Palomar Health

Consolidated Financial Statements as of and for the Periods Ended June 30, 2013 and 2012, Supplemental Schedules as of and for the Periods Ended June 30, 2013 and 2012, and Independent Auditors’ Report

PALOMAR HEALTH

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PALOMAR HEALTH

MANAGEMENT'S DISCUSSION AND ANALYSIS

Overview

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

PH was formerly known as Palomar Pomerado Health. On March 20, 2012, the Board of Directors by resolution voted to change the name to Palomar Health.

This section of PH's annual financial report presents our analysis of PH's financial performance for the periods ended June 30, 2013 and 2012. Although the 2011 condensed consolidated balance sheet, condensed consolidated statement of revenue, expenses, and changes in net assets, and condensed consolidated statement of cash flows are presented in this section, they are not presented in the accompanying consolidated financial statements and notes to the consolidated financial statements. Please read this analysis in conjunction with the consolidated financial statements that follow this section.

This annual financial report includes:

- Management's Discussion and Analysis
- Independent Auditors' Report
- Consolidated Financial Statements of PH, including notes that explain in more detail some of the information in the consolidated financial statements. The consolidated financial statements also include 18-month financial statements for Arch Health Partners, Inc. (ARCH), as of and for the period ended June 30, 2013. (see Note 1)

PH's consolidated financial statements report information using accounting methods required by the Governmental Accounting Standards Board (GASB), which, while similar to those used by private sector health care organizations, include some differences as described further in this management's discussion and analysis. In accordance with GASB, the General Obligation Bonds (G.O. Bonds) issued by PH are included in the Consolidated Balance Sheets and Consolidated Statements of Revenue, Expenses, and Changes in Net Assets. Repayment of the obligations is from a separate G.O. Bonds tax levy. While the collected funds, the interest expense, and the debt are reflected in the consolidated financial statements according to GASB reporting requirements, they are held and treated separately from ongoing operations. These consolidated financial statements contain short-term and long-term financial information about PH's activities.

On August 19, 2012, PH opened the new Palomar Medical Center (PMC). Services at this campus include critical care, general acute, trauma and cardiovascular services. The former Palomar Medical Center was renamed Palomar Health Downtown Campus (PHDC) and includes the following services: acute behavioral medicine, acute rehabilitation, acute women's (including labor and delivery), and various ambulatory programs. Operations for the period ended June 30, 2013, reflect the effectiveness of readying, licensing, opening, and normalizing the new facility. Significant one-time costs were incurred with the opening of the facility and negatively affected the results for the period ended June 30, 2013.

Required Financial Statements

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

CONDENSED CONSOLIDATED BALANCE SHEETS
AS OF JUNE 30, 2013, 2012, AND 2011
($ in thousands)

	2013	2012	2011
ASSETS			
Current assets	$ 299,369	$ 335,433	$ 328,340
Capital assets — net	1,265,756	1,276,404	1,061,644
Noncurrent assets	89,561	102,573	279,460
TOTAL	$1,654,686	$1,714,410	$1,669,444
LIABILITIES AND NET ASSETS			
Current liabilities	$ 115,966	$ 123,615	$ 126,662
Workers' compensation — net of current portion	1,068	1,063	1,036
Deferred revenue	7,647	7,778	8,180
Fair value of interest rate swap	26,343	40,375	19,463
Long-term debt — net of current portion	1,123,398	1,115,598	1,107,689
Total liabilities	1,274,422	1,288,429	1,263,030
Invested in capital assets — net of related debt	196,667	209,281	167,599
Restricted for repayment of debt	13,753	17,071	33,062
Restricted for capital acquisitions	13,167	13,921	14,161
Restricted for other purposes	329	326	318
Unrestricted	156,348	185,382	191,274
Total net assets	380,264	425,981	406,414
TOTAL	$1,654,686	$1,714,410	$1,669,444

See notes to consolidated financial statements.

2013: Analysis of the Consolidated Balance Sheets

- Current assets decreased by $36,064,000 in 2013, primarily due to decreases in the current portion of assets whose use is limited of $4,732,000, investments of $71,820,000, and prepaid expenses of $1,528,000. These were offset by increases in cash of $12,430,000, net patient accounts receivable of $19,781,000, other receivables of $2,816,000, estimated third-party settlements receivable of $3,212,000, the current portion of assets whose use is limited — G.O. Bonds of $1,488,000, and inventories of $2,289,000.

- Capital assets decreased by $10,648,000 primarily due to purchases related to major building projects of $45,829,000, which were offset by net disposals of $553,000, depreciation expense of $55,885,000, and others of $40,000.

- Noncurrent assets decreased by $13,012,000 primarily due to a decrease in assets whose use is limited of $10,373,000 and other noncurrent assets of $2,639,000.

- Current liabilities decreased by $7,649,000 primarily due to a decrease in accounts payable of $14,346,000, estimated third-party settlements liability of $180,000, and accrued interest payable of $22,000. These were offset by increases in accrued compensation and related liabilities of $4,238,000, the current portion of the G.O. Bonds of $576,000, the current portion of long-term debt of $406,000, and other accrued liabilities of $1,679,000.

- Long-term liabilities decreased by $6,358,000, primarily a result of the decrease in the interest rate swap (adjustment to market value) of $14,032,000, long-term debt of $7,139,000, and deferred revenue of $131,000. They were offset by increases in G.O. Bonds of $14,939,000 and the long-term portion of workers' compensation of $5,000.

- Net assets decreased by $45,717,000, primarily due to results of operations of $36,806,000, and interest expense of $56,753,000, which were offset by property tax revenue of $28,713,000, the unrealized gain on the interest rate swap of $14,032,000, investment income of $1,571,000, and other nonoperating revenue of $2,831,000.

2012: Analysis of the Consolidated Balance Sheets

- Current assets increased by $7,093,000 in 2012, primarily due to increases in net patient accounts receivable of $22,866,000, prepaid expenses of $3,709,000, the current portion of assets whose use is limited — G.O. Bonds of $1,663,000, estimated third-party settlements receivable of $7,201,000, and inventories of $310,000. These were offset by decreases in the current portion of assets whose use is limited of $17,622,000, cash of $5,043,000, investments of $4,890,000, and other receivables of $1,101,000.

- Capital assets increased by $214,760,000, primarily due to purchases related to major building projects of $234,965,000, which were offset by net disposals of $870,000, depreciation expense of $22,420,000, and others of $110,000. During the period ended June 30, 2012, PH became a guarantor for ARCH (see Note 1).

- Noncurrent assets decreased by $176,887,000 primarily due to a decrease in assets whose use is limited of $175,897,000 and other noncurrent assets of $990,000.

- Current liabilities decreased by $3,047,000, primarily due to a decrease in accounts payable of $12,820,000. These were offset by increases in accrued compensation and related liabilities of $3,157,000, the current portion of the G.O. Bonds of $580,000, the current portion of long-term debt of $375,000, estimated third-party settlements liability of $5,521,000, other accrued liabilities of $109,000, and accrued interest payable of $31,000.

- Long-term liabilities increased by $28,446,000, primarily because of the increase in the interest rate swap (adjustment to market value) of $20,912,000, G.O. Bonds of $14,622,000, and the long-term portion of workers' compensation of $27,000. These were offset by decreases in long-term debt of $6,713,000 and deferred revenue of $402,000.

- Net assets increased by $19,567,000, primarily due to results of operations of $10,204,000, property tax revenue of $28,039,000, investment income of $2,014,000, and other nonoperating revenue of $2,458,000, which were offset by the unrealized loss on the interest rate swap of $20,912,000 and interest expense of $3,830,000.

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

CONDENSED CONSOLIDATED STATEMENTS OF REVENUE, EXPENSES, AND CHANGES IN NET ASSETS FOR THE PERIODS ENDED JUNE 30, 2013, 2012, AND 2011 ($ in thousands)

	2013	2012	2011
OPERATING REVENUE:			
Net patient service revenue	$ 579,516	$ 484,922	$ 442,142
Net premium revenue	61,310	53,842	36,673
Other revenue	16,710	13,397	11,192
Total operating revenue	657,536	552,161	490,007
OPERATING EXPENSES	694,342	541,957	478,502
(LOSS) INCOME FROM OPERATIONS	(36,806)	10,204	11,505
NONOPERATING INCOME (EXPENSE):			
Investment income	1,571	2,014	2,626
Unrealized gain (loss) on interest rate swap	14,032	(20,912)	4,859
Interest expense	(56,753)	(3,830)	(4,720)
Property tax revenue — unrestricted	12,914	12,686	12,625
Property tax revenue — G.O. bonds	15,799	15,353	15,019
Other — net	2,831	2,458	3,149
Total nonoperating (expense) income — net	(9,606)	7,769	33,558
(DEFICIENCY) EXCESS OF REVENUE OVER EXPENSES	(46,412)	17,973	45,063
INTERFUND	695	(98)	(283)
CHANGE IN INTEREST IN COMPONENT UNIT		1,692	
(DECREASE) INCREASE IN NET ASSETS	(45,717)	19,567	44,780
NET ASSETS — Beginning of year	425,981	406,414	361,634
NET ASSETS — End of year	$ 380,264	$ 425,981	$ 406,414
ADJUSTED DISCHARGES	43,334	40,222	40,337

See notes to consolidated financial statements.

2013: Analysis of the Consolidated Statement of Revenue, Expenses, and Changes in Net Assets

- In accordance with accounting principles generally accepted in the United States of America ("generally accepted accounting principles") for governmental health care providers, PH's Consolidated Statement of Revenue, Expenses, and Changes in Net Assets reflects the following: (1) net patient service revenue includes the provision for bad debts and (2) nonoperating income (expenses) includes interest expense, which for nongovernmental hospitals is typically grouped as an operating expense. While these GASB requirements make district hospitals conform to other governmental entities, such as colleges and universities, they may be less comparable to nongovernment hospitals because the GASB requirements do not apply to them. This must be considered in order to compare PH to nonprofit and for-profit hospitals. The provision for bad debts was $98,097,000 in the period ended June 30, 2013, and $73,413,000 in the period ended June 30, 2012, and interest expense was $56,753,000 in the period ended June 30, 2013, and $3,830,000 in the period ended June 30, 2012. Beginning with the licensure and opening of PMC in August 2012, capitalization of interest was discontinued and commenced being expensed to nonoperating income (expense) and included in the Consolidated Statement of Revenue, Expenses, and Changes in Net Assets. Adjusted discharges are utilized as an aggregate indicator of hospital activity. The calculation of adjusted discharges applies factors representing outpatient activity and skilled nursing activity to acute inpatient discharges.

- Operating revenue is generated through the primary activity of treating patients (providing inpatient and outpatient, ancillary, and other patient care service) as well as other affiliated revenue. Operating revenue increased by $105,375,000 in the period ended June 30, 2013, due to increases in net patient service revenue of $94,594,000, increase in net premium revenue of $7,468,000, and an increase in other revenue of $3,313,000. Increases in inpatient and outpatient ancillary revenue and negotiated increases in contracted payer rates resulted in an increase in net charges during the period.

- Operating expenses are those expenses related to the treatment of patients, including overhead and administration expenses. Operating expenses increased by $152,385,000 in the period ended 2013, primarily due to increases in labor (unionized and non-unionized) costs of approximately $60,530,000, purchased services of $35,722,000, depreciation of $33,539,000, supplies of $10,475,000, professional fees of $3,919,000, and other expenses of $8,200,000. Effective August 19, 2012, PH opened PMC. In conjunction with stocking, staffing, readiness, licensure, and post-opening stabilization, PH incurred significant one-time expenses in excess of planned amount by $12,400,000. The expenses were primarily salaries, wages, and benefits.

- The increase in depreciation of $33,539,000 was attributed to the opening of PMC in August 2012. The depreciable value of the new assets, excluding land cost of $34,853,000, is $1,071,209,000 with a useful life of five to forty years.

- The increase in supplies was attributed to acute hospital facility expansion from two acute care facilities to three, which included service growth and new service start-up. Examples of expanded services and new services include Robotic Surgery and Electrophysiological Lab Services. Additional growth in services includes the Surgical and IR/Cath Lab suites as well as an additional Emergency Department over the prior period. The physical plant expansion required additional supply utilization for janitorial, facilities management, office supply, food, and other supply needs for the third campus. Supplies were necessary and utilized in the third campus for patient ancillary services support areas (Laboratory, Radiology, Pharmacy, Respiratory, Rehabilitation, and Other as reflected in the Consolidated Balance sheets as an increase in inventory).

- The increase in purchased services and professional fees is due to new contracts effective August 2012 when PMC opened. These contracts are for Labor and Delivery and expressCare Plus (subsequently changed to Stand by ER) at PHDC and Emergency and Trauma at PMC. Additional contracts include the purchase services of PIMG, Inc., Orthopedic Surgery of North County, Inc., and Escondido Family Medicine.

- Loss from Operations in the period ended 2013 was $36,806,000 due to PH loss of $22,298,000 and ARCH loss of $14,508,000. This operating loss is a result of operating expenses in excess of revenues.

- Nonoperating (expense) income consists of interest earned on invested monies, interest expense, unrealized gain in interest rate swap for $14,032,000, PH's share of unrestricted property tax revenues of $12,914,000 collected by the County of San Diego, and restricted property tax revenue for repayment of G.O. Bonds of $15,799,000. Nonoperating loss was $9,606,000 in the period ended June 30, 2013, and nonoperating gain of $7,769,000 in the period ended June 30, 2012. The decrease in nonoperating (expense) income is primarily due to the $52,923,000 increase in interest expense.

- As a result of the factors noted above, net assets decreased by $45,717,000 in the period ended June 30, 2013.

2012: Analysis of the Consolidated Statement of Revenue, Expenses, and Changes in Net Assets

- In accordance with generally accepted accounting principles for governmental health care providers, PH's Consolidated Statement of Revenue, Expenses, and Changes in Net Assets reflects the following: (1) net patient service revenue includes the provision for bad debts and (2) nonoperating income (expenses) includes interest expense, which for nongovernmental hospitals is typically grouped as an operating expense. While these GASB requirements make district hospitals conform to other governmental entities, such as colleges and universities, they may be less comparable to nongovernment hospitals because the GASB requirements do not apply to them. This must be considered in order to compare PH to nonprofit and for-profit hospitals. The provision for bad debts was $73,413,000 in the period ended June 30, 2012, and $60,030,000 in the period ended June 30, 2011, and interest expense was $3,830,000 in the period ended June 30, 2012, and $4,720,000 in the period ended June 30, 2011.

- Adjusted discharges are utilized as an aggregate indicator of hospital activity. The calculation of adjusted discharges applies factors representing outpatient activity and skilled nursing activity to inpatient discharges.

- Operating revenue is generated by the primary activity of treating patients (providing inpatient and outpatient, ancillary, and other patient care service) and other affiliate revenue. Operating revenue increased by $62,154,000 in the period ended June 30, 2012, due to increases in net patient service revenue of $42,780,000, increase in net premium revenue of $17,169,000, and an increase in other revenue of $2,205,000. Increases in inpatient and outpatient ancillary revenue and negotiated increases in contracted payer rates resulted in an increase in net charges during the period.

- Operating expenses are those expenses related to the treatment of patients, including overhead and administration expenses. Operating expenses increased by $63,455,000 in the period ended June 30, 2012, primarily due to increases in labor (unionized and non-unionized) costs of approximately $31,563,000, purchased services of $19,741,000, rent expense of $4,471,000, supplies of $4,234,000, and other expenses of $3,446,000.

- Income from Operations in the period ended June 30, 2012, was $10,204,000 due to PH income of $13,711,000 and ARCH loss of $3,507,000. This operating income is a result of operating revenues in excess of expenses.

- Nonoperating income (expense) consists of interest earned on invested monies, interest expense, PH's share of unrestricted property taxes of $12,686,000 collected by the County of San Diego, and restricted G.O. Bond tax levy revenue for repayment of G.O. Bonds of $15,353,000. PH's nonoperating income was $7,769,000 in the period ended June 30, 2012, and $33,558,000 in the period ended June 30, 2011. The $25,789,000 decrease in nonoperating income (expense) is primarily due to the $20,912,000 unrealized loss on the interest rate swap in the period ended June 30, 2012.

- As a result of the factors noted above, net assets increased by $19,567,000 in the period ended June 30, 2012.

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

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED JUNE 30, 2013, 2012, AND 2011
($ in thousands)

	2013	2012	2011
CASH FLOWS FROM:			
Operating activities	$ 9,628	$ (25,793)	$ 39,447
Noncapital financing activities	12,185	13,153	15,491
Capital and related financing activities	(96,391)	(191,162)	(41,615)
Investing activities	87,008	198,759	(8,618)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	12,430	(5,043)	4,705
CASH AND CASH EQUIVALENTS — Beginning of year	6,918	11,961	7,256
CASH AND CASH EQUIVALENTS — End of year	$ 19,348	$ 6,918	$ 11,961

See notes to consolidated financial statements.

2013: Analysis of the Consolidated Statement of Cash Flows

- Operating activities cash inflow reflected an increase of $35,421,000 in the period ended June 30, 2013, over the period ended June 30, 2012. This increase is mostly attributable to increases in cash collections of patient accounts of $111,034,000 offset by increased payments to suppliers and employees of $82,978,000.

- Net cash outflows from capital and related financing activities in 2013 were $96,391,000, primarily due to interest payments of $44,910,000, and the payment of long-term debt of $9,655,000 offset by the receipt of $15,799,000 of property taxes for debt service.

- Investing activities cash inflows were $87,008,000 in 2013. This inflow is mainly composed of sale of investments.

- The ending cash and cash equivalents of $19,348,000 reflect the checking account and overnight investment balances held by PH. In addition, there were current investments of $99,631,000 at June 30, 2013.

2012: Analysis of the Consolidated Statement of Cash Flows

- Operating activities cash inflow reflected a decrease of $65,240,000 in 2012 over 2011. This decrease is attributable to increases in cash collections of patient accounts of $41,163,000 offset by increased payments to suppliers and employees of $114,868,000.

- Net cash outflows from capital and related financing activities in 2012 were $191,162,000, primarily due to the funding of PH's building projects of $158,322,000, interest payments of $39,826,000, and the payment of long-term debt of $8,367,000 offset by the receipt of $15,353,000 of property taxes for debt service.

- Investing activities cash inflows were $198,759,000 in 2012. This outflow is mainly composed of sale of investments.

- The ending cash and cash equivalents of $6,918,000 reflect the checking account and overnight investment balances held by PH. In addition, there were current investments of $171,451,000 at June 30, 2012.

2013: Capital Assets and Long-Term Debt

The Board of Directors approved a facilities master plan (the "Facilities Master Plan") budgeted at $1,057,000,000. In November 2004, the residents of the district voted and approved to fund $496,000,000 of this expansion by the issuance of G.O. Bonds. Payment for these bonds is funded by an ad valorem property tax levied on the district residents. The approximate amount of the tax levy for each taxable property remained at $23.50 per $100,000 of assessed value for the period ended June 30, 2013. The levy is established by Board of Director's resolution each period in an amount sufficient to service the debt for the upcoming period along with a reserve amount.

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

Other building projects include the renovation of existing hospital facilities at Pomerado Hospital, renovation of PHDC, and construction of ambulatory and support facilities at various locations in the District.

The renovations at Pomerado Hospital, which commenced in 2008, include the construction of a new central power plant (the "Central Plant") and various site improvements. The Central Plant was placed in service in the period ended June 30, 2010.

Outpatient facilities expansion plans include the Ramona Satellite Clinic, which was opened in March 2013 with ARCH as the primary tenant. The new clinic offers outpatient services and after-hours urgent care.

PH has four outstanding revenue bond issues that are classified as long-term debt. These are the 1999 Insured Revenue Bonds, the 2006 Insured Certificates of Participation, the 2009 Certificates of Participation, and the 2010 Certificates of Participation. PH made principal payments on these issues totaling $7,080,000, bringing the net long-term bond principal to $584,015,000. All debt payments were made timely. More detailed information about PH's debt is presented in Note 8 to the consolidated financial statements. PH has an underlying Moody's Investor Service ("Moody's) rating of Baa3 on its revenue bonds and certificates of participation.

In July 2005, PH issued its first series of G.O. Bonds authorized by voter approval in 2004 (measure BB) in the amount of $80,000,000 for use in funding the building expansion project. In December 2007, PH issued its second series of G.O. Bonds in the amount of $241,083,000. In March 2009, PH issued its third series of G.O. Bonds in the amount of $110,000,000. In November 2010, PH issued the final series of G.O. Bonds in the amount of $64,917,000. A principal payment of $2,232,000 reduced the G.O. Bonds' principal to $477,632,000 as of June 30, 2013. PH has an underlying Moody's rating of A1 on its G.O. Bonds.

2012: Capital Assets and Long-Term Debt

The Board of Directors approved the Facilities Master Plan budgeted at $1,057,000,000. In November 2004, the residents of the district voted and approved to fund $496,000,000 of this expansion by the issuance of G.O. Bonds. Payment for these bonds is funded by an ad valorem property tax levied on the district residents. The approximate amount of the tax levy for each taxable property remained at $23.50 per $100,000 of assessed value for the period ended June 30, 2012. The levy is established by Board of Director's resolution each period in an amount sufficient to service the debt for the upcoming period along with a reserve amount.

One of the major components of the Facilities Master Plan included the construction of PMC in Escondido. Other building projects included the renovation of existing hospital facilities at Pomerado Hospital, renovation of PHDC, and addition of outpatient facilities at several community locations.

PMC was able to achieve Temporary Certificate of Occupancy (TCO) on April 5, 2012. The receipt of TCO represented substantial completion of the construction activities and allowed the commencement of the activation phase for the building, which includes the installation and delivery of all medical equipment, supplies, and the start of staff education. On June 21, 2012, PH received formal certificate of occupancy from the State, which marked the formal end of all construction activities related to PMC. Subsequent to period-end, on August 15, 2012, a license was received to operate and maintain from the State Department of Public Health, and on August 19, 2012, PH opened PMC for patient care. Depreciation will commence as of the licensure date.

The renovation at Pomerado Hospital, which commenced in 2008, included the construction of the Central Plant as well as various site improvements. The Central Plant was placed in service in the period ended June 30, 2013.

Outpatient facilities expansion plans for the Ramona Satellite Clinic was under construction. Grading operations were completed in late July and the foundation was being readied. The new clinic will offer outpatient services and an after-hours urgent care.

PH has four outstanding revenue bond issues that are classified as long-term debt. These are the 1999 Insured Revenue Bonds, the 2006 Certificates of Participation, the 2009 Certificates of Participation, and the 2010 Certificates of Participation. PH made principal payments on these issues totaling $6,715,000, bringing the net long-term bond principal to $591,095,000. All debt payments were made timely and PH was in good standing on all bond covenants throughout the period. More detailed information about PH's debt is presented in Note 8 to the consolidated financial statements. PH had an underlying Moody's rating of Baa3 on its revenue bonds and certificates of participation.

In July 2005, PH issued its first series of G.O. Bonds authorized by voter approval in 2004 (measure BB) in the amount of $80,000,000 for use in funding the building expansion project. In December 2007, PH issued its second series of G.O. Bonds in the amount of $241,083,000. In March 2009, PH issued its third series of G.O. Bonds in the amount of $110,000,000. In November 2010, PH issued the final series of G.O. Bonds in the amount of $64,917,000. A principal payment of $1,652,000 reduced the G.O. Bonds' principal to $479,863,000 as of June 30, 2012. PH had an underlying Moody's rating of A1 on its G.O. Bonds.

Liquidity and Capital Resources

PH's unrestricted liquidity position as of June 30, 2013, was $118,979,000, including $19,348,000 in operating cash and $99,631,000 in unrestricted investments stated at fair market value. PH's unrestricted liquidity position as of June 30, 2012, was $178,369,000, including $6,918,000 in operating cash and $171,451,000 in unrestricted investments stated at fair market value. The available liquidity of $118,979,000 represents a $59,390,000 decrease over the $178,369,000 in available liquidity as of June 30, 2012, and equaled 20.4% of total outstanding debt exclusive of the G.O. Bonds, which are funded separately from ad valorem taxes as of June 30, 2013.

Economic and Other Factors

A number of significant factors are affecting the financial health of health care providers. Some major factors are as follows:

Patient Projection and Affordable Care Act H.R. 3590 (the "Act") — This Act, also known as Federal Healthcare Reform, signed into law in March 2010 is focused on reducing Medicare costs and will result in extensive changes to the U.S. health care system. Hospitals face lower Medicare reimbursement related to bundled payments programs and readmissions and continued recovery audit contractor (RAC) reviews. PH continues to explore the establishment of an Accountable Care Organization (ACO) and strategic development of network relationships to establish viable delivery options that will provide provider reimbursement to quality metrics and reductions in cost.

Sequestration Transparency Act — The sequester cuts mandated by the Budget Contract Act of 2011 went into effect on April 1, 2013, putting into place a 2% cut in Medicare spending. The resulting impact of these cuts threatens to weaken an already compromised payment system with total effect to revenues and jobs yet to be determined.

California's Health Insurance Exchange (Covered California) — On October 1, 2013, the State of California implemented the American Health Benefit Exchange provisions of the Act. The six-month enrollment period for the state-designed health insurance marketplace is open to more than five million Californians. Although total impact is uncertain, PH anticipates increased demand for emergency and urgent care services and primary and specialty care.

Hospital Provider Fee — Assembly Bill (AB) 1653 was passed by the California Legislature on August 31, 2010, and outlined the changes necessary to deliver the supplemental Medi-Cal payments to hospitals. As a District Hospital, PH is not allowed to participate in the provider fee program, but rather is allowed to participate in Intergovernmental transfer programs (IGTs). PH participated in a federal match IGT model program and received $2.4 million fee-for-service payment for program year 2011-2012. Subsequent to period-end, PH was notified of its eligibility for the program period 2012-2013 NDPH-IGT. It is anticipated that PH will receive a net benefit of $2.5 million.

State Budget Difficulties — In March 2011, the California Legislature passed AB97 to reduce the state's budget deficit which included a 10% reimbursement rate cut for providers of Medi-Cal, California's Medicaid program. Beginning January 9, 2014, the Department of Health Care Services (DHCS) will implement the prospective payment reduction on all claims for the Distinct Part Nursing Facilities.

American Recovery & Reinvestment Act of 2009 (ARRA) — ARRA is an economic stimulus package enacted by Congress in February 2009. Among some of the measures included in ARRA include expansion of social welfare provisions and domestic spending in health care. PH received $0 as of June 30, 2013, and $24,000 as of June 30, 2012, in Consolidated Omnibus Budget Reconciliation Act (COBRA) coverage credits.

The Health Information Technology for Economic and Clinical Health Act (*HITECH*) — HITECH is part of the ARRA, which contains incentives related to health care information technology in general (e.g., creation of a national health care infrastructure) and contains specific incentives designed to accelerate the adoption of electronic health record (EHR) systems among providers. PH received EHR incentive funds in the amounts of $1,718,000 from Medi-Cal and $3,317,000 from Medicare for meeting the Stage 1 meaningful use criteria.

Quality of Care — On October 14, 2014, the U.S. healthcare industry will transition to ICD-10 (International Statistical Classification of Diseases) to accurately evaluate the outcome of new procedures and emerging health care conditions using a more precise code. Anticipated benefits include claims accurately reflecting current technology and medical treatments by utilizing the more expansive coding system.

Seismic Compliance — California Senate Bill (SB) 1953 requires hospitals to meet more stringent seismic guidelines, which represent an unfunded mandate and impose a financial burden by 2008 under current regulation. Under certain criteria, it was possible to extend the SB 1953 deadline to 2013. PH applied for an extension from the California Department of Health Services, moving PH's deadline to 2013. PH's noncompliant buildings were reassessed using HAZards United States criteria and now have a structural performance category of SPC-2, which have until 2030 to comply with the structural seismic safety standards, further extending the economical and functional use of the majority of the acute inpatient beds at PHDC. Some PHDC buildings, Pomerado Hospital, and PMC have no seismic restriction.

Finance Contact

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

Deloitte.

Deloitte & Touche LLP
Suite 200
350 South Grand Avenue
Los Angeles, CA 90071-3462
USA

Tel: +1 213 688 0800
Fax: +1 213 688 0100
www.deloitte.com

INDEPENDENT AUDITORS' REPORT

To the Board of Directors of
Palomar Health:

We have audited the accompanying consolidated financial statements of Palomar Health (PH), which comprise the consolidated balance sheets as of June 30, 2013 and 2012, and the related consolidated statements of revenue, expenses, and changes in net assets and of cash flows for the periods then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Consolidated Financial Statements

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

Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We did not audit the consolidated financial statements of Arch Health Partners, Inc. (ARCH), a blended component unit, which statements reflect total assets constituting 1% of consolidated total assets as of June 30, 2013 and 2012, and total revenues constituting 10% and 6%, respectively, of consolidated total revenues for the periods then ended. Those statements were audited by other auditors, whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for ARCH, is based solely on the report of the other auditors. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

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

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

Opinion

In our opinion, based on our audit and the report of the other auditors, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of PH as of June 30, 2013 and 2012, and the results of their operations and their cash flows for the periods then ended in accordance with accounting principles generally accepted in the United States of America.

Report on Supplemental Schedules

Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The supplemental consolidating schedules listed in the table of contents (pages 41–47) are presented for the purpose of additional analysis and are not a required part of the consolidated financial statements. These schedules are the responsibility of PH's management and were derived from and relate directly to the underlying accounting and other records used to prepare the consolidated financial statements. Such schedules have been subjected to the auditing procedures applied in the audits of the consolidated financial statements and certain additional procedures, including comparing and reconciling such schedules directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, based on our audits and (as to the amounts included for ARCH) the report of the other auditors, such schedules are fairly stated in all material respects in relation to the consolidated financial statements as a whole.

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that management's discussion and analysis on pages 1 through 12 be presented to supplement the basic consolidated financial statements. Such information, although not a part of the basic consolidated financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic consolidated financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic 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.

Deloitte & Touche LLP

November 19, 2013

PALOMAR HEALTH

CONSOLIDATED BALANCE SHEETS
AS OF JUNE 30, 2013 AND 2012
($ in thousands)

ASSETS	2013	2012
CURRENT ASSETS:		
Cash and cash equivalents	$ 19,348	$ 6,918
Investments	99,631	171,451
Patient accounts receivable — net of allowances for uncollectible accounts of $60,930 in 2013 and $37,383 in 2012	122,199	102,418
Other receivables	9,730	6,914
Supplies/inventories	9,775	7,486
Prepaid expenses and other	4,923	6,451
Estimated third-party payor settlements receivable	10,413	7,201
Assets whose use is limited — current portion	5,245	9,977
Assets whose use is limited — general obligation bonds — current portion	18,105	16,617
Total current assets	299,369	335,433
ASSETS WHOSE USE IS LIMITED:		
Held by trustee under indenture agreements	54,803	69,157
Held by trustee under general obligation bonds indenture	18,105	16,617
Held in escrow for street improvements	13,167	13,921
Restricted by donor	329	326
Total assets whose use is limited	86,404	100,021
Less current portion	23,350	26,594
Total assets whose use is limited — long-term portion	63,054	73,427
CAPITAL ASSETS — Net	1,265,756	1,276,404
OTHER ASSETS:		
Deferred financing costs — net	21,707	23,059
Investment in and amounts due from affiliated entities	3,159	3,064
Other	1,641	3,023
Total other assets	26,507	29,146
TOTAL	$1,654,686	$1,714,410

(Continued)

PALOMAR HEALTH

CONSOLIDATED BALANCE SHEETS
AS OF JUNE 30, 2013 AND 2012
($ in thousands)

LIABILITIES AND NET ASSETS	2013	2012
CURRENT LIABILITIES:		
Accounts payable	$ 28,950	$ 43,296
Accrued compensation and related liabilities	36,860	32,622
Current portion of general obligation bonds	2,808	2,232
Current portion of long-term debt	7,829	7,423
Estimated third-party payor settlements liability	8,694	8,874
Other accrued liabilities	21,325	19,646
Accrued interest payable	9,500	9,522
Total current liabilities	115,966	123,615
WORKERS' COMPENSATION — Net of current portion	1,068	1,063
DEFERRED REVENUE	7,647	7,778
LONG-TERM DEBT — General obligation bonds — net of current portion	554,765	539,826
LONG-TERM DEBT — Net of current portion	568,633	575,772
FAIR VALUE OF INTEREST RATE SWAP	26,343	40,375
Total liabilities	1,274,422	1,288,429
COMMITMENTS AND CONTINGENCIES (Note 16)		
NET ASSETS:		
Invested in capital assets — net of related debt	196,667	209,281
Restricted for repayment of debt	13,753	17,071
Restricted for capital acquisitions	13,167	13,921
Restricted for other purposes	329	326
Unrestricted	156,348	185,382
Total net assets	380,264	425,981
TOTAL	$ 1,654,686	$ 1,714,410

See notes to consolidated financial statements. (Concluded)

PALOMAR HEALTH

CONSOLIDATED STATEMENTS OF REVENUE, EXPENSES, AND CHANGES IN NET ASSETS FOR THE PERIODS ENDED JUNE 30, 2013 AND 2012
($ in thousands)

	2013	2012
OPERATING REVENUE:		
Net patient service revenue	$ 579,516	$ 484,922
Net premium revenue	61,310	53,842
Other revenue	16,710	13,397
Total operating revenue	657,536	552,161
OPERATING EXPENSES:		
Salaries, wages, and benefits	383,361	322,831
Professional fees	29,634	25,715
Supplies	89,041	78,566
Purchased services	93,934	58,212
Depreciation and amortization	55,885	22,346
Rent expense	16,678	13,095
Utilities expense	8,248	5,512
Other	17,561	15,680
Total operating expenses	694,342	541,957
(LOSS) INCOME FROM OPERATIONS	(36,806)	10,204
NONOPERATING INCOME (EXPENSES):		
Investment income	1,571	2,014
Unrealized gain (loss) on interest rate swap	14,032	(20,912)
Interest expense	(56,753)	(3,830)
Property tax revenue	12,914	12,686
Property tax revenue — general obligation bonds	15,799	15,353
Other — net	2,831	2,458
Total nonoperating (expenses) income — net	(9,606)	7,769
(DEFICIENCY) EXCESS OF REVENUE OVER EXPENSES	(46,412)	17,973
INTERFUND — ARCH	695	(195)
INTERFUND — PIMG		97
CHANGE IN INTEREST IN COMPONENT UNIT		1,692
(DECREASE) INCREASE IN NET ASSETS	(45,717)	19,567
NET ASSETS — Beginning of year	425,981	406,414
NET ASSETS — End of year	$ 380,264	$ 425,981

See notes to consolidated financial statements.

PALOMAR HEALTH

CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE PERIODS ENDED JUNE 30, 2013 AND 2012
($ in thousands)

	2013	2012
CASH FLOWS FROM OPERATING ACTIVITIES:		
Receipts from:		
Patients, insurers, and other third-party payors	$ 655,974	$ 544,940
Other sources	23,917	16,552
Payments to:		
Employees	(379,118)	(319,647)
Suppliers	(291,145)	(267,638)
Net cash provided by (used in) operating activities	9,628	(25,793)
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:		
Receipt of district taxes	12,914	12,686
Other	(729)	467
Net cash provided by noncapital financing activities	12,185	13,153
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:		
Acquisition of capital assets	(57,625)	(158,322)
Interest paid	(44,910)	(39,826)
Repayment of long-term debt	(9,655)	(8,367)
Receipt of property taxes restricted for debt service on general obligation bonds	15,799	15,353
Net cash used in capital and related financing activities	(96,391)	(191,162)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of investments	(238,690)	(173,137)
Sale of investments	320,777	371,769
Interest received on investments and notes receivable	4,921	127
Net cash provided by investing activities	87,008	198,759
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	12,430	(5,043)
CASH AND CASH EQUIVALENTS — Beginning of year	6,918	11,961
CASH AND CASH EQUIVALENTS — End of year	$ 19,348	$ 6,918

(Continued)

PALOMAR HEALTH

CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE PERIODS ENDED JUNE 30, 2013 AND 2012
($ in thousands)

	2013	2012
RECONCILIATION OF OPERATING INCOME TO NET CASH FLOWS FROM OPERATING ACTIVITIES:		
(Loss) Income from operations	$ (36,806)	$ 10,204
Adjustments to reconcile (loss) income from operations to net cash provided by (used) in by operating activities:		
Depreciation and amortization	55,885	22,346
Provision for bad debts	98,096	73,413
Equity in earnings of affiliates	(95)	(180)
Change in interest in component unit	1,692	428
Changes in assets and liabilities:		
Patient accounts receivable	(117,877)	(96,279)
Other receivables	(2,816)	1,101
Supplies/inventories	(2,289)	(310)
Prepaid expenses and other	1,528	(3,709)
Estimated third-party payor settlements receivable	(3,212)	(7,201)
Other — net	4,418	(213)
Accounts payable	5,493	(33,805)
Accrued compensation and related liabilities	4,243	3,184
Other accrued liabilities	1,679	109
Estimated third-party payor settlements liability	(180)	5,521
Deferred revenue	(131)	(402)
NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES	$ 9,628	$ (25,793)
NONCASH INVESTING AND CAPITAL AND FINANCING ACTIVITIES — Capital expenditures included in accounts payable	$ 1,147	$ 20,986

See notes to consolidated financial statements. (Concluded)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization — Palomar Health (PH), a public health care district, is organized under the provisions of the Health and Safety Code of the State of California to provide and operate health care facilities. PH was formerly known as Palomar Pomerado Health. On March 20, 2012, the Board of Directors, by resolution, voted to change the name to Palomar Health. The accompanying consolidated financial statements include the accounts of the following commonly controlled divisions and entities of PH:

- Palomar Medical Center, located in West Escondido, California (opened August 19, 2012), includes a 288 bed general acute care hospital including tertiary services, trauma services, and cardiovascular surgery
- Pomerado Hospital, located in Poway, California, includes a 107 bed general acute care hospital, and Villa Pomerado, a distinct part skilled nursing facility and sub-acute facility
- Palomar Health Downtown Campus (PHDC), formerly known as Palomar Medical Center, is located in East Escondido, California and includes women's services, Center for Behavioral Health, Rehabilitation Institute, and Palomar Continuing Care Center, a distinct part skilled nursing facility
- Home Health, located in Escondido, California
- San Marcos Ambulatory Care Center, located in San Marcos, California
- San Marcos Behavioral Medicine Center, located in San Marcos, California
- Central Office, providing management, financial, data processing, materials management, and public affairs services to the other divisions
- Palomar Health Development, a charitable nonprofit organization created to provide assistance and support for PH by obtaining grant funding from federal, state, local, and private sources
- Palomar Health expressCare clinics, located in Albertson Grocery stores in Escondido, Rancho Penasquitos, Temecula, and San Elijo Hills, California
- Arch Health Partners, Inc. (ARCH), a 1206(l) Medical Foundation, located in Poway, California, with nine additional clinical provider offices in Escondido, Poway, Ramona, and San Marcos, California

In April 2010, PH aligned with ARCH as its sole member, for the purpose of improving access, patient experience, and providing comprehensive and high-quality medical care. ARCH provides primary and specialty care medical services and adds another component in effective health care delivery to residents within PH's community.

PH entered into a guaranty agreement with ARCH in September 2011 under which PH guarantees to assist ARCH in meeting the minimum financial responsibility and regulation requirements of the California Department of Managed Healthcare. In accordance with Governmental Accounting Standards Board (GASB) 2100, *The Financial Reporting Entity*, for financial reporting purposes, PH's reporting entity includes ARCH as a blended component unit as a result of the fiscal dependency on PH. On December 3, 2012, the Board of Directors of ARCH approved a change in ARCH's fiscal year end from December 31 to June 30. The financial statements as of and for the 18-month period ended June 30, 2013, and as of and for the year ended December 31, 2011, has been blended (reported as if it is part of PH) with those of PH.

Basis of Presentation — The consolidated financial statements have been prepared in accordance with the applicable provisions of the American Institute of Certified Public Accountants' (AICPA) Audit and Accounting Guide, *Health Care Organizations*, and pronouncements of GASB. PH uses proprietary (enterprise) fund accounting. Revenues and expenses are recognized on the accrual basis using the economic resources measurement focus. Eliminations of internal activity have been made in the consolidated financial statements. As a result of the different reporting periods between PH and ARCH, inconsistencies in amounts have been reported in the following activities:

	Period Ended June 30, 2013
Other revenues	$ 1,595
Operating expenses	1,595

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

Proprietary Fund Accounting — PH utilizes the proprietary fund method of accounting, whereby revenue and expenses are recognized on the accrual basis.

Accounting Standards — Pursuant to GASB P.08.103, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, PH has elected to apply the provisions of all relevant pronouncements of the Financial Accounting Standards Board, including those issued after November 30, 1989, that do not conflict with or contradict GASB pronouncements.

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

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

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

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

PH has entered into an agreement with the City of Escondido (the "City") to financially participate in street improvements near the site of PH's new hospital being constructed in the City. Under the agreement, PH was required to deposit $13,000,000 into a jointly managed account between the City and PH. PH's financial obligation is limited to the deposited amount plus any earned interest on the deposited funds. The balance of $13,167,000 and $13,921,000 as of June 30, 2013 and 2012, respectively, is included in assets whose use is limited in the accompanying consolidated balance sheets.

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

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

Interest cost incurred on borrowed funds during the period of construction of capital assets, net of interest earned of $153,000 and $839,000 for the periods ended June 30, 2013 and 2012, respectively, is capitalized as a component of the cost of acquiring those assets. Net interest cost capitalized was $8,017,000 and $60,234,000 for the periods ended June 30, 2013 and 2012, respectively.

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

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

Debt Discounts, Debt Premiums, and Deferred Financing Costs — Debt discounts, debt premiums, and deferred financing costs are amortized by the bonds' outstanding method over the life of the related bonds. Deferred financing costs for $21,707,000 and $23,059,000 are net of accumulated amortization of $9,605,000 and $8,253,000 as of June 30, 2013 and 2012, respectively.

Interest Rate Swaps — PH has entered into variable-to-fixed interest rate swaps, which are reflected at fair value in the consolidated balance sheets. The fair value of the interest rate swaps will fluctuate based generally on changes in market rates of interest. Any unrealized gains or losses resulting from changes in fair value are reported as nonoperating income (expenses) in the consolidated statements of revenue, expenses, and changes in net assets. Interest cost on variable interest rate debt is reported based on the fixed interest rate paid by PH under the interest rate swaps. As of June 30, 2013 and 2012, the interest rate swaps are recorded as a liability of $26,343,000 and $40,375,000, respectively.

Net Assets — Net assets of PH are classified in five components. Net assets invested in capital assets — net of related debt consist of capital assets net of accumulated depreciation and reduced by the current balances of any outstanding borrowing used to finance the purchase or construction of those assets. Net assets restricted for repayment of debt are amounts deposited with trustees as required by bond indentures, as described in Note 8. Net assets restricted for capital acquisitions relate to amounts restricted to acquire capital assets. Net assets restricted for other purposes are noncapital net assets that must be used for a particular purpose, as specified by contributors external to PH. Unrestricted net assets are remaining net assets that do not meet the definition of invested in capital assets — net of related debt or restricted.

Consolidated Statements of Revenue, Expenses, and Changes in Net Assets — All revenues and expenses directly related to the delivery of health care services are included in operating revenue and expenses in the consolidated statements of revenue, expenses, and changes in net assets. Nonoperating income and expenses consist of those revenues and expenses that result from nonexchange transactions and interest expense and investment income.

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

Net Premium Revenue — PH has agreements with various third-party payors to provide medical services to subscribing participants. Under some of these agreements, PH receives monthly capitation payments based on the number of each payor's participants, regardless of services actually performed by PH. Under these agreements, PH also participates in shared risk pools with medical groups, through which it could receive additional reimbursement or pay additional amounts to the medical groups. In conjunction with the shared risk pools, PH estimates incurred but not reported (IBNR) claims for medical services provided to patients. IBNR of $8,237,000 and $7,434,000 are included in other accrued liabilities in the accompanying consolidated balance sheets as of June 30, 2013 and 2012, respectively.

Charity Care — PH provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. Amounts determined to qualify as charity care are not reported as revenue in the accompanying consolidated financial statements. Charity care charges forgone, at established rates, for the periods ended June 30, 2013 and 2012, were $14,696,000 and $24,639,000, respectively. PH's cost of providing charity care for the periods ended June 30, 2013 and 2012, were $3,320,000 and $5,566,000, respectively. The cost of providing charity care is calculated using the cost to charge ratio.

Property Taxes — PH receives financial support from property taxes. Property taxes are levied by the County of San Diego on behalf of PH to finance PH's activities. Amounts levied for General Obligation Bonds ("G.O. Bonds") are based on assessed property values set annually by the Board of Directors. Property tax revenue for the periods ended June 30, 2013 and 2012, consists of the following:

	2013	2012
To support operations — unrestricted use	$12,914,000	$12,686,000
For debt service on general obligation bonds — restricted use	15,799,000	15,353,000
Total	$28,713,000	$28,039,000

Income Taxes — PH is a governmental subdivision of the State of California and is exempt from federal income and state franchise taxes.

ARCH is exempt from income taxes under Section 501(c)(3) of the Internal Revenue Code (IRC) and Section 23701(d) of the California Revenue and Taxation Code. ARCH, however, may be subject to tax on income, which is not related to its exempt purpose. ARCH is reporting no such unrelated business taxable income, and therefore, no provision for income taxes has been made as of June 30, 2013, and 2012, respectively.

Recent Accounting Pronouncements —

In March 2012, the GASB issued GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities.* This 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. The provisions of this statement are effective for financial statements for periods beginning after December 15, 2012. Management does not believe that the adoption of this statement will have a material impact on PH's consolidated financial statements.

In March 2012, the GASB issued GASB Statement No. 66, *Technical Corrections — 2012 — an amendment of GASB Statements No. 10 and No. 62.* The objective of this statement is to improve accounting and financial reporting for a governmental financial reporting entity by resolving conflicting guidance that resulted from the issuance of two pronouncements, Statements No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions,* and No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements.* The provisions of this statement are effective for financial statements for periods beginning after December 15, 2012. Management does not believe that the adoption of this statement will have a material impact on PH's consolidated financial statements.

In June 2012, the GASB issued GASB Statement No. 67, *Financial Reporting for Pension Plans — an amendment of GASB Statement No. 25*. The objective of this statement is to improve financial reporting by state and local governmental pension plans. This statement results from a comprehensive review of the effectiveness of existing standards of accounting and financial reporting for pensions with regard to providing decision-useful information, supporting assessments of accountability and interperiod equity, and creating additional transparency. This statement replaces the requirements of Statements No. 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans*, and No. 50, *Pension Disclosures*, as they relate to pension plans that are administered through trusts or equivalent arrangements (hereafter jointly referred to as "trusts") that meet certain criteria. The requirements of Statements No. 25 and 50 remain applicable to pension plans that are not administered through trusts covered by the scope of this statement and to defined contribution plans that provide postemployment benefits other than pensions. The provisions of this statement are effective for financial statements for periods beginning after June 15, 2013. Management does not believe that the adoption of this statement will have a material impact on PH's consolidated financial statements.

In June 2012, the GASB issued GASB Statement No. 68, *Accounting and Financial Reporting for Pensions — an amendment of GASB Statement No. 27.* The primary objective of this statement is to improve accounting and financial reporting by state and local governments for pensions. It also improves information provided by state and local governmental employers about financial support for pensions that is provided by other entities. This statement results from a comprehensive review of the effectiveness of existing standards of accounting and financial reporting for pensions with regard to providing decision-useful information, supporting assessments of accountability and interperiod equity, and creating additional transparency. The provisions of this statement are effective for financial statements for periods beginning after June 15, 2014. Management does not believe that the adoption of this statement will have a material impact on PH's consolidated financial statements.

In January 2013, the GASB issued GASB Statement No. 69, *Government Combinations and Disposals of Government Operations*. This statement establishes accounting and financial reporting standards related to government combinations and disposals of government operations. As used in this statement, the term *government combinations* includes a variety of transactions referred to as mergers, acquisitions, and transfers of operations. The requirements of this statement are effective for government combinations and disposals of government operations occurring in financial reporting periods beginning after December 15, 2013, and should be applied on a prospective basis. Management has not determined the effect of GASB Statement No. 69 on PH's consolidated financial statements.

In April 2013, the GASB issued GASB Statement No. 70, *Accounting and Financial Reporting for Nonexchange Financial Guarantees*. This statement requires a government that extends a nonexchange financial guarantee to recognize a liability when qualitative factors and historical data, if any, indicate that it is more likely than not that the government will be required to make a payment on the guarantee. The provisions of this statement are effective for reporting periods beginning after June 15, 2013. Management has not determined the effect of GASB Statement No. 70 on PH's consolidated financial statements.

2. NET PATIENT SERVICE REVENUE

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

Revenue from the Medicare and Medi-Cal programs, inclusive of risk (capitated) and non-risk managed care programs, accounted for approximately 53% and 55% of PH's net patient service revenue for the periods ended June 30, 2013 and 2012, respectively.

Third-party settlements are recorded when received, which include tentative settlements and lump-sum adjustments and final settlements for prior or current cost reporting periods. The cost reports for the Medicare program have been settled through the period ended June 30, 2010, and the costs reports for Medi-Cal programs have been settled through fiscal year 2011. Results of cost report settlements, as well as estimates for settlements of all periods through 2012, have been reflected in the accompanying consolidated financial statements.

As of June 30, 2013 and 2012, estimated third-party settlements resulted in a receivable of $10,413,000 and $7,201,000, respectively, and a liability of $8,694,000 and $8,874,000, respectively. During the periods ended June 30, 2013 and 2012, PH settled various prior-year cost reports and appeal issues. These settlements resulted in approximately $13,373,000 and $8,765,000 of additional revenues in the periods ended June 30, 2013 and 2012, respectively, which are included in net patient service revenue in the accompanying consolidated statements of revenue, expenses, and changes in net assets.

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

3. CASH AND CASH EQUIVALENTS AND INVESTMENTS

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

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

The California State Treasury makes available the Local Agency Investment Fund (LAIF) through which local governments may pool investments. Each governmental entity may invest up to $50,000,000 of unrestricted monies in the fund and an unlimited amount of qualified bond proceeds. PH had invested $29,331,000 and $47,641,000 of unrestricted funds in this fund as of June 30, 2013 and 2012, respectively. PH had invested $10,122,000 and $10,088,000 in jointly managed funds under an escrow agreement with the City of Escondido as of June 30, 2013 and 2012, respectively. Investments in the LAIF are highly liquid, as deposits can be converted to cash within 24 hours without loss of interest. PH is a voluntary participant in the LAIF. The fair value of PH's investments in the LAIF is reported in the accompanying consolidated balance sheets based on PH's pro rata share of the fair value provided by LAIF for the entire LAIF portfolio.

As of June 30, 2013 and 2012, PH had the following investments:

	2013	2012
Investments — current	$ 99,631,000	$171,451,000
Assets whose use is limited — current	23,350,000	26,594,000
Assets whose use is limited — long-term	63,054,000	73,427,000
Total	$186,035,000	$271,472,000

As of June 30, 2013 and 2012, PH had investments by type and maturity as follows:

	2013		
		Investment Maturities (in Years)	
Investment Type	Fair Value	Less than 1	1–5
LAIF	$ 39,453,000	$ 39,453,000	$ -
U.S. government bonds	31,567,000	1,545,000	30,022,000
U.S. Treasury bills	17,733,000	2,379,000	15,354,000
Corporate bonds	19,634,000	2,786,000	16,848,000
Money market mutual funds	77,648,000	77,648,000	
Total	$186,035,000	$123,811,000	$ 62,224,000

	2012		
		Investment Maturities (in Years)	
Investment Type	Fair Value	Less than 1	1–5
LAIF	$ 57,730,000	$ 57,730,000	$ -
U.S. government bonds	50,128,000	3,758,000	46,370,000
U.S. Treasury bills	46,884,000	12,750,000	34,134,000
Corporate bonds	24,254,000	2,374,000	21,880,000
Money market mutual funds	92,476,000	92,476,000	
Total	$271,472,000	$169,088,000	$102,384,000

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

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

Similarly, PH has an exposure to variable interest rate risk stemming from volatility in the auction-rate bond market. The auction-rate bond market allows public agencies to issue long-term debt at short-term rates that typically reset in weekly or monthly auctions.

Credit Risk — Fixed income securities are subject to credit risk, which is the chance that an issuer will fail to pay interest or principal in a timely manner or that negative perceptions of the issuer's ability to make these payments will cause security prices to decline. Certain fixed income securities, including obligations of the U.S. government or those explicitly guaranteed by the U.S. government, are not considered to have credit risk. State law limits PH's investment in commercial paper, corporate bonds, and bond mutual funds with an "A" rating issued by nationally recognized statistical rating organizations. PH has no investment policy that would further limit investment choices. As of June 30, 2013 and 2012, PH's investments, excluding U.S. government obligations, consisted of the following: corporate bond investments rated "A" or better by Standard & Poor's (S&P) and Moody's Investor Services (Moody's), U.S. Government Agency investments rated "AAA" by Moody's, "AA+" by S&P and PH's investments in the LAIF, which were not rated.

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

Investments in any one issuer (other than U.S. Treasury securities and external investment pools) that represent 5% or more of the total investments as of June 30, 2013 and 2012, are as follows:

	Investment Type	2013	2012
Federal National Mortgage Association	Federal Agency Securities	$ 17,756,000	$ 24,391,000
Federal Home Loan Mortgage Corp.	Federal Agency Securities	13,811,000	24,286,000
U.S. Bank, Trustee	U.S. Bank Money Market	54,801,000	69,157,000
Wells Fargo Advantage Government Money Market	U.S. Government Money Market Funds	21,150,000	20,449,000
Total		$ 107,518,000	$ 138,283,000

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

Custodial Credit Risk — Deposits — Custodial credit risk is the risk that in the event of a bank failure, PH's deposits may not be returned to it. PH does not have a policy for custodial credit risk. As of June 30, 2013 and 2012, PH's bank balances totaled $20,780,000 and $19,058,000, respectively, and were not exposed to custodial credit risk, as the uninsured deposits are with financial institutions that are individually required by state law to have government deposits collateralized at a rate of 110% of the deposits. Such collateral is considered to be held in PH's name.

4. CONCENTRATIONS OF CREDIT RISK

PH grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payor agreements. The mix of gross receivables from patients and third-party payors as of June 30, 2013 and 2012, was as follows:

	2013	2012
Medicare	18 %	18 %
Medi-Cal	9	8
HMO/PPO/commercial	40	43
Patient	23	18
Others	10	13
Total	100 %	100 %

5. CAPITAL ASSETS

A summary of changes in capital assets for the periods ended June 30, 2013 and 2012, is as follows:

	Beginning Balance Fiscal 2013	Additions	Disposals	Transfers	Ending Balance Fiscal 2013
Land improvements	$ 15,416,000	$ -	$ -	$ 33,091,000	$ 48,507,000
Buildings and leasehold improvements	211,761,000	1,724,000	(384,000)	953,575,000	1,166,676,000
Equipment	204,862,000	4,011,000	(4,166,000)	84,582,000	289,289,000
Land	15,717,000			34,853,000	50,570,000
Construction in progress	1,099,155,000	40,055,000		(1,106,101,000)	33,109,000
	1,546,911,000	45,790,000	(4,550,000)	-	1,588,151,000
Less accumulated depreciation and amortization	(270,507,000)	(55,885,000)	3,997,000		(322,395,000)
Capital assets — net	$1,276,404,000	$ (10,095,000)	$ (553,000)	$ -	$1,265,756,000

	Beginning Balance Fiscal 2012	Additions	Disposals	Transfers	Ending Balance Fiscal 2012
Land improvements	$ 15,416,000	$ -	$ -	$ -	$ 15,416,000
Buildings and leasehold improvements	208,144,000	1,465,000	(1,000)	2,153,000	211,761,000
Equipment	188,619,000	6,515,000	(4,401,000)	14,129,000	204,862,000
Land	15,717,000				15,717,000
Construction in progress	884,799,000	230,748,000		(16,392,000)	1,099,155,000
	1,312,695,000	238,728,000	(4,402,000)	(110,000)	1,546,911,000
Less accumulated depreciation and amortization	(251,051,000)	(22,988,000)	3,532,000		(270,507,000)
Capital assets — net	$1,061,644,000	$215,740,000	$ (870,000)	$ (110,000)	$1,276,404,000

6. INVESTMENT IN AND AMOUNTS DUE FROM AFFILIATED ENTITIES

During the period ended June 30, 2007, PH entered into a partnership agreement with PDP Pomerado, LLC in exchange for a ground lease agreement. During fiscal year 2010, the partnership with PDP Pomerado, LLC was terminated and the ground lease agreement was transferred to NHP/PMP Pomerado, LLC. In conjunction with the termination of the partnership, PDP Pomerado, LLC was dissolved, and its assets were liquidated. PH received proceeds of $9,672,000 for its interest in PDP Pomerado, LLC, which is presented as deferred revenue in the accompanying consolidated financial statements. The deferred revenue of $7,647,000 and $7,778,000 as of June 30, 2013 and 2012, respectively, is recognized as income based on the terms of the ground lease agreement.

A partnership with San Diego Radiosurgery (SDRS) was created in April 2008. SDRS offers a method for treating harmful tumors that does not require an invasive procedure or anesthesia and lets the patient go home immediately afterwards. Under this partnership, PH and SDRS entered into a reciprocal leasing arrangement wherein the equipment is leased in exchange for office and clinical space in PHDC.

In an effort to strengthen the pediatric/NICU services in North County, PH and Rady Children's Hospital, San Diego (Rady), entered into an affiliation in April 2010, whereby PH transferred day-to-day operation of the inpatient pediatric and neonatal program, including licensure of beds to Rady. As of August 2010, Rady provides these services at PHDC and leases this space from PH under what is commonly known as a hospital in a hospital arrangement. On a fee basis, PH directly provides ancillary services including lab, imaging, and pharmacy as well as other support services. Because certain costs are allocated to the parties, an oversight committee was created to oversee administrative, operational, and clinical components of the Affiliated Program Agreement.

PH acquired a minority interest of 2.5% in Parkway Endoscopy in September 2010 to allow community members and physicians to utilize state-of-the-art equipment at one convenient location.

To position itself in outpatient imaging services in North County, in April 2011, PH and Imaging Services Associates, LLC created a joint venture, Palomar Pomerado Imaging, LLC, to provide high-tech medical imaging services.

PH acquired a minority interest of 5% in the preexisting Pomerado Outpatient Surgical Center, L.P. in July 2012. This partnership provides outpatient surgeries to the Rancho Bernardo Surgery Center in Rancho Bernardo, California.

7. RELATED ORGANIZATIONS

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

The Foundation funds various programs on behalf of PH. Funding for these programs provided by the Foundation totaled $1,228,000 and $2,334,000 for the periods ended June 30, 2013 and 2012, respectively.

In September 2005, PH entered into a management services agreement with the Foundation, whereby PH provides administrative support to the Foundation. Support provided to the Foundation totaled $1,933,000 and $2,246,000 for the periods ended June 30, 2013 and 2012, respectively. The management services agreement includes a line of credit with a $5,000,000 limit that renewed on June 30, 2010. The amount outstanding on the line of credit was $1,322,000 and $617,000 as of June 30, 2013 and 2012, respectively.

A summary of the Foundation's assets, liabilities, and net assets (unaudited) as of June 30, 2013 and 2012, is as follows:

	2013	2012
Assets	$ 10,323,000	$ 10,214,000
Liabilities	$ 2,587,000	$ 1,758,000
Net assets	7,736,000	8,456,000
Total liabilities and net assets	$ 10,323,000	$ 10,214,000

8. LONG-TERM DEBT

A summary of changes in long-term debt for the periods ended June 30, 2013 and 2012, is as follows:

	Beginning Balance Fiscal Year 2013	Additions	Reductions	Ending Balance Fiscal Year 2013	Amounts Due within One Year
Bonds payable:					
Series 2010 certificates of participation	$ 159,252,000	$ 197,000	$ -	$ 159,449,000	$ -
Series 2010 general obligation bonds	65,752,000		(31,000)	65,721,000	
Series 2009 certificates of participation	228,477,000	247,000		228,724,000	
Series 2009 general obligation bonds	114,624,000		(222,000)	114,402,000	
Series 2007 general obligation bonds	245,084,000		(1,306,000)	243,778,000	1,533,000
Series 2006 certificates of participation	171,607,000	66,000		171,673,000	
Series 2005 general obligation bonds	66,989,000		(1,363,000)	65,626,000	1,275,000
Series 1999 insured refunding revenue bonds	22,190,000		(6,963,000)	15,227,000	7,455,000
Accrued interest on capital appreciation bonds	49,610,000	18,437,000		68,047,000	353,000
Capital leases	1,668,000		(280,000)	1,388,000	374,000
Total long-term debt	$1,125,253,000	$18,947,000	$ (10,165,000)	$1,134,035,000	$10,990,000

	Beginning Balance Fiscal Year 2012	Additions	Reductions	Ending Balance Fiscal Year 2012	Amounts Due within One Year
Bonds payable:					
Series 2010 certificates of participation	$ 159,056,000	$ 196,000	$ -	$ 159,252,000	$ -
Series 2010 general obligation bonds	65,782,000		(30,000)	65,752,000	
Series 2009 certificates of participation	228,231,000	246,000		228,477,000	
Series 2009 general obligation bonds	114,846,000		(222,000)	114,624,000	
Series 2007 general obligation bonds	245,896,000		(812,000)	245,084,000	1,052,000
Series 2006 certificates of participation	171,534,000	73,000		171,607,000	
Series 2005 general obligation bonds	68,269,000		(1,280,000)	66,989,000	1,180,000
Series 1999 insured refunding revenue bonds	28,741,000		(6,551,000)	22,190,000	7,080,000
Accrued interest on capital appreciation bonds	32,063,000	17,547,000		49,610,000	198,000
Capital leases	1,971,000		(303,000)	1,668,000	343,000
Total long-term debt	$1,116,389,000	$18,062,000	$ (9,198,000)	$1,125,253,000	$ 9,853,000

The terms and due dates of PH's long-term debt as of June 30, 2013 and 2012, are as follows:

- Series 2010 Certificates of Participation, interest at 5.25% to 6% due semiannually, principal due in annual amounts ranging from $2,255,000 in fiscal 2016 to $20,725,000 in fiscal 2042, net of unamortized original issue discount of $3,915,000 and $4,112,000 at June 30, 2013 and 2012, respectively, collateralized by PH revenues as defined in the indenture agreement.

- Series 2010A G.O. Bonds, accreted interest compounds at 6.84% to 7.85% on $14,917,000 Capital Appreciation Bonds with the first payment to bondholders on August 1, 2034. Accreted interest compounds at 6.75% on $49,999,000 Convertible Capital Appreciation Bonds with the first payment to bondholders also due on August 1, 2034. Principal amounts due in annual amounts ranging from $1,476,000 in fiscal 2038 to $33,159,000 in fiscal 2041, net of unamortized premium of $804,000 and $835,000 at June 30, 2013 and 2012, respectively.

- Series 2009 Certificates of Participation, interest at 4.50% to 6.75% due semiannually, principal due in annual amounts ranging from $3,515,000 in fiscal 2016 to $28,730,000 in fiscal 2040, net of unamortized original issue discount of $4,616,000 and $4,863,000 at June 30, 2013 and 2012, respectively, collateralized by PH revenues as defined in the indenture agreement.

- Series 2009A G.O. Bonds, accreted interest compounds at 6.84% to 9% on $50,001,000 Capital Appreciation Bonds with the first payment to bondholders on August 1, 2019. Accreted interest compounds at 7% on $59,999,000 Convertible Capital Appreciation Bonds with the first payment to bondholders on August 1, 2033. Principal amounts due in annual amounts ranging from $327,000 in fiscal 2021 to $18,868,000 in fiscal 2039, net of unamortized premium of $4,402,000 and $4,624,000 at June 30, 2013 and 2012, respectively.

- Series 2007A G.O. Bonds, interest at 4.5% to 5.125% is due semiannually on $175,000,000 of Current Interest Bonds. Interest on the $66,083,000 Capital Appreciation Bonds is compounded at 3.67% to 4.92% with the first payment to bondholders on August 1, 2011. Principal amounts due in annual amounts ranging from $557,000 in fiscal 2012 to $21,585,000 in fiscal 2038, net of unamortized premium of $4,303,000 and $4,557,000 at June 30, 2013 and 2012, respectively.

- Series 2006 Certificates of Participation, a portion of which refunded the Series 1993 Insured Refunding Revenue Bonds. In addition, PH entered into an interest rate agreement with Citibank, N.A., New York with respect to the Series 2006 Certificates of Participation in a notional amount of $180,00,000 (the "Swap Agreement") (see Note 9) . Interest on the Series 2006 Certificates of Participation is 3.218%, which is the fixed rate to be paid by PH under the Swap Agreement, due semiannually, principal due in annual amounts ranging from $2,775,000 in fiscal 2009 to $12,350,000 in fiscal 2037, net of unamortized loss on refunding of $328,000 and $393,000 at June 30, 2013 and 2012, respectively, collateralized by PH revenues as defined in the indenture agreement.

- Series 2005A G.O. Bonds, interest at 3% to 5% due semiannually, principal due in annual amounts ranging from $945,000 in fiscal 2009 to $5,115,000 in fiscal 2035, net of unamortized premium of $2,386,000 and $2,569,000 at June 30, 2013 and 2012, respectively.

- Series 1999 Insured Refunding Revenue Bonds, interest at 4.375% to 5.375% due semiannually, principal due in annual amounts ranging from $6,060,000 in fiscal 2009 to $7,855,000 in fiscal 2015, net of unamortized premium of $10,000 and $23,000 at June 30, 2013 and 2012, respectively, and unamortized loss on defeasance of $93,000 and $223,000 at June 30, 2013 and 2012, respectively, collateralized by PH revenues as defined in the indenture agreement.

During November 2010, PH issued $163,365,000 of Palomar Pomerado Health Certificates of Participation. The net proceeds of the 2010 Certificates of Participation are used by PH to finance or reimburse PH for its prior payment of certain costs relating to the construction, renovation, expansion, and equipping of its hospital and medical facilities included in a facilities master plan (the "Facilities Master Plan").

During November 2010, PH issued $64,917,000 of Palomar Pomerado Health General Obligation Bonds, Election of 2004, Series 2010A (the "2010 G.O. Bonds"). This bond issue consists of $14,917,000 Capital Appreciation Bonds and $49,999,000 Convertible Capital Appreciation Bonds. The net proceeds of the 2010 G.O. Bonds are used by PH to pay a portion of the costs to construct Palomar Medical Center, expand Pomerado Hospital, renovate PHDC, and the development of satellite ambulatory care facilities in PH's service area.

During November 2009, PH issued $233,340,000 of Palomar Pomerado Health Certificates of Participation. The net proceeds of the 2009 Certificates of Participation are used by PH to finance or reimburse PH for its prior payment of certain costs relating to the construction, renovation, expansion, and equipping of its hospital and medical facilities included in the Facilities Master Plan.

During March 2009, PH issued $110,000,000 of Palomar Pomerado Health General Obligation Bonds, Election of 2004, Series 2009A (the "2009 G.O. Bonds"). This bond issue consists of $50,001,000 Capital Appreciation Bonds and $59,999,000 Convertible Capital Appreciation Bonds. The net proceeds of the 2009 G.O. Bonds are used by PH to pay a portion of the costs to construct Palomar Medical Center, expand Pomerado Hospital, renovate PHDC, and the development of satellite ambulatory care facilities in PH's service area.

During December 2007, PH issued $241,083,000 of Palomar Pomerado Health General Obligation Bonds, Election of 2004, Series 2007A (the "2007 G.O. Bonds"). The net proceeds of the 2007 G.O. Bonds are used by PH to pay a portion of the costs to construct Palomar Medical Center, expand Pomerado Hospital, renovate PHDC, and the development of satellite ambulatory care facilities in PH's service area.

During December 2006, PH issued $180,000,000 of Palomar Pomerado Health Certificates of Participation. The net proceeds of the 2006 Certificates of Participation are used by PH to pay a portion of the costs to construct Palomar Medical Center, expand Pomerado Hospital, renovate PHDC, and the development of satellite ambulatory care facilities in PH's service area. The refunding of the 1993 Insured Revenue Bonds ($23,348,000) resulted in a loss on extinguishment of debt of $884,000, which has been deferred and is being amortized as a component of interest expense over 16 years.

During July 2005, PH issued $80,000,000 of Palomar Pomerado Health General Obligation Bonds Election of 2004, Series 2005A (the "2005 G.O. Bonds"). The net proceeds of the 2005 G.O. Bonds are used by PH to pay a portion of the costs to construct Palomar Medical Center, expand Pomerado Hospital, renovate PHDC, and the development of satellite ambulatory care facilities in PH's service area.

All the G.O. Bonds represent the general obligation of PH, in an amount sufficient to service the obligation, and PH has the power and is obligated to cause to be levied and collected by the County of San Diego annual ad valorem taxes upon all property within PH's boundaries subject to taxation by PH for payment of the principal of and interest on the bonds when due. However, PH is legally required to repay the 2005, 2007, 2009, and 2010 G.O. Bonds if collected ad valorem taxes are insufficient.

In June 1999, PH issued its Series 1999 insured refunding revenue bonds to refund its Series 1989A bonds. The refunding resulted in a loss on extinguishment of debt of $5,241,000, which has been deferred and is being amortized as a component of interest expense over 15 years.

PH is required to maintain certain debt covenants — Days Cash on Hand (DCOH), Maximum Annual Debt Service, and Cushion Ratio under its indenture agreements for the Bonds. The covenant stipulates that in the event of underachievement, the Insurers may require PH to call-in mutually agreed upon consultants to perform mutually agreed upon scope of services to assist PH in achieving the covenants. Under the terms of its master indenture, there was no event of default for any of the covenants related to the insured or uninsured revenue bonds. PH did not achieve the Insurer requirement for DCOH, for the 1999 and 2006 insured revenue bonds, and so advised the Insurers, MBIA Inc. and Assured Guaranty, Corp. (Assured Guaranty). PH also advised the Insurers of the initiatives which PH has implemented to remedy its underachievement, including the scope of services which will be performed by a consultant engaged by PH to assist PH in remedying its underachievement, which initiatives have been acknowledged as acceptable by the Insurers.

At June 30, 2013, long-term capital leases, net of current portion, amounted to $1,014,000. Related net book value of leased equipment is $1,275,000 and depreciation expense totaled $368,000 for the current period.

The estimated fair value of PH's long-term debt was approximately $1,219,800,000 and $1,247,000,000 as of June 30, 2013 and 2012, respectively, based on quotations from independent third parties.

Estimated future principal and interest payments on long-term debt, including capital leases as of June 30, 2013, are as follows:

Years Ending June 30	Principal	Interest	Total
2014	$ 10,637,000	$ 43,557,000	$ 54,194,000
2015	11,600,000	43,323,000	54,923,000
2016	15,279,000	43,142,000	58,421,000
2017	16,261,000	42,992,000	59,253,000
2018	17,188,000	42,878,000	60,066,000
2019-2023	107,396,000	270,326,000	377,722,000
2024-2028	142,607,000	316,564,000	459,171,000
2029-2033	241,196,000	317,953,000	559,149,000
2034-2038	312,483,000	245,381,000	557,864,000
2039-2042	188,386,000	116,588,000	304,974,000
Total	$1,063,033,000	$1,482,704,000	$2,545,737,000

9. INTEREST RATE SWAP

On November 17, 2006, PH entered into the Swap Agreement (see Note 8) as a means to lower its borrowing costs on the Series 2006 Certificate of Participation bonds when compared against fixed-rate bonds at the time of issuance. The agreement was effective December 28, 2006, with a notional amount of $180,000,000 for the Series 2006 Certificate of Participation bonds.

The Series 2006 Certificate of Participation bonds were issued as ARS, whereby the auction rate for each series is generally determined during successive seven-day auction periods.

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

The significant terms of the swap are as follows:

Corresponding bond series	Series 2006 Certificate of Participation bonds
Swap type	Fixed Income
Notional amount	$180,000,000
Effective date	December 28, 2006
Termination date	November 1, 2036
Final bond maturity	November 1, 2036
PH pays	3.218%
Cash payments remitted by PH for period ended June 30, 2013	$4,909,000
PH receives	56% of 30-day LIBOR + 0.23%
Swap fair value — June 30, 2013	$(26,343,000)
Change in fair value for the period ended June 30, 2013	$14,032,000
Classification	Liability

Fair Value — As of June 30, 2013 and 2012, the swap had a negative fair value of $26,343,000 and $40,375,000, respectively, developed by a mark-to-market pricing service using the zero-coupon method. This method calculates the future net settlement payments required by the swap, assuming that the current forward rates implied by the yield curve correctly anticipate future spot interest rates. These payments are then discounted using the spot rates implied by the current yield curve for hypothetical zero-coupon bonds due on the date of each future net settlement of the swap.

Credit Risk — PH seeks to limit its counterparty risk by contracting only with highly rated entities. As of June 30, 2013, the credit rating for the counterparty of the interest rate swap was rated A3 by Moody's, A by S&P, and A by Fitch Investor Services (Fitch). To mitigate the potential for credit risk, under the terms of the Swap Agreement, if the counterparty's credit quality falls below (1) Moody's rating of Baa2, (2) S&P's rating of BBB, or (3) Fitch's rating of BBB, the fair value of the swap will be collateralized by the counterparty with cash and/or treasury securities.

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

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

The negative swap fair value is the termination payment that would be owed by PH to the swap counterparty if the swap were terminated. The payments from PH to the swap counterparty are insured by Assured Guaranty. This insurance provides protection to the swap counterparty in the event palomar health fails to make payments due under the swap. Under the terms of the Swap Agreement, an "insurer event" will occur if both Moody's and S&P's ratings for Assured Guaranty. fall below the A category. If an insurer event happens, PH would be required to post collateral by a first priority perfected security interest in the gross revenues of PH.

As of June 30, 2013, Assured Guaranty was rated by Moody's with A3 for long-term rating and with a stable outlook effective January 17, 2013.

10. PROFESSIONAL SERVICE AGREEMENTS AND ADVANCE TO PIMG, INC.

ARCH entered into professional service agreements with PIMG, Inc., and Escondido Family Medicine in April 2010 and February 2013, respectively, where PIMG, Inc., and Escondido Family Medicine are to provide professional medical services to patients seeking services from and enrolled with ARCH. The agreements expire in March 2035 and February 2038, respectively.

ARCH expensed $22,019,000 and $11,008,000 for the period ended June 30, 2013 and December 31, 2011, respectively, as compensation to PIMG, Inc., and expensed $1,204,000 for the period ended June 30, 2013, as compensation to Escondido Family Medicine,

As part of the professional service agreement with PIMG, Inc., ARCH advanced $702,000 to PIMG, Inc. The amount advanced is to be repaid upon ARCH's request and does not bear interest. The outstanding balance is $702,000 and $702,000 as of June 30, 2013, and December 31, 2011, respectively.

11. OPERATING LEASES

PH leases certain office space and equipment under operating leases. Lease expense on all such leases for the periods ended June 30, 2013 and 2012, totaled $15,773,000 (including $739,000 in nonoperating expense) and $13,641,000 (including $1,023,000 in nonoperating expense), respectively. PH also leases to others office space under operating leases. Future minimum lease payments and receipts under office space and equipment leases as of June 30, 2013, are as follows:

June 30	**Payments**	**Receipts**
2014	$ 9,134,000	$1,537,000
2015	8,949,000	825,000
2016	8,735,000	257,000
2017	8,673,000	140,000
2018	8,633,000	44,000
2019–2023	40,948,000	
2024–2028	18,884,000	
2029–2033	6,145,000	
2034–2038	5,281,000	
Total	$115,382,000	$2,803,000

12. DEFERRED ANNUITY CONTRACTS

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

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

13. RETIREMENT PLAN

PH sponsors a defined contribution retirement plan under which benefits are limited to amounts accumulated from total contributions by PH and by certain employees, plus accrued interest. Prior to January 1, 2004, all employees with three years of service were covered by the plan. On January 1, 2004, the retirement plan was revised to change the eligibility to all employees with one year of service. Contributions under the retirement plan by PH were equal to 5% of covered employees' basic compensation and were funded as accrued through August 2010. The employer contribution rate was 6.5% starting January 2011 and decreased to 6% on January 2013. Total PH contributions expensed for the periods ended June 30, 2013 and 2012, were $15,447,457 and $15,153,000, respectively.

14. SEVERANCE

In June 2013, the PH Board of Directors approved a plan of termination for a reduction in workforce. The severance liability and expense of $818,000 are included in accrued compensation and related liabilities and operating expenses in the accompanying consolidated financial statements for the period ended June 30, 2013. There was no severance liability and expense recorded as June 30, 2012.

15. POSTEMPLOYMENT HEALTHCARE PLAN

The Company accounts for *Postemployment Benefits Other Than Pensions (OPEB)* under GASB Statement No, 45. As of June 30, 2013 and 2012, the annual required contribution (ARC) was $420,000 and $300,000, respectively, and is included in accrued compensation and related liabilities in the accompanying consolidated balance sheets.

Plan Description and Funding Policy — PH's Postemployment Healthcare Plan (the "Plan") is a single employer-defined benefit healthcare plan administered by Tri-Ad Actuaries Inc. The Plan provides medical and dental insurance benefits to qualified postemployment participants on a gap coverage basis. Coverage is limited to those employees that have provided 10 years of consecutive service, are below the age of 65, and do not receive coverage from other sources. The contribution requirements of the Plan members and PH are established and may be amended by the Board of Directors. The required contribution is based on estimated pay-as-you-go financing requirements. For the period ended June 30, 2013 and 2012, PH contributed $121,000 and $101,000, respectively, to the Plan, which consisted entirely of current premiums and included no additional contribution to prefund benefits.

Annual OPEB Cost — PH's annual OPEB cost is calculated based on the ARC of the employer, and the amount actuarially determined in accordance with the guidelines of GASB Statement No. 45.

Actuarial Methods and Assumption — Projections of benefits for financial reporting purposes are based on the substantive plan (the Plan as understood by the employer and the Plan members) and include the types of benefits provided at the time of each valuation and the historical pattern of sharing the benefit costs between the employer and the Plan members to that point. The actuarial methods and assumptions used include techniques that are designed to reduce the effects of short-term volatility in actuarial accrued liabilities and the actuarial value of assets, consistent with the long-term perspective of the calculations. The actuarial valuations are effective for the period ended June 30, 2013 and 2012.

For the periods ended June 30, 2013 and 2012, the actuarial assumptions included a 3% discount rate, which approximates the employer's own rate of return on investments. The unfunded actuarial accrued liability (UAAL) of $3,277,000 is being amortized over the maximum permissible amortization period of 30 years on an open basis. The actuarial valuation uses the projected unit credit and the entry age normal actuarial cost methods.

Funded Status and Funding Progress — As of June 30, 2013, the most recent actuarial valuation date, the plan was unfunded. The actuarial accrued liability for benefits was $3,277,000 and the actuarial value of assets was $0, resulting in an UAAL of $3,277,000. The estimated covered payroll was $163,850,000, and the ratio of the UAAL to the covered payroll was 2%.

16. COMMITMENTS AND CONTINGENCIES

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

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

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

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

Workers' Compensation Program — PH is a participant in the Association of California Healthcare Districts ALPHA Fund ("ALPHA Fund") that administers a self-insured workers' compensation plan for participating districts and other qualifying nonprofit entities. PH pays premiums to the ALPHA Fund that are adjusted annually. Effective July 1, 2002, PH changed its participation in the ALPHA Fund from first dollar coverage of workers' compensation claims to self-insured retention by PH of the first $350,000 of each claim. Effective July 1, 2003, PH increased its retention level to the first $500,000 of each claim. Effective July 1, 2004, PH increased its retention level to the first $750,000 of each claim.

Effective July 1, 2008, PH eliminated its retention and currently has a guaranteed loss/zero deductible. At June 30, 2013 and 2012, estimated claims liabilities for workers' compensation totaled $1,299,000 and $1,328,000, respectively.

The ALPHA Fund was in a deficit position for several years prior to fiscal year 2007, as actuarial claims estimates had exceeded cash reserves. However, the ALPHA Fund has been able to maintain positive cash flow. If the ALPHA Fund were terminated, PH would be liable for its share of any additional premiums necessary for final disposition of claims and losses covered by the ALPHA Fund. If PH were to withdraw from the ALPHA Fund, it would be required to fund its share of a deficit as defined under the joint powers agreement. From fiscal year 2007 onwards, the ALPHA Fund has been in a surplus position. PH accounts for its investment in the ALPHA Fund under the equity method and has recorded its share of $2,244,000 and $2,449,000 as of June 30, 2013 and 2012, respectively, as an asset within other assets in the accompanying consolidated balance sheets.

Comprehensive Liability Insurance Coverage — PH is insured for comprehensive liability (professional liability, bodily injury and property damage liability, personal injury, advertising injury and discrimination liability, and employee benefit liability) under a claims-made policy, which covers asserted claims and incidents reported to the insurance carrier, and has a per-claim deductible of $50,000 for professional liability. PH's comprehensive liability insurance was renewed effective July 1, 2013, and the current policy expires on June 30, 2014. PH has reserved for estimated claims through 2013, including an estimate of IBNR. Such reserves totaled $1,963,000 as of June 30 2013 and 2012, and are recorded as other accrued liabilities in the accompanying consolidated balance sheets.

Medicare Recovery Audit Contractor (RAC) Program — PH is subject to the Medicare RAC Program, which is a program designed to identify improper Medicare payments — both underpayments and overpayments. RAC auditors are contracted by the Centers for Medicare and Medicaid Services on a contingency fee basis, receiving a percentage of the improper overpayments and underpayments they collect from providers. PH has established a reserve to account for potential negative settlements when these cost reports are audited and final settled. The reserve amount is $412,000 and $1,274,000 as of June 30, 2013 and 2012, respectively, and is recorded as estimated third-party payor settlements in the accompanying consolidated balance sheets.

Seismic Compliance — California Senate Bill (SB) 1953 requires hospital acute care buildings to meet more stringent seismic guidelines by 2008. In fiscal 2005, PH received approval from the Office of Statewide Health Planning and Development of a time extension for compliance with SB 1953 until January 1, 2013. The Board of Directors of PH has approved a $1.057 billion expansion plan, which included building Palomar Medical Center, downsizing the existing PHDC (altering the use of the sections that are not compliant with SB 1953), expanding Pomerado Hospital, and building new outpatient satellite clinics. The plan enabled PH to comply with SB 1953 seismic guidelines. Subsequently, as a result of new criteria established by HAZards United States, it was determined that PH's noncompliant buildings are in fact compliant at a SPC-2 rating. This has resulted in those buildings being eligible to render acute inpatient care until 2030.

17. SUBSEQUENT EVENTS

In October 2013, PH closed the skilled nursing facility, Palomar Continuing Care Center in Escondido.

ARCH will be transferring management of its capitated contracts to Sharp Community Medical Group on January 1, 2014. This will relieve ARCH of the risk bearing function and should eliminate the necessity of the PH guaranty agreement as of that date.

18. HEALTH CARE REFORM ACT

On March 23, 2010, President Obama signed the Patient Protection and Affordable Care Act into law, and then, on March 30, 2010, President Obama signed into law the Health Care and Education Affordability Reconciliation Act of 2010 (collectively, "health insurance reform"). PH is evaluating the effect that health insurance reform may have on its financial position and changes in net assets.

* * * * * *

SUPPLEMENTAL SCHEDULES

PALOMAR HEALTH

CONSOLIDATING SCHEDULE — BALANCE SHEETS
AS OF JUNE 30, 2013
($ in thousands)

ASSETS	PH and Entities	ARCH	Elimination	Total
CURRENT ASSETS:				
Cash and cash equivalents	$ 19,032	$ 316	$ -	19,348
Investments	99,631			99,631
Patient accounts receivable — net of allowances for uncollectible accounts of $60,930	118,085	4,114		122,199
Other receivables	7,611	2,441	(322)	9,730
Supplies/inventories	9,775			9,775
Prepaid expenses and other	3,130	1,793		4,923
Estimated third-party payor settlements receivable	10,413			10,413
Assets whose use is limited — current portion	5,245			5,245
Assets whose use is limited — general obligation bonds — current portion	18,105			18,105
Total current assets	291,027	8,664	(322)	299,369
ASSETS WHOSE USE IS LIMITED:				
Held by trustee under indenture agreements	54,803			54,803
Held by trustee under general obligation bonds indenture	18,105			18,105
Held in escrow for street improvements	13,167			13,167
Restricted by donor	329			329
Total assets whose use is limited	86,404	-	-	86,404
Less current portion	23,350			23,350
Total assets whose use is limited — long-term portion	63,054	-	-	63,054
CAPITAL ASSETS — Net	1,260,581	5,175		1,265,756
OTHER ASSETS:				
Deferred financing costs — net	21,707			21,707
Investment in and amounts due from affiliated entities	3,159			3,159
Other	15,825		(14,184)	1,641
Total other assets	40,691	-	(14,184)	26,507
TOTAL	$ 1,655,353	$ 13,839	$ (14,506)	$ 1,654,686

(Continued)

PALOMAR HEALTH

CONSOLIDATING SCHEDULE — BALANCE SHEETS
AS OF JUNE 30, 2013
($ in thousands)

LIABILITIES AND NET ASSETS	PH and Entities	ARCH	Elimination	Total
CURRENT LIABILITIES:				
Accounts payable	$ 26,246	$ 2,704	$ -	$ 28,950
Accrued compensation and related liabilities	36,111	749		36,860
Current portion of general obligation bonds	2,808			2,808
Current portion of long-term debt	7,829			7,829
Estimated third-party payor settlements	8,694			8,694
Other accrued liabilities	15,328	6,319	(322)	21,325
Accrued interest payable	9,594		(94)	9,500
Total current liabilities	106,610	9,772	(416)	115,966
WORKERS’ COMPENSATION — Net of current portion	1,068			1,068
DEFERRED REVENUE	7,647			7,647
LONG-TERM DEBT — General obligation bonds — net of current portion	554,765			554,765
LONG-TERM DEBT — Net of current portion	568,633			568,633
FAIR VALUE OF INTEREST RATE SWAP	26,343			26,343
LINE OF CREDIT — PH		14,090	(14,090)	-
Total liabilities	1,265,066	23,862	(14,506)	1,274,422
COMMITMENTS AND CONTINGENCIES (Note 16)				
NET ASSETS:				
Invested in capital assets — net of related debt	196,667			196,667
Restricted for repayment of debt	13,753			13,753
Restricted for capital acquisitions	13,167			13,167
Restricted for other purposes	329			329
Unrestricted	166,371	(10,023)		156,348
Total net assets	390,287	(10,023)	-	380,264
TOTAL	$ 1,655,353	$ 13,839	$ (14,506)	$ 1,654,686

(Concluded)

PALOMAR HEALTH

CONSOLIDATING SCHEDULE — STATEMENTS OF REVENUE, EXPENSES, AND CHANGES IN NET ASSETS FOR THE PERIOD ENDED JUNE 30, 2013
($ In thousands)

	PH and Entities	ARCH	Eliminations	Total
OPERATING REVENUE:				
Net patient service revenue	$545,689	$ 33,827	$ -	$579,516
Net premium revenue	34,903	26,407		61,310
Other revenue	13,535	6,721	(3,546)	16,710
Total operating revenue	594,127	66,955	(3,546)	657,536
OPERATING EXPENSES:				
Salaries, wages, and benefits	362,850	20,511		383,361
Professional fees	32,066	1,114	(3,546)	29,634
Supplies	83,701	5,340		89,041
Purchased services	51,413	42,521		93,934
Depreciation and amortization	53,718	2,167		55,885
Rent expense	8,987	7,691		16,678
Utilities	8,248			8,248
Other	15,442	2,119		17,561
Total operating expenses	616,425	81,463	(3,546)	694,342
LOSS FROM OPERATIONS	(22,298)	(14,508)	-	(36,806)
NONOPERATING EXPENSES:				
Investment income	1,571			1,571
Unrealized gain on interest rate swap	14,032			14,032
Interest expense	(56,409)	(344)		(56,753)
Property tax revenue	12,914			12,914
Property tax revenue — general obligation bonds	15,799			15,799
Other — net	2,831			2,831
Total nonoperating expenses — net	(9,262)	(344)	-	(9,606)
DEFICIENCY OF REVENUE OVER EXPENSES	(31,560)	(14,852)		(46,412)
INTERFUND — ARCH	(4,110)	4,805		695
INTERFUND — PIMG				-
CHANGE IN INTEREST IN COMPONENT UNIT				-
DECREASE IN NET ASSETS	(35,670)	(10,047)		(45,717)
NET ASSETS — Beginning of year	425,957	24		425,981
NET ASSETS — End of year	$390,287	$ (10,023)	$ -	$380,264

PALOMAR HEALTH

CONSOLIDATING SCHEDULE — BALANCE SHEETS
AS OF JUNE 30, 2012
($ in thousands)

ASSETS	PH and Entities	ARCH	Elimination	Total
CURRENT ASSETS:				
Cash and cash equivalents	$ 6,432	$ 486	$ -	6,918
Investments	171,451			171,451
Patient accounts receivable — net of allowances for uncollectible accounts of $37,383	100,021	2,397		102,418
Other receivables	5,822	1,645	(553)	6,914
Supplies/inventories	7,197	289		7,486
Prepaid expenses and other	5,399	1,052		6,451
Estimated third-party payor settlements receivable	7,201			7,201
Assets whose use is limited — current portion	9,977			9,977
Assets whose use is limited — general obligation bonds — current portion	16,617			16,617
Total current assets	330,117	5,869	(553)	335,433
ASSETS WHOSE USE IS LIMITED:				
Held by trustee under indenture agreements	69,157			69,157
Held by trustee under general obligation bonds indenture	16,617			16,617
Held in escrow for street improvements	13,921			13,921
Restricted by donor	326			326
Total assets whose use is limited	100,021	-	-	100,021
Less current portion	26,594			26,594
Total assets whose use is limited — long-term portion	73,427	-	-	73,427
CAPITAL ASSETS — Net	1,273,281	3,123		1,276,404
OTHER ASSETS:				
Deferred financing costs — net	23,059			23,059
Investment in and amounts due from affiliated entities	3,064			3,064
Other	6,059		(3,036)	3,023
Total other assets	32,182	-	(3,036)	29,146
TOTAL	$ 1,709,007	$ 8,992	$ (3,589)	$ 1,714,410

(Continued)

PALOMAR HEALTH

CONSOLIDATING SCHEDULE — BALANCE SHEETS
AS OF JUNE 30, 2012
($ in thousands)

LIABILITIES AND NET ASSETS	PH and Entities	ARCH	Elimination	Total
CURRENT LIABILITIES:				
Accounts payable	$ 41,855	$ 1,441	$ -	$ 43,296
Accrued compensation and related liabilities	32,117	505		32,622
Current portion of general obligation bonds	2,232			2,232
Current portion of long-term debt	7,423			7,423
Estimated third-party payor settlements	8,874			8,874
Other accrued liabilities	16,213	3,986	(553)	19,646
Accrued interest payable	9,522			9,522
Total current liabilities	118,236	5,932	(553)	123,615
WORKERS' COMPENSATION — Net of current portion	1,063			1,063
DEFERRED REVENUE	7,778			7,778
LONG-TERM DEBT — General obligation bonds — net of current portion	539,826			539,826
LONG-TERM DEBT — Net of current portion	575,772			575,772
FAIR VALUE OF INTEREST RATE SWAP	40,375			40,375
LINE OF CREDIT — PH		3,036	(3,036)	-
Total liabilities	1,283,050	8,968	(3,589)	1,288,429
COMMITMENTS AND CONTINGENCIES (Note 16)				
NET ASSETS:				
Invested in capital assets — net of related debt	209,281			209,281
Restricted for repayment of debt	17,071			17,071
Restricted for capital acquisitions	13,921			13,921
Restricted for other purposes	326			326
Unrestricted	185,358	24		185,382
Total net assets	425,957	24	-	425,981
TOTAL	$ 1,709,007	$ 8,992	$ (3,589)	$ 1,714,410

(Concluded)

PALOMAR HEALTH

CONSOLIDATING SCHEDULE — STATEMENTS OF REVENUE, EXPENSES, AND CHANGES IN NET ASSETS FOR THE PERIOD ENDED JUNE 30, 2012
($ In thousands)

	PH and Entities	ARCH	Eliminations	Total
OPERATING REVENUE:				
Net patient service revenue	$470,171	$ 14,751	$ -	$484,922
Net premium revenue	38,552	15,290		53,842
Other revenue	12,994	2,421	(2,018)	13,397
Total operating revenue	521,717	32,462	(2,018)	552,161
OPERATING EXPENSES:				
Salaries, wages, and benefits	310,260	12,571		322,831
Professional fees	27,381	352	(2,018)	25,715
Supplies	76,250	2,316		78,566
Purchased services	43,472	14,740		58,212
Depreciation and amortization	21,323	1,023		22,346
Rent expense	8,904	4,191		13,095
Utilities	5,512			5,512
Other	14,904	776		15,680
Total operating expenses	508,006	35,969	(2,018)	541,957
INCOME FROM OPERATIONS	13,711	(3,507)	-	10,204
NONOPERATING INCOME (EXPENSES):				
Investment income	2,014			2,014
Unrealized loss on interest rate swap	(20,912)			(20,912)
Interest expense	(3,776)	(54)		(3,830)
Property tax revenue	12,686			12,686
Property tax revenue — general obligation bonds	15,353			15,353
Other — net	2,458			2,458
Total nonoperating income — net	7,823	(54)	-	7,769
EXCESS OF REVENUE OVER EXPENSES	21,534	(3,561)		17,973
INTERFUND — ARCH	(1,991)	1,796		(195)
INTERFUND — PIMG		97		97
CHANGE IN INTEREST IN COMPONENT UNIT			1,692	1,692
INCREASE IN NET ASSETS	19,543	(1,668)	1,692	19,567
NET ASSETS — Beginning of year	406,414	1,692	(1,692)	406,414
NET ASSETS — End of year	$425,957	$ 24	$ -	$425,981