established incentive payments under the Medicare and Medicaid programs for certain professionals and hospitals that meaningfully use certified electronic health record ("EHR") technology. The Medicare incentive payments will be paid out to qualifying hospitals over four consecutive years on a transitional schedule. To qualify for Medicare incentives, hospitals and physicians must meet EHR meaningful use criteria that become more stringent over three stages designated by the Centers for Medicare and Medicaid ("CMS").

Medicaid programs and payment schedules vary from state to state. The Medi-Cal programs requires hospitals to register for the program prior to 2016, to engage in efforts to adopt, implement or upgrade certified EHR technology in order to qualify for the initial year of participation, and to demonstrate meaningful use of certified EHR technology in order to qualify for payment for up to three additional years.

As of June 30, 2013, the District was in the process of applying for Medi-Cal and Medicare Meaningful Use funding. As such, no amounts were recorded as of June 30, 2013. Subsequent to June 30, 2013, the District received approximately $2,675,000 and $3,440,000 in Meaningful Use funds from Medi-Cal and Medicare, respectively. These incentives will be recognized following the grant accounting model, recognizing income ratably over the applicable reporting period as management becomes reasonably assured of meeting the required criteria.

REQUIRED SUPPLEMENTARY INFORMATION

ANTELOPE VALLEY HEALTHCARE DISTRICT
SCHEDULES OF FUNDING PROGRESS
FOR THE YEAR ENDED JUNE 30, 2013

Defined Benefit Pension Plan

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Unfunded AAL (UAAL) (b - a)	Funded Ratio (a / b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll (b - a) / c
July 1, 2012	$ 102,307,703	$ 163,941,625	$ 61,633,922	62.4%	$ 138,940,618	44.4%
July 1, 2011	$ 98,337,418	$ 151,697,557	$ 53,360,139	64.8%	$ 134,153,568	39.8%
July 1, 2010	$ 96,009,652	$ 136,285,151	$ 40,275,499	70.4%	$ 125,816,685	32.0%

Postretirement Health Plan

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Unfunded AAL (UAAL) (b - a)	Funded Ratio (a / b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll (b - a) / c
July 1, 2012	$ -	$ 3,095,719	$ 3,095,719	0.0%	$ 1,774,716	174.4%
July 1, 2010	$ -	$ 1,387,822	$ 1,387,822	0.0%	$ 1,491,088	93.1%
July 1, 2008	$ -	$ 2,839,784	$ 2,839,784	0.0%	$ 3,928,007	72.3%

ADDITIONAL SUPPLEMENTARY INFORMATION

ANTELOPE VALLEY HEALTHCARE DISTRICT
CONSOLIDATING SCHEDULE OF NET POSITION
JUNE 30, 2013

	AVH	AVOIC	Other	Total	Eliminations	Consolidated Balance
ASSETS						
CURRENT ASSETS						
Cash and cash equivalents	$ 7,526,865	$ 241,462	$ 2,752,321	$ 10,520,648	$ -	$ 10,520,648
Short-term investments	45,172,239	-	-	45,172,239	-	45,172,239
Restricted cash and investments, current	3,207,016	-	-	3,207,016	-	3,207,016
Patient accounts receivable, net of estimated uncollectible accounts	46,325,451	2,615,250	12,811	48,953,512	-	48,953,512
Other receivables, net of estimated uncollectible accounts	3,653,360	48,277	1,024,502	4,726,139	(70,716)	4,655,423
Supplies	5,164,951	75,991	843	5,241,785	-	5,241,785
Prepaid expenses and other assets	2,369,169	66,616	1,260	2,437,045	-	2,437,045
Estimated third-party payor settlements	6,915,885	-	-	6,915,885	-	6,915,885
Total current assets	120,334,936	3,047,596	3,791,737	127,174,269	(70,716)	127,103,553
NONCURRENT CASH AND INVESTMENTS						
Held by trustee for debt service	19,454,601	-	-	19,454,601	-	19,454,601
Less amounts required to meet current obligations	2,378,511	-	-	2,378,511	-	2,378,511
	17,076,090	-	-	17,076,090	-	17,076,090
Other long-term investments	54,291,004	-	-	54,291,004	-	54,291,004
Total noncurrent cash and investments	71,367,094	-	-	71,367,094	-	71,367,094
CAPITAL ASSETS, net	167,027,028	2,215,663	30,593	169,273,284	-	169,273,284
OTHER ASSETS, net	3,244,681	-	-	3,244,681	(985,655)	2,259,026
Total noncurrent assets	241,638,803	2,215,663	30,593	243,885,059	(985,655)	242,899,404
TOTAL ASSETS	$ 361,973,739	$ 5,263,259	$ 3,822,330	$ 371,059,328	$ (1,056,371)	$ 370,002,957

(Continued)

ANTELOPE VALLEY HEALTHCARE DISTRICT
CONSOLIDATING SCHEDULE OF NET POSITION (CONTINUED)
JUNE 30, 2013

LIABILITIES AND NET POSITION	AVHD	AVOIC	Other	Total	Eliminations	Consolidated Balance
CURRENT LIABILITIES						
Accounts payable and accrued liabilities	$ 16,899,979	$ 1,330,845	$ 164,904	$ 18,395,728	$ (70,716)	$ 18,325,012
Accrued payroll and related expenses	20,452,731	461,888	763	20,915,382	-	20,915,382
Current maturities of long-term debt	6,126,546	566,014	-	6,692,560	-	6,692,560
Accrued workers' compensation and professional liability claims, current portion	5,515,000	-	-	5,515,000	-	5,515,000
Accrued interest payable	2,378,511	-	-	2,378,511	-	2,378,511
Total current liabilities	51,372,767	2,358,747	165,667	53,897,181	(70,716)	53,826,465
LONG-TERM DEBT, net of current portion	127,989,990	1,001,617	-	128,991,607	-	128,991,607
ACCRUED WORKERS' COMPENSATION AND PROFESSSIONAL LIABILITY CLAIMS, net of current portion	14,521,142	-	-	14,521,142	-	14,521,142
PENSION AND OPEB LIABILITIES	54,909,160	-	-	54,909,160	-	54,909,160
Total liabilities	248,793,059	3,360,364	165,667	252,319,090	(70,716)	252,248,374
NET POSITION						
Members' contributed capital	-	1,000,000	280,000	1,280,000	(1,280,000)	-
Net investment in capital assets	52,365,093	648,032	30,593	53,043,718	-	53,043,718
Restricted, expendable for:						
Workers' compensation collateral	44,133	-	-	44,133	-	44,133
Specific operating activities	100,437	-	545,127	645,564	-	645,564
Restricted, nonexpendable for minority interests	-	-	-	-	561,346	561,346
Unrestricted	60,671,017	254,863	2,800,943	63,726,823	(267,001)	63,459,822
Total net position	$ 113,180,680	$ 1,902,895	$ 3,656,663	$ 118,740,238	$ (985,655)	$ 117,754,583

See accompanying notes of independent auditors.

ANTELOPE VALLEY HEALTHCARE DISTRICT
CONSOLIDATING SCHEDULE OF REVENUES, EXPENSES AND CHANGES IN NET POSITION
FOR THE YEAR ENDED JUNE 30, 2013

	AVH	AVOIC	Other	Total	Eliminations	Consolidated Balance
OPERATING REVENUES						
Net patient service revenue, net	$ 336,369,560	$ 13,847,152	$ 264,477	$ 350,481,189	$ -	$ 350,481,189
Other revenue	5,522,189	16,112	15	5,538,316	(1,194,383)	4,343,933
Total operating revenue	341,891,749	13,863,264	264,492	356,019,505	(1,194,383)	354,825,122
OPERATING EXPENSES						
Salaries and wages	154,191,025	3,974,627	248,042	158,413,694	-	158,413,694
Employee benefits	48,626,004	579,090	70,263	49,275,357	-	49,275,357
Fees to individuals and organizations	22,700,622	6,567,026	2,598	29,270,246	-	29,270,246
Purchased services	21,007,527	-	32,408	21,039,935	-	21,039,935
Supplies and other expenses	78,261,050	3,310,718	327,595	81,899,363	(2,274,298)	79,625,065
Depreciation and amortization	11,871,399	786,847	21,085	12,679,331	-	12,679,331
Total operating expenses	336,657,627	15,218,308	701,991	352,577,926	(2,274,298)	350,303,628
OPERATING INCOME (LOSS)	5,234,122	(1,355,044)	(437,499)	3,441,579	1,079,915	4,521,494
NONOPERATING REVENUES (EXPENSES)						
Grant revenue and contributions	3,013,409	-	1,040,971	4,054,380	-	4,054,380
Investment income	418,624	80	87,049	505,753	-	505,753
Interest expense	(5,441,228)	(44,620)	-	(5,485,848)	-	(5,485,848)
Total nonoperating (expense) income, net	(2,009,195)	(44,540)	1,128,020	(925,715)	-	(925,715)
Income (loss) before capital contributions	3,224,927	(1,399,584)	690,521	2,515,864	1,079,915	3,595,779
CAPITAL CONTRIBUTIONS	98,312	-	-	98,312	(98,312)	-
Change in net position	3,323,239	(1,399,584)	690,521	2,614,176	981,603	3,595,779
NET POSITION, Beginning of year, as adjusted	109,857,441	3,302,479	2,966,142	116,126,062	(1,967,258)	114,158,804
NET POSITION, End of year	$ 113,180,680	$ 1,902,895	$ 3,656,663	$ 118,740,238	$ (985,655)	$ 117,754,583

See accompanying notes of independent auditors.

ANTELOPE VALLEY HEALTHCARE DISTRICT
CONSOLIDATING SCHEDULE OF NET POSITION
JUNE 30, 2012

	AVHD	AVOIC	Other	Total	Eliminations	Consolidated Balance
ASSETS						
CURRENT ASSETS						
Cash and cash equivalents	$ 5,617,653	$ 1,698,240	$ 2,361,439	$ 9,677,332	$ -	$ 9,677,332
Short-term investments	43,301,821	-	-	43,301,821	-	43,301,821
Restricted cash and investments, current	3,500,557	-	-	3,500,557	-	3,500,557
Patient accounts receivable, net of estimated uncollectible accounts	37,209,727	1,897,429	20,384	39,127,540	-	39,127,540
Other receivables, net of estimated uncollectible accounts	3,541,394	48,277	1,024,502	4,614,173	(337,704)	4,276,469
Supplies	4,768,063	81,741	843	4,850,647	-	4,850,647
Prepaid expenses and other assets	2,365,915	44,138	930	2,410,983	-	2,410,983
Total current assets	100,305,130	3,769,825	3,408,098	107,483,053	(337,704)	107,145,349
NONCURRENT CASH AND INVESTMENTS						
Held by trustee for debt service	27,971,624	-	-	27,971,624	-	27,971,624
Less amounts required to meet current obligations	2,456,557	-	-	2,456,557	-	2,456,557
	25,515,067	-	-	25,515,067	-	25,515,067
Other long-term investments	70,309,957	-	-	70,309,957	-	70,309,957
Total noncurrent cash and investments	95,825,024	-	-	95,825,024	-	95,825,024
CAPITAL ASSETS, net	157,656,697	2,872,724	51,677	160,581,098	-	160,581,098
OTHER ASSETS, net	4,622,116	-	-	4,622,116	(1,967,258)	2,654,858
Total noncurrent assets	258,103,837	2,872,724	51,677	261,028,238	(1,967,258)	259,060,980
TOTAL ASSETS	$ 358,408,967	$ 6,642,549	$ 3,459,775	$ 368,511,291	$ (2,304,962)	$ 366,206,329

(Continued)

See accompanying notes of independent auditors.

ANTELOPE VALLEY HEALTHCARE DISTRICT
CONSOLIDATING SCHEDULE OF NET POSITION (CONTINUED)
JUNE 30, 2012

	AVHD	AVOIC	Other	Total	Eliminations	Consolidated Balance
LIABILITIES AND NET POSITION						
CURRENT LIABILITIES						
Accounts payable and accrued liabilities	$ 13,196,150	$ 630,659	$ 492,345	$ 14,319,154	$ (337,704)	$ 13,981,450
Accrued payroll and related expenses	19,165,494	589,092	1,288	19,755,874	-	19,755,874
Current maturities of long-term debt	6,124,778	552,688	-	6,677,466	-	6,677,466
Accrued workers' compensation and professional liability claims, current portion	5,399,000	-	-	5,399,000	-	5,399,000
Accrued interest payable	2,456,557	-	-	2,456,557	-	2,456,557
Estimated third-party payor settlements	4,542,591	-	-	4,542,591	-	4,542,591
Total current liabilities	50,884,570	1,772,439	493,633	53,150,642	(337,704)	52,812,938
LONG-TERM DEBT, net of current portion	132,867,493	1,567,631	-	134,435,124	-	134,435,124
ACCRUED WORKERS' COMPENSATION AND PROFESSSIONAL LIABILITY CLAIMS, net of current portion	15,546,141	-	-	15,546,141	-	15,546,141
PENSION AND OPEB LIABILITIES	49,253,322	-	-	49,253,322	-	49,253,322
Total liabilities	248,551,526	3,340,070	493,633	252,385,229	(337,704)	252,047,525
NET POSITION						
Members' contributed capital	-	1,000,000	280,000	1,280,000	(1,280,000)	-
Net investment in capital assets	46,636,050	752,405	51,677	47,440,132	-	47,440,132
Restricted, expendable for:						
Workers' compensation collateral	44,000	-	-	44,000	-	44,000
Specific operating activities	223,633	-	570,715	794,348	-	794,348
Restricted, nonexpendable for minority interests	-	-	-	-	982,495	982,495
Unrestricted	62,953,758	1,550,074	2,063,750	66,567,582	(1,669,753)	64,897,829
Total net position	$ 109,857,441	$ 3,302,479	$ 2,966,142	$ 116,126,062	$ (1,967,258)	$ 114,158,804

See accompanying notes of independent auditors.

ANTELOPE VALLEY HEALTHCARE DISTRICT
CONSOLIDATING SCHEDULE OF REVENUES, EXPENSES AND CHANGES IN NET POSITION
FOR THE YEAR ENDED JUNE 30, 2012

	AVHD	AVOIC	Other	Total	Eliminations	Consolidated Balance
OPERATING REVENUES						
Net patient service revenue, net	$ 330,110,481	$ 14,856,393	$ 374,237	$ 345,341,111	$ -	$ 345,341,111
Other revenue	5,617,542	17,525	-	5,635,067	(969,194)	4,665,873
Total operating revenue	335,728,023	14,873,918	374,237	350,976,178	(969,194)	350,006,984
OPERATING EXPENSES						
Salaries and wages	158,226,885	3,928,225	368,665	162,523,775	-	162,523,775
Employee benefits	51,362,936	573,451	161,911	52,098,298	-	52,098,298
Fees to individuals and organizations	14,315,627	7,210,459	32,638	21,558,724	-	21,558,724
Purchased services	19,591,653	-	42,072	19,633,725	-	19,633,725
Supplies and other expenses	76,191,761	3,211,447	226,478	79,629,686	(1,366,938)	78,262,748
Depreciation and Amortization	12,103,974	398,627	21,655	12,524,256	-	12,524,256
Total operating expenses	331,792,836	15,322,209	853,419	347,968,464	(1,366,938)	346,601,526
OPERATING INCOME (LOSS)	3,935,187	(448,291)	(479,182)	3,007,714	397,744	3,405,458
NONOPERATING REVENUES (EXPENSES)						
Grant revenue and contributions	3,674,442	-	450,772	4,125,214	-	4,125,214
Investment income	1,248,914	1,328	65,894	1,316,136	-	1,316,136
Interest expense	(5,216,637)	(19,562)	-	(5,236,199)	-	(5,236,199)
Total nonoperating (expense) income	(293,281)	(18,234)	516,666	205,151	-	205,151
Income (loss) before capital contributions	3,641,906	(466,525)	37,484	3,212,865	397,744	3,610,609
CAPITAL CONTRIBUTIONS	53,369	-	-	53,369	(53,369)	-
Change in net position	3,695,275	(466,525)	37,484	3,266,234	344,375	3,610,609
NET POSITION, Beginning of year as, adjusted	106,162,166	3,769,004	2,928,658	112,859,828	(2,311,633)	110,548,195
NET POSITION, End of year, as adjusted	$ 109,857,441	$ 3,302,479	$ 2,966,142	$ 116,126,062	$ (1,967,258)	$ 114,158,804

See accompanying notes of independent auditors.

ANTELOPE VALLEY HEALTHCARE DISTRICT
CHARITY CARE AND COMMUNITY BENEFIT (UNAUDITED)
FOR THE YEAR ENDED JUNE 30, 2013 AND 2012

In support of its mission, the District voluntarily provides free care to patients who lack financial resources and are deemed to be medically indigent. Because the District does not pursue collection of amounts determined to qualify as charity care, they are not reported in net patient service revenue. In addition, the District provides services to other medically indigent patients under the state welfare program. The state welfare program pays providers amounts which are less than established charges for the services provided to the recipients, and many times the payments are less than the cost of rendering the services provided.

Charges for charity care accounts, uncollectible accounts and unpaid costs relating to public programs for the years ended June 30 are as follows:

	2013	2012
Charity care charges	$ 16,329,000	$ 29,387,000
Provision for uncollectible accounts	34,791,000	31,937,000
Unpaid costs of public programs	24,727,922	8,675,600
	$ 75,847,922	$ 69,999,600

In addition to uncompensated care, the District also commits significant time and resources to endeavors and critical services which meet otherwise unfilled community needs. Many of these activities are sponsored with the knowledge that they will not be self-supporting or financially viable. Such programs include health screening and assessments, prenatal education and care, community educational services and various support groups.

SINGLE AUDIT REPORTS AND RELATED SCHEDULES

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REPORT OF INDEPENDENT AUDITORS ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

To Management and Board of Directors
Antelope Valley Healthcare District

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 consolidated financial statements of Antelope Valley Healthcare District (the "District") as of and for the year ended June 30, 2013, and the related notes to the financial statements, which collectively comprise Antelope Valley Healthcare District's basic financial statements, and have issued our report thereon dated November 26, 2013.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered Antelope Valley Healthcare District's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of Antelope Valley Healthcare District's internal control. Accordingly, we do not express an opinion on the effectiveness of Antelope Valley Healthcare 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 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 and therefore, material weaknesses or significant deficiencies may exist that were not identified. Given these 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. We did identify certain deficiencies in internal control, described in the accompanying schedule of findings and questioned costs as items 2013-001 and 2013-002 that we consider to be significant deficiencies.

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Compliance and Other Matters

As part of obtaining reasonable assurance about whether Antelope Valley Healthcare District's 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 determination of financial statement amounts. 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*.

Antelope Valley Healthcare District's Response to Findings

Antelope Valley Healthcare District's responses to the findings identified in our audit are described in the accompanying schedule of findings and questioned costs. Antelope Valley Healthcare District's responses were not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on them.

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 entity'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 entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Moss Adams LLP

Los Angeles, California
November 26, 2013

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REPORT OF INDEPENDENT AUDITORS ON COMPLIANCE FOR EACH MAJOR FEDERAL PROGRAM; REPORT ON INTERNAL CONTROL OVER COMPLIANCE; AND REPORT ON THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS REQUIRED BY OMB CIRCULAR A-133

To Management and Board of Directors
Antelope Valley Healthcare District

Report on Compliance for Each Major Federal Program

We have audited Antelope Valley Healthcare District's compliance with the types of compliance requirements described in the *OMB Circular A-133 Compliance Supplement* that could have a direct and material effect on each of Antelope Valley Healthcare District's major federal programs for the year ended June 30, 2013. Antelope Valley Healthcare District's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs.

Management's Responsibility

Management is responsible for compliance with the requirements of laws, regulations, contracts, and grants applicable to its federal programs.

Auditor's Responsibility

Our responsibility is to express an opinion on compliance for each of Antelope Valley Healthcare District's major federal programs based on our audit of the types of compliance requirements referred to above. We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about Antelope Valley Healthcare District's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances.

We believe that our audit provides a reasonable basis for our opinion on compliance for each major federal program. However, our audit does not provide a legal determination of Antelope Valley Healthcare District's compliance.

Opinion on Each Major Federal Program

In our opinion, Antelope Valley Healthcare District complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended June 30, 2013.

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Other Matters

The results of our auditing procedures disclosed instances of noncompliance which are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying schedule of findings and questioned costs as item 2013-003. Our opinion on each major federal program is not modified with respect to these matters.

Antelope Valley Healthcare District's response to the noncompliance finding identified in our audit is described in the accompanying schedule of findings and questioned costs. Antelope Valley Healthcare District's response was not subjected to the auditing procedures applied in the audit of compliance and, accordingly, we express no opinion on the response.

Report on Internal Control Over Compliance

Management of Antelope Valley Healthcare District is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered Antelope Valley Healthcare District's internal control over compliance with the types of requirements that could have a direct and material effect on each major federal program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for each major federal program and to test and report on internal control over compliance in accordance with OMB Circular A-133, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of Antelope Valley Healthcare District's internal control over compliance.

A *deficiency in internal control over compliance* exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. A *material weakness in internal control over compliance* is a deficiency, or a combination of deficiencies, in internal control over compliance such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis. A *significant deficiency in internal control over compliance* is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses. However, we identified a deficiency in internal control over compliance, as described in the accompanying

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schedule of findings and questioned costs as item 2013-003 that we consider to be a significant deficiency.

Antelope Valley Healthcare District's response to the internal control over compliance findings identified in our audit are described in the accompanying schedule of findings and questioned costs. Antelope Valley Healthcare District's response was not subjected to the auditing procedures applied in the audit of compliance and, accordingly, we express no opinion on the response.

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of OMB Circular A-133. Accordingly, this report is not suitable for any other purpose.

Moss Adams LLP

Los Angeles, California
November 26, 2013

ANTELOPE VALLEY HEALTHCARE DISTRICT
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2013

Federal Grantor/Pass-through Grantor/Program Title	Federal CFDA Number	Grant Number/Pass-through Entity Identifying Number	Federal Exp. through 6/30/2013
U.S. Department of Agriculture			
Passed through the California Department of Health:			
Special Supplemental Nutrition Program for Women, Infants and Children	10.557	11-10433	$ 2,921,836
Total U.S. Department of Agriculture			2,921,836
U.S. Department of Health and Human Services			
Passed through the Los Angeles County Department of Health Services:			
National Bioterrorism Hospital Preparedness Program	93.889	300089	107,116
Total U.S. Department of Health and Human Services			107,116
Total Federal Expenditures			$ 3,028,952

See accompanying notes to the Schedule of Expenditures of Federal Awards.

ANTELOPE VALLEY HEALTHCARE DISTRICT
NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2013

Note 1 - Basis of Presentation

The accompanying schedule of expenditures of federal awards (the "Schedule") includes the federal grant activity of the Antelope Valley Healthcare District (District) under programs of the federal government for the year ended June 30, 2013. The information in this schedule is presented in accordance with the requirements of the Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Because the schedule presents only a selected portion of the operations of the District, it is not intended to and does not present the financial position, changes in net position or cash flow of the District.

Note 2 - Summary of Significant Accounting Policies

Expenditures reported on the Schedule are reported on the accrual basis of accounting. Under the accrual basis of accounting, expenditures are recognized when incurred. Such expenditures are recognized following the cost principles contained in OMB Circular A-87, *Cost Principles for State, Local and Indian Tribal Governments*, wherein certain types of expenditures are not allowable or are limited as to reimbursement. Expenditures reported included any property or equipment acquisitions incurred under the federal program. Pass-through entity identifying numbers are presented where available.

Note 3 - Sub-Recipients

During the fiscal year ended June 30, 2013, the District disbursed no Federal funds to sub-recipients.

Section I - Summary of Auditor's Results

Financial Statements

Type of auditor's report issued: *Unmodified*

Internal control over financial reporting:

- Material weakness(es) identified? ☐ Yes ☒ No
- Significant deficiency(ies) identified? ☒ Yes ☐ None reported

Noncompliance material to financial statements noted? ☐ Yes ☒ No

Federal Awards

Internal control over major programs:

- Material weakness(es) identified? ☐ Yes ☒ No
- Significant deficiency(ies) identified? ☒ Yes ☐ None reported

Any audit findings disclosed that are required to be reported in accordance with section 510(a) of Circular A-133? ☒ Yes ☐ No

Identification of Major Programs

CFDA Numbers	*Name of Federal Program or Cluster*	*Type of Auditor's Report Issued*
10.557	U. S. Department of Agriculture - Special Supplemental Nutrition Program for Women, Infants and Children	*Unmodified*

Dollar threshold used to distinguish between type A and type B programs: $ 300,000

Auditee qualified as low-risk auditee? ☐ Yes ☒ No

Section II - Financial Statement Findings

FINDING 2013-001 – Allowances for Patient Accounts Receivable (Significant Deficiency in Internal Control)

Criteria: The District records estimated reserves for contractual and bad debt allowances on patient accounts receivable based on historical experience to reduce patient accounts receivable to their estimated net realizable value.

Condition: During fiscal 2013, the District changed their methodology from providing a 100% reserve on accounts aged greater than 180 days, to providing a 100% reserve on accounts aged greater than 270 days. This change in methodology was not adequately supported.

Context: During our analysis of the estimated reserves, we considered historical collection experience, including a look-back on the allowances provided in the prior year. Based on the historical collection experience of the District, this change in methodology was not supported.

Effect: The impact of this change in methodology required an adjustment to increase allowances for patient accounts receivable by approximately $2 million.

Cause: The District did not conduct a detailed analysis to support changing the methodology in the current year.

Recommendation: Management should ensure all changes in the methodology to determine the estimated allowances for patient accounts receivable should be thoroughly documented and supported by historical data.

Views of responsible officials and planned corrective actions: Management agrees with the recommendation and will ensure any future changes in methodology are thoroughly documented and supported by historical data.

FINDING 2013-002 – Third Party Cost Report Settlement Estimates (Significant Deficiency in Internal Control)

Criteria: The District files their annual Medicare cost report several months after the financial statements are issued. As a result, an estimate is required at year end to ensure adequate provision for estimated amounts receivable or payable to Medicare for services provided during the year.

Condition: The District's June 30, 2013 financial statements did not provide an accrual for amounts receivable or payable for the fiscal 2013 Medicare cost report.

Context: The District utilizes an outside consultant to provide information regarding estimated amounts receivable or payable on each open cost report year. Though use of an outside consultant is common practice, it remains the responsibility of management to support the amounts to be recorded in the financial statements, and to provide a detailed analysis supporting the District's position as to whether an accrual is necessary.

Effect: The results of our analysis indicated an estimated overpayment by Medicare to the District of approximately $775,000.

Cause: The District did not prepare or obtain a detailed analysis to support the amount to be recorded.

Recommendation: A detailed analysis should be prepared by management on a semi-annual or annual basis, with the assistance of an outside consultant as necessary, utilizing current year data to determine the estimated amount receivable or payable upon final settlement of the cost report by Medicare.

Views of responsible officials and planned corrective actions: Management agrees with the recommendation and will ensure a detailed analysis is prepared supporting the District's position as to whether an accrual for estimated cost report settlements is necessary.

Section III - Federal Award Findings and Questioned Costs

FINDING 2013-003 – Equipment Management (Significant Deficiency in Internal Control and Instances of Noncompliance)

CFDA Number	*Federal Agency/Pass-through Entity - Program Name*	*Award Number*	*Award year*	*Questioned Costs*
10.557	U.S. Department of Agriculture: California Department of Health - Special Supplemental Nutrition Program for Women, Infants and Children	11-10433	2012/ 2013	$0

Criteria or specific requirement (including statutory, regulatory, or other citation): Per the Special Supplemental Nutrition Program for Women, Infants and Children (WIC) contract, the California Department of Health (CDPH) requires the reporting, tagging, and annual inventory of all equipment and/or property that is furnished by CDPH or purchased/reimbursed with funds provided by CDPH to the Local Agency Inventory System (LAIS), a computer based inventory system designed specifically for WIC local agencies. If equipment is damaged, lost, destroyed, or stolen, a disposal request must be submitted to the State WIC Property Controller.

In relation to physical inventories, 2 CFR Section 215.34 states, "Any differences between quantities determined by the physical inspection and those shown in the accounting records shall be investigated to determine the causes of the difference. The recipient shall, in connection with the inventory, verify the existence, current utilization, and continued need for the equipment. "

Questioned Costs: There are no questioned costs associated with this finding.

Condition: In connection with our audit, we obtained support for the District's physical inventory records as of June 17, 2013 over all equipment purchased with WIC funds. In determining the effectiveness of the District's controls over performing the physical inventory, we selected a sample of 27 items to verify the existence of each asset and to observe the measures employed by management to properly secure it. We noted two assets as reported on the inventory listing that could not be located.

Context: Both of the instances noted in the condition above were stationary telephones. When the telephones were no longer operational they were replaced by the District's centralized IT department with new telephones purchased by the District.

Effect: The District's inventory listing was not accurate and resulted in delayed submission of the disposal request to the State WIC Property Controller.

Cause: No communications were made to the District's WIC program management to inform them of the replacement of each telephone. Therefore the inventory records were not appropriately updated. Moreover, staff reconciled the total number of telephones by location to the inventory listing rather than each individual Asset ID number. Had each asset been reconciled by its Asset ID number the disposals would have been detected.

Recommendation: We recommend that the District's WIC management implement new procedures to ensure that all disposed equipment originally purchased with federal funds are communicated to management in a timely manner. We recommend that during the physical inventory inspection, individual Asset ID numbers, as reported on each piece of equipment, be reconciled to the inventory detail and all discrepancies be investigated.

Views of responsible officials and planned corrective actions: Management agrees with the recommendation and is in the process of writing a policy to ensure all equipment purchased with federal funds is inventoried and disposed of in a timely and well documented manner.

FINDING 2012-1 – ***Self-Insurance – Medical Malpractice and Workers' Compensation***

Current Year Status: Corrected

FINDING 2012-2 – ***Construction Retention Payable***

Current Year Status: Corrected

FINDING 2012-3 – ***Unapplied Cash***

Current Year Status: Corrected