REPORT OF INDEPENDENT AUDITORS AND CONSOLIDATED FINANCIAL STATEMENTS

FOR

PALOMAR HEALTH

June 30, 2017 and 2016

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Overview

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

This section of PH's annual financial report presents management's discussion and analysis of the financial performance for the years ended June 30, 2017 and 2016. Although the 2015 condensed consolidated statement of net position, the condensed consolidated statement of revenue, expenses, and changes in net position, and the condensed consolidated statement of cash flows are presented in this section, they are not presented in the accompanying audited consolidated financial statements and notes to the consolidated financial statements. We encourage the reader to consider the information presented here in conjunction with the audited consolidated financial statements that follow this section.

This annual financial report includes:

- Management's Discussion and Analysis.
- Independent Auditor's 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 statement of PH include the financial statements of Arch Health Partners, Inc. (Arch). In accordance with Governmental Accounting Standards Board (GASB) Codification Section 2100, *The Financial Reporting Entity,* for financial reporting purposes, PH's reporting entity includes Arch as a blended component unit as a result of the fiscal dependency of Arch on PH, and because PH is the sole corporate member of Arch. Effective August 31, 2017, PH, Arch, and US Bank National Association added Arch as an additional member of the Obligated Group created pursuant to the Master Trust Indenture. Unless otherwise indicated, amounts presented in Management's Discussion and Analysis are in thousands.

Required Financial Statements

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

Table 1: Assets, Liabilities and Net Position as of June 30,

	2017	2016	2015
ASSETS			
Current assets	$ 417,348	$ 400,435	$ 355,385
Capital assets - net	1,074,031	1,113,730	1,154,277
Noncurrent assets	70,927	68,532	71,502
Total assets	1,562,306	1,582,697	1,581,164
Deferred outflow of resources - loss on refunding of debt	44,278	-	-
TOTAL ASSETS AND DEFERRED OUTFLOW OF RESOURCES	$ 1,606,584	$ 1,582,697	$ 1,581,164
LIABILITIES			
Current liabilities	$ 151,423	$ 159,745	$ 140,022
Workers' compensation - net of current portion	1,963	530	699
Fair value of interest rate swap	26,473	38,740	28,664
Long-term debt - net of current portion	1,202,333	1,141,388	1,136,411
Total liabilities	1,382,192	1,340,403	1,305,796
Deferred inflow of resources - unearned revenue	8,041	8,159	8,277
Total liabilities and deferred inflow of resources	1,390,233	1,348,562	1,314,073
NET POSITION			
Invested in capital assets - net of related debt	(56,155)	188	49,173
Restricted, expendable for:			
Repayment of debt	21,350	13,867	11,701
Capital acquisitions	9,880	9,843	10,363

2017: Analysis of the Consolidated Statement of Net Position from 2016 to 2017

- Current assets increased by $16,913 or 4% in the year ended June 30, 2017, primarily due to increases in cash and cash equivalents of $6,951, estimated third-party payor settlements of $10,931, other receivables of $1,543, and current restricted cash and investments of $6,185 offset by decreases in net patient accounts receivable of $7,902 and investments of $913. The decrease in accounts receivable is primarily due to leadership's focus on accounts receivable days and other key revenue cycle matters.

- Capital assets – net decreased by $39,699 or 4% primarily due to depreciation and amortization expense of $51,425 and sale and write-down of abandoned projects of $9,255, offset by purchases related to major building projects of $20,977.

- Noncurrent assets increased by $2,395 or 3% primarily due to increases in loan receivable from affiliates of $4,538 offset by decreases in restricted noncurrent cash and investments of $727, Owner Controlled Insurance Program (OCIP) receivable of $130, and prepaid insurance of $1,546.

- Current liabilities decreased by $8,322 or 5% primarily due to a decrease in accounts payable of $6,371 due to the implementation of more efficient processes and a decrease in accrued compensation and related liabilities of $9,483.

- Long-term liabilities increased by $50,111 or 4% primarily due to an increase in long-term debt of $60,945 primarily due to the refinancing of long-term debt (See Note 9) and workers' compensation reserve of $1,433 offset by a decrease in the unrealized loss of the fair value of the interest rate swap of $12,267.

- Net position decreased by $17,784 or 8% due to income from operations of $6,033 and total non-operating expenses of $23,817.

2016: Analysis of the Consolidated Statement of Net Position from 2015 to 2016

- Current assets increased by $45,050 or 13% in the year ended June 30, 2016, primarily due to increases in cash and cash equivalents of $14,304, investments of $17,578, net patient accounts receivable of $5,351 and estimated third-party payor settlements of $4,324. Investments increased by $17,578 due to excess cash available from investments and estimated third-party settlements increased by $4,324 due to a shift in payor mix from traditional Medicare and Medi-Cal to Managed Medicare and Medi-Cal programs.

- Capital assets – net decreased by $40,547 or 4% primarily due to depreciation and amortization expense of $54,273 and net disposals of $603, offset by purchases related to major building projects of $14,329.

- Noncurrent assets decreased by $2,967 or 4% primarily due to decreases in restricted noncurrent cash and investments of $511, Owner Controlled Insurance Program (OCIP) receivable of $1,142, prepaid insurance of $571 and loan receivable from affiliates of $92.

- Current liabilities increased by $19,723 or 14% primarily due to an increase in accounts payable of $12,884, an increase in accrued compensation and related liabilities of $7,523, offset by a decrease in estimated third-party payor settlements of $7,577. The decrease in estimated third party settlements is due to prior years cost reports and appeals under settlement as well as the elimination of the Medi-Cal reimbursement claw-back.

- Long-term liabilities increased by $14,766 or 1% primarily due to an increase in the negative fair value of the interest rate swap of $10,076 and an increase in long-term debt of $4,977.

- Net position decreased by $32,956 or 12% due to income from operations of $6,054 and total non-operating expenses of $39,010.

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

In accordance with accounting principles generally accepted in the United States of America (also known as GAAP or generally accepted accounting principles) for governmental health care providers, PH's consolidated statements of revenue, expenses, and changes in net position reflect that non-operating income (expenses) including 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 cities and counties, they may be less comparable to nongovernment hospitals because of these GASB requirements. This must be a consideration of any comparison of PH to nonprofit and for-profit hospitals.

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

	2017	2016	2015
OPERATING REVENUE:			
Net patient service revenue	$ 691,503	$ 667,244	$ 619,636
Shared risk revenue	79,798	71,380	66,761
Other revenue	15,423	22,309	17,205
Total operating revenue	786,724	760,933	703,602
OPERATING EXPENSES	780,691	754,879	719,115
INCOME (LOSS) FROM OPERATIONS	6,033	6,054	(15,513)
NONOPERATING INCOME (EXPENSE):			
Investment income	1,380	2,496	1,834
Unrealized gain (loss) on interest rate swap	12,267	(10,076)	(2,136)
Interest expense	(69,164)	(67,302)	(66,278)
Property tax revenue - unrestricted	15,910	15,145	14,303
Property tax revenue - restricted	20,077	18,923	17,730
Other - net	(4,287)	1,804	4,689
Total nonoperating expense - net	(23,817)	(39,010)	(29,858)
CHANGE IN NET POSITION	(17,784)	(32,956)	(45,371)
NET POSITION - Beginning of year	234,135	267,091	312,462
NET POSITION - End of year	$ 216,351	$ 234,135	$ 267,091

2017: Analysis of the Consolidated Statement of Revenue, Expenses, and Changes in Net Position from 2016 to 2017

- Operating revenue increased by $25,791 or 4% in the year ended June 30, 2017, primarily due to improved pricing from payor contracts, additional revenue cycle management programs focusing on limiting preventive claim denials, case management initiatives, and volume growth. Also included in this amount are various government reimbursement programs including, but not limited to: Medi-Cal Expansion program, Managed Care Rate Range Plan, Public Hospital Redesign and Incentives in Medi-Cal, Public Hospital Redesign and Incentives in Medi-Cal (PRIME) and Outpatient Supplemental Program. Other Revenue decreased $6,886 due to Rady Children's Hospital of $3,932, lower Electronic Health Record (EHR) payments of $1,346 and other of $454. The decrease related to Rady Children's Hospital is driven by the move from the Palomar Medical Center Downtown Campus (PHDC) to Palomar Medical Center (PMC) Escondido.

- Operating expenses are those expenses related to the treatment of patients as well as overhead and administrative expenses. Operating expenses increased by $25,812 or 3% in the year ended June 30, 2017, primarily due to increases in professional fees arising from consulting services related to the planned closing of the PHDC and the new medical office building under construction of $7,851; purchased services of $9,472 as a result of an increase in business development and technology services; salaries and wages of $8,288 primarily driven by an increase in contract labor as a result of continued nursing shortages and industry hiring challenges; supplies of $7,898 due to inflation of pharmacy costs coupled with increased volume in higher cost surgeries and emergency department visits. These increases were offset by decreases in workers' compensation and hospital professional liability insurance premiums of $3,575 due to the transition to a self-insured retention model; offset by a decrease in depreciation and amortization of $2,848.

- Non-operating expenses (net) - decreased by $15,193 or 39% in the year ended June 30, 2017, primarily due to an increase in the unrealized gain on the interest rate swap which is included in non-operating income of $22,343, offset by an increase in other non-operating expenses of $6,091.

- As a result of the factors noted above, net position decreased by $17,784 or 8% for the year ended June 30, 2017.

2016: Analysis of the Consolidated Statement of Revenue, Expenses, and Changes in Net Position from 2015 to 2016

- Operating revenue increased by $57,331 or 8% in the year ended June 30, 2016, primarily due to payor contract rate increases, governmental payor increases, revenue cycle management initiatives, case management improvement, and volume growth. Also included in this amount are various governmental reimbursements programs including; Medi-Cal Waiver program, Managed Care Rate Range Plan, Outpatient Supplemental Program, and elimination of Medi-Cal reimbursement claw-back.

- Operating expenses are those expenses related to the treatment of patients, including overhead and administrative expenses. Operating expenses increased by $35,764 or 5% in the year ended June 30, 2016, primarily due to increase in salaries, wages, and benefits of $36,310 as a result of premiums associated with nursing labor shortages, increase in purchased services of $6,836 as a result of an increase in technology services, increase in supplies of $2,533 due to inflation of costs coupled with increased volume in higher cost surgeries, and an increase in other of $2,958 primarily due to $1,359 increase in malpractice insurance premium because of increased volumes and $1,208 increase in the estimated claims reserve for comprehensive insurance liability.

- Non-operating expense (net) – increased by $9,152 or 31% in the year ended June 30, 2016, primarily due to an increase in the unrealized loss on interest rate swap of $7,940 and an increase in other non-operating loss of $2,885. Interest expense was $67,302 in the year ended June 30, 2016, and $66,278 in the year ended June 30, 2015.

- As a result of the factors noted above, net position decreased by $32,956 or 12% for the year ended June 30, 2016.

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

Table 3: Consolidated Statement of Cash Flows for the years ended June 30,

	2017	2016	2015
CASH FLOWS FROM:			
Operating activities	$ 52,155	$ 62,300	$ 54,046
Noncapital financing activities	12,458	16,287	16,649
Capital and related financing activities	(53,449)	(49,081)	(27,488)
Investing activities	(4,213)	(15,202)	(44,893)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	6,951	14,304	(1,686)
CASH AND CASH EQUIVALENTS - Beginning of year	59,587	45,283	46,969
CASH AND CASH EQUIVALENTS - End of year	$ 66,538	$ 59,587	$ 45,283

2017: Analysis of the Consolidated Statement of Cash Flows from 2016 to 2017

- Operating activities net cash inflow reflected a decrease of $10,415 or 16% in the year ended June 30, 2017, over the year ended June 30, 2016. This decrease is mostly attributable to decreases in payments to suppliers of $18,626 due to the implementation of more efficient processes, payments to employees of $23,691 and other sources of $13,972 offset by increases in cash collections of patient accounts of $46,145 due to improved pricing from payor contracts and additional revenue cycle management programs focusing on limiting preventive claim denials.

- Net cash outflows used in capital and related financing activities increased by $4,368 primarily due to an increase in the acquisition of property, plant and equipment of $27,777, decreases in repayment of long-term debt of $2,653 and interest paid of $4,032 due to the refinancing of debt, increases in restricted property tax revenue of $1,154, proceeds on the sale of capital assets of $1,795 and other of $6,234.

- Net cash used in investing activities decreased by $10,990 primarily due to a decrease in the purchase of investments of $50,205 and a decrease in proceeds from the sale of investments of $36,756.

- The ending cash and cash equivalents of $66,538 at June 30, 2017 reflect the checking account and overnight investment balances held by PH. In addition, there were current investments of $157,181 at June 30, 2017.

2016: Analysis of the Consolidated Statement of Cash Flows from 2015 to 2016

- Operating activities net cash inflow reflected an increase of $8,254 or 15% in the year ended June 30, 2016, over the year ended June 30, 2015. This increase is mostly attributable to increases in cash collections of patient accounts of $45,691 and increases in payments to employees of $46,918 offset by decreases in payments to suppliers of $5,097 and increases in other sources of $4,384.

- Net cash outflows from capital and related financing activities in 2016 were $49,081, primarily due to interest payments of $45,174, and the payment of long-term debt of $15,324 offset by the receipt of $18,923 of property taxes for debt service and $35 on proceeds from sale of fixed assets.

- Investing activities net cash outflows were $15,202 in 2016. This is primarily due to cash outflows from purchases of investments of $199,050, offset by cash inflow on proceeds from sale of investments of $180,009.

- The ending cash and cash equivalents of $59,587 at June 30, 2016 reflect the checking account and overnight investment balances held by PH. In addition, there were current investments of $158,094 at June 30, 2016.

2017 and 2016: Capital Assets and Long-Term Debt

In 2004, the Board of Directors approved the Facilities Master Plan (the Facilities Master Plan) budgeted at $1,057,000. In November 2004, the residents of the district voted and approved to fund $496,000 of this expansion by the issuance of general obligation bonds (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 23.5% of assessed value in the years ended June 30, 2017 and 2016. The levy is established by the Board of Director's resolution each year in an amount sufficient to service the debt for the upcoming year along with a reserve amount.

One of the major components of the Facilities Master Plan included the construction of Palomar Medical Center Campus, now known as Palomar Medical Center Escondido (Escondido). On August 19, 2012, PH opened the 288-bed facility. It includes critical, intermediate and general inpatient care, surgical and interventional services, a women’s center, and emergency and trauma services.

Other building projects include the renovation of existing hospital facilities at Pomerado Hospital, now known as Palomar Medical Center Poway (Poway), renovation of PHDC, and construction of ambulatory and outpatient facilities at various locations in the District.

On July 27, 2016, the Board of Directors authorized management to commence the due diligence associated with the refunding of the 2005 and 2007 General Obligation (G.O.) Bonds and the 2009 Revenue Bonds (see Note 9).

On October 20, 2016, the $246,750 Refunding Revenue Bonds Series 2016 were issued with the purpose of refunding the 2009 Certificates of Participation, funding a reserve account and paying the costs of issuance of the Series 2016 Revenue Bonds (see Note 9).

PH has three outstanding revenue bonds issued that are classified as long-term debt. These are the 2006 Certificates of Participation (COP), the 2010 COP, and the 2016 Refunding Revenue Bonds. Principal payments of $237,730 and $11,070 during the years ended June 30, 2017 and 2016, respectively, reduced the Bonds’ principal to $566,655 and $557,635 as of June 30, 2017 and 2016, respectively. All debt payments have been made timely. As of June 30, 2017, the outstanding principal balance of the 2009 COP that was advanced refunded during FY 2017 was $226,205.

In July 2005, PH issued its first series of G.O. Bonds authorized by voter approval in 2004 (measure BB) in the amount of $80,000 for use in funding the building expansion project. In December 2007, PH issued its second series of G.O. Bonds totaling $241,083. In March 2009, PH issued its third series of G.O. Bonds in the amount $110,000. In November 2010, PH issued the final series of G.O. Bonds in the amount of $64,917.

On October 27, 2016, the $48,520 General Obligation Refunding Bonds Series 2016A were issued with the purpose of refunding the General Obligations Bonds, Election of 2004, Series 2005A and paying a portion of the costs of issuance of the Series 2016 G.O. Bonds (see Note 9).

On October 27, 2016, the $164,450 General Obligation Refunding Bonds Series 2016B were issued with the purpose of refunding a portion of the General Obligation Bonds, Election of 2004, Series 2007A, funding a reserve account and paying a portion of the costs of issuance of the Series 2016 G.O. Bonds (see Note 9).

Principal payments of $237,014 and $3,931 during the years ended June 30, 2017 and 2016, respectively, reduced the G.O. Bonds' principal to $443,466 and $467,510 as of June 30, 2017 and 2016, respectively.

Liquidity and Capital Resources
PH's unrestricted liquid assets as of June 30, 2017 was $223,719, including $66,538 in operating cash and $157,181 in unrestricted investments stated at fair market value. The current liquidity position represents a $6,038 increase over the $209,891 in available liquidity as of June 30, 2016, and equaled 37.7% of the total outstanding debt as of June 30, 2017 (excluding the existing G.O. Bonds, which are paid from *ad valorem* property taxes), as compared to available liquidity representing 38.1% of total outstanding debt as of June 30, 2016.

PH's days' cash on hand on a consolidated basis as of June 30, 2017 and 2016 is 111.8 and 113.7, respectively.

Economic and Other Factors
On June 24, 2015, PH's Board of Directors voted to transfer all services from PHDC to other PH-owned facilities. Due to failing infrastructure and absent a seismic retrofit, the Board also voted to close the facility. The transition is currently active and management expects that transition of services will be completed by June 30, 2018. This transition of the downtown services continues to require additional outlay of capital beyond normal capital funding trends. Additional funding and resources will be needed for the build out of the remaining vacant floors at Escondido as well as the 4th emergency room pod, tenant improvement costs for the medical office building, and construction costs at Villa Pomerado in Poway to absorb the transitioning behavioral health unit from PHDC.

The challenge of meeting these capital needs and consumer demands becomes more difficult as the health care industry is highly dependent upon a number of factors that could have a significant effect on the operations and financial condition of PH. The healthcare industry is moving towards value-based care which requires improved efficiency and quality measures. As PH shifts towards these patient-centric drivers, inpatient utilization rates will lower with the decrease of readmission rates and improved continuum of care management.

Government payors continue to present reimbursement challenges for healthcare districts. In addition to the 2% sequestration cuts that were put in place in 2013, Medicare continues to look for additional ways to cut medical costs by way of reimbursement modeling. Quality-based reimbursement methods incentivize health care providers to improve quality outcomes and patient experiences and penalize those who are not able to meet these measures. PH is working diligently to improve upon quality metrics which will mitigate the risk of reimbursement cuts.

At the state level, the Affordable Care Act (ACA) has significantly increased the coverage for the Medi-Cal population which in turn has reduced the amount of uncompensated/self-pay care. The shift to Medi-Cal managed care is likely to continue with the goal of improved patient quality and outcomes.

The financial challenges presented to PH due to federal and state budget changes that reduced reimbursement and eliminated safety net supplemental revenue programs for healthcare services these past few years have been substantial and continues to stress on the bottom line.

Union Contract

PH and the two unions, the California Nurses Association (CNA) and the California Healthcare Employee Union (CHEU) have not reached an agreement on a new four-year contract. On May 31, 2017, the parties negotiated a 30-day extension of both contracts. On June 22, 2017, both contracts expired with no additional extension. Active negotiations are still underway covering pay rates, benefits, staffing levels and health and safety issues; however, no assurance can be given regarding the outcome of such negotiations. In the event of a strike, PH is prepared to bring in temporary replacement staff in order to provide ongoing patient care and plans to reduce elective surgeries and outpatient procedures.

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

Report of Independent Auditors

To the Audit Committee of
Palomar Health

Report on Financial Statements

We have audited the accompanying consolidated financial statements of Palomar Health, which comprise the consolidated statements of net position as of June 30, 2017 and 2016, and the related consolidated statements of revenue, expenses, and changes in net position, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the 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.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the California Code of Regulations, Title 2, Section 1131.2, State Controller's Minimum Audit Requirements for California Special Districts. 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 the entity'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 the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Palomar Health as of June 30, 2017 and 2016, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Required Supplementary Information

Accounting standards generally accepted in the United States of America require that the management's discussion and analysis on pages 1 through 9 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, and historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United Statements of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic consolidated financial statements, and other knowledge we obtained during our audit of the basic consolidated financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Moss Adams LLP

Irvine, California
September 29, 2017

Palomar Health
Consolidated Statements of Net Position
June 30, 2017 and 2016
(Dollars in Thousands)

	2017	2016
Assets		
Current Assets		
Cash and cash equivalents	$ 66,538	$ 59,587
Investments	157,181	158,094
Patient accounts receivable - net of allowances for uncollectible accounts of $27,720 in 2017 and $35,721 in 2016	124,067	131,969
Other receivables	7,670	6,127
Supplies and inventories	10,556	10,420
Prepaid expenses and other	4,209	4,227
Estimated third-party payor settlements receivable	16,943	6,012
Restricted cash and investments, current	30,184	23,999
Total current assets	417,348	400,435
Restricted Noncurrent Cash and Investments:		
Held by trustee under indenture agreements	43,653	44,446
Held by trustee under general obligation bonds indenture	30,004	23,791
Held in escrow for street improvements	9,880	9,843
Restricted by donor and other	347	346
Total restricted cash and investments	83,884	78,426
Less amounts required to meet current obligations	30,184	23,999
Total restricted noncurrent cash and investments	53,700	54,427
Capital Assets - net	1,074,031	1,113,730
Other Assets:		
Prepaid debt insurance costs	6,056	7,602
Investment in and amounts due from affiliated entities	4,561	3,792
Other	6,610	2,711
Total other assets	17,227	14,105
Total assets	1,562,306	1,582,697
Deferred outflow of resources - loss on refunding of debt	44,278	-
Total Assets and Deferred Outflow of Resources	$ 1,606,584	$ 1,582,697

See accompanying notes.

Palomar Health
Consolidated Statements of Net Position (continued)
June 30, 2017 and 2016
(Dollars in Thousands)

	2017	2016
Liabilities		
Current Liabilities:		
Accounts payable	$ 34,939	$ 41,310
Accrued compensation and related liabilities	39,864	49,347
Current portion of general obligation bonds	7,107	4,489
Current portion of long-term debt	13,662	11,819
Estimated third-party payor settlements liability	3,896	3,997
Other accrued liabilities	43,124	38,653
Accrued interest payable	8,831	10,130
Total current liabilities	151,423	159,745
Workers' compensation - net of current portion	1,963	530
Long-term debt - general obligation bonds - net of current portion	622,681	602,447
Long-term debt - net of current portion	579,652	538,941
Fair value of interest rate swap	26,473	38,740
Total liabilities	1,382,192	1,340,403
Deferred inflow of resources - unearned revenue	8,041	8,159
Total liabilities and deferred inflow of resources	1,390,233	1,348,562
Commitments and Contingencies (Note 15)		
Net Position:		
Net investment in capital assets	(56,155)	188
Restricted, expendable for:		
Repayment of debt	21,350	13,867
Capital acquisitions	9,880	9,843
Other purposes	347	346
Unrestricted	240,929	209,891
Total net position	216,351	234,135
Total Liabilities, Deferred Inflow of Resources, and Net Position	$ 1,606,584	$ 1,582,697

See accompanying notes.

Palomar Health
Consolidated Statements of Revenue, Expenses, and Changes in Net Position
For the Years Ended June 30, 2017 and 2016
(Dollars in Thousands)

	2017	2016
Operating Revenue:		
Patient service revenue, net of provision for uncollectible accounts of $49,459 in 2017 and $50,548 in 2016	$ 691,503	$ 667,244
Shared risk revenue	79,798	71,380
Other revenue	15,423	22,309
Total operating revenue	786,724	760,933
Operating Expenses:		
Salaries, wages, and benefits	446,100	437,812
Professional fees	41,527	33,676
Supplies	107,845	99,947
Purchased services	86,333	76,861
Depreciation and amortization	51,425	54,273
Rent expense	17,789	18,573
Utilities	9,961	11,031
Other	19,711	22,706
Total operating expenses	780,691	754,879
Income From Operations	6,033	6,054
Nonoperating Income (Expenses):		
Investment income	1,380	2,496
Unrealized gain (loss) on interest rate swap	12,267	(10,076)
Interest expense	(69,164)	(67,302)
Property tax revenue - unrestricted	15,910	15,145
Property tax revenue - restricted	20,077	18,923
Other - net	(4,287)	1,804
Total nonoperating expenses - net	(23,817)	(39,010)
Change in Net Position	(17,784)	(32,956)
Net Position - Beginning of year	234,135	267,091
Net Position - End of year	$ 216,351	$ 234,135

See accompanying notes.

Palomar Health
Consolidated Statements of Cash Flows
For the Years Ended June 30, 2017 and 2016
(Dollars in Thousands)

	2017	2016
Cash From Operating Activities:		
Receipts from:		
Patients, insurers, and other third-party payers	$ 823,660	$ 777,515
Other sources	9,213	23,185
Payments to:		
Employees	(454,149)	(430,458)
Suppliers	(326,568)	(307,942)
Net cash provided by operating activities	52,155	62,300
Cash Flows From Noncapital Financing Activities:		
Receipt of district taxes	15,910	15,145
Other	(3,452)	1,142
Net cash provided by noncapital financing activities	12,458	16,287
Cash Flows From Capital and Related Financing Activities:		
Acquisition and construction of capital assets	(27,777)	(7,541)
Interest payments on long-term debt	(41,142)	(45,174)
Principal repayment on long-term debt	(12,671)	(15,324)
Proceeds on sale of capital assets	1,830	35
Receipt of property taxes restricted for debt service on general obligation bonds	20,077	18,923
Other	6,234	-
Net cash used in capital and related financing activities	(53,449)	(49,081)
Cash Flows From Investing Activities:		
Purchases of investments	(148,846)	(199,050)
Proceeds from sale of investments	143,253	180,009
Interest received on investments and notes receivable	1,380	2,035
Other	-	1,804
Net cash used in by investing activities	(4,213)	(15,202)
Net Increase in Cash and Cash Equivalents	6,951	14,304
Cash and Cash Equivalents - Beginning of year	59,587	45,283

See accompanying notes.

Palomar Health
Consolidated Statements of Cash Flows
For the Years Ended June 30, 2017 and 2016 (continued)
(Dollars in Thousands)

	2017	2016
Reconciliation of Income from Operations to Net Cash Flows Provided by Operating Activities:		
Income from operations	$ 6,033	$ 6,054
Adjustments to reconcile income from operations to net cash provided by operating activities:		
Depreciation and amortization	51,425	54,273
Provision for bad debts	49,459	50,548
Equity in (earnings) losses of affiliates	(769)	92
Loss on disposal of fixed assets	7,418	568
Changes in assets and liabilities:		
Patient accounts receivable	(41,849)	(55,899)
Other receivables	(1,543)	133
Supplies and inventories	(136)	(558)
Prepaid expenses and other	18	(633)
Estimated third-party payor settlements	(11,032)	(11,901)
Other - net	(3,899)	651
Accounts payable	725	6,096
Accrued compensation and related liabilities	(8,049)	7,354
Other accrued liabilities	4,471	5,640
Unearned revenue	(118)	(118)
Net Cash Provided by Operating Activities	$ 52,155	$ 62,300
Noncash Investing and Capital and Financing Activities:		
Capital expenditures included in accounts payable	$ 884	$ 7,688
Premium related to issuance of 2016 General Obligation and Revenue Bonds	$ 60,934	$ -
Proceeds from issuance of debt used to defease debt	$ 459,720	$ -
Defeasance of debt	$ 461,667	$ -
Settlement of future interest payments and fees related to defeasance of debt	$ 58,304	$ -

See accompanying notes.

Note 1 – Operations and Reporting Entity

Organization

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

- Palomar Medical Center Escondido (Escondido), located in west Escondido, California, includes a 288-bed general acute care hospital, including tertiary services, trauma services, cardiovascular surgery, women's services and retail pharmacy.

- Palomar Medical Center Poway (Poway), 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 Medical Center Downtown Campus (PHDC), located in east Escondido, California, includes acute rehab, Center for Behavioral Health, radiation therapy and a crisis stabilization unit.

- Palomar Home Health Services, located in Escondido, California.

- San Marcos Ambulatory Care Center located in San Marcos, California, includes outpatient therapy.

- Jean McLaughlin Women's Center for Health and Healing, located on the Poway campus.

- Palomar Outpatient Behavioral Health, located in San Marcos, California.

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

- PH Expresscare clinics, located in select grocery stores in Escondido and San Elijo Hills, California. The Temecula Expresscare clinic was closed in fiscal year 2017.

- Arch Health Partners, Inc. (Arch), a non-profit medical foundation established under Section 1206(1) of the California Health and Safety Code, with fifteen clinics located in Poway, Escondido, Ramona and San Marcos, California that provide primary and specialty care medical services and add another component in effective health care delivery to residents within PH's community. In accordance with Governmental Accounting Standards Board (GASB) Codification Section 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 of Arch on PH, and because PH is the sole corporate member of Arch.

Note 2 – Summary of Significant Accounting Policies

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.

Basis of accounting and presentation
The accompanying financial statements have been prepared using the economic resource measurement focus and the accrual basis of accounting, in accordance with U.S. generally accepted accounting principles for healthcare organizations and the State Controller's Minimum Audit Requirements and Reporting Guidelines, and are presented in accordance with the reporting model as prescribed in GASB Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments*. PH follows the business-type activities requirements of GASB Statement No. 34 and No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*.

Fiscal year
PH has adopted a fiscal year ending June 30. All references to years herein refer to the respective fiscal year.

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

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

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

Supplies and inventories
Supplies and inventories are stated at the lower of cost (first-in, first-out) or market value.

Note 2 – Summary of Significant Accounting Policies (continued)

Restricted cash and investments
Restricted cash and investments primarily includes assets held by trustees under indenture agreements and designated assets set aside by the Board of Directors for future capital improvements over which the Board of Directors retains control and may, at its discretion, subsequently use for other purposes. Amounts required to meet current liabilities of PH have been classified as current assets in the accompanying consolidated statements of net position.

PH has entered into an agreement with the City of Escondido (the City) to financially participate in street improvements near the site of Escondido. Under the agreement, PH was required to deposit $13,000 into an account jointly managed by PH and the City. PH's financial obligation is limited to the deposited amount plus any earned interest on the deposited funds. The balance of $9,880 and $9,843 as of June 30, 2017 and 2016, respectively, is included in restricted cash and investments in the accompanying consolidated statements of net position.

Capital assets
Capital asset acquisitions are recorded at cost. The capitalization threshold for individual item cost is $5 or greater and similar items that have cost less than $5 but have an aggregate cost of $20 or greater. 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	10-40
Buildings and building improvements	10-40
Leasehold improvements	3-15
Equipment	3-20

Gifts of long-lived assets, such as land, buildings, or equipment, are recorded at their fair market value and are reported in non-operating income. 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 for other purposes in net position. Absent explicit donor stipulations about how long those long-lived assets must be maintained; expirations of donor restrictions are reported when the donated or acquired long-lived assets are placed in service.

Note 2 – Summary of Significant Accounting Policies (continued)

Capital assets are reviewed for impairment when events or changes in circumstances suggest that the service utility of the capital asset may have significantly and unexpectedly declined. Capital assets are considered impaired if both the decline in service utility of the capital asset is large in magnitude and the event or change in circumstance is outside the normal life cycle of the capital asset. Such events or changes in circumstances that may be indicative of impairment include evidence of physical damage, enactment, or approval of laws or regulations or other changes in environmental factors; technological changes or evidence of obsolescence; changes in the manner or duration of use of a capital asset; and construction stoppage. The determination of the impairment loss is dependent upon the event or circumstance in which the impairment occurred. Impairment losses are recorded in the consolidated statements of revenue, expenses, and changes in net position. In the years ended June 30, 2017 and 2016, no impairment charges were recorded. On June 24 2015, PH's Board of Directors voted to close PHDC and transfer all services to other PH facilities. The closure of PHDC is expected to be completed near the end of fiscal year 2018.

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

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

Deferred outflows of resources
Deferred outflows of resources represent a consumption of net position that applies to a future period(s) and so will not be recognized as an outflow of resources (expense) until that time. The deferred outflows of resources reported in the financial statements is loss on refunding of debt which is amortized over the shorter of the remaining life of the refunded bonds or the refunding debt as a component of interest expense. See Note 9.

Note 2 – Summary of Significant Accounting Policies (continued)

Deferred inflows of resources
Deferred inflows of resources represent an increase in net position that applies to future periods and so will not be recognized as an inflow of resources (revenue) until that time. The deferred outflows of resources reported in the financial statements are unearned rental income that will be recognized as revenue over the life of the rental agreement.

Interest rate swaps
PH has entered into variable-to-fixed interest rate swaps, which are reflected at fair value in the consolidated statements of net position. The fair value of the interest rate swaps will fluctuate based generally on changes in market rates of interest. Unrealized gains or losses resulting from changes in fair value are reported as interest expense in non-operating income (expenses) in the consolidated statements of revenue, expenses, and changes in net position. Interest cost on variable interest rate debt is reported based on the fixed interest rate paid by PH under the interest rate swaps and is also recorded as interest expense. As of June 30, 2017 and 2016, the interest rate swaps are recorded as a liability of $26,473 and $38,740, respectively.

Net position
Net position of PH is classified in three broad components: net investment in capital assets, restricted (distinguishing between major categories of restrictions), and unrestricted. Net investment in capital assets consists of capital assets, net of accumulated depreciation, and reduced by the outstanding balances of borrowings used to finance the purchase or construction of those assets. Net position restricted for repayment of debt includes amounts deposited with trustees as required by bond indentures, as described in Note 9. Net position restricted for capital acquisitions relates to amounts restricted to acquire capital assets. Net position restricted for other purposes relates to noncapital net position that must be used for a particular purpose, as specified by contributors or others external to PH. Unrestricted net position represents the remaining net position that does not meet the definition of net investment in capital assets or restricted.

Risk management
PH is exposed to various risks of loss from torts; theft of, damage to, and destruction of assets; business interruption; errors and omissions; employee injuries and illnesses; natural disasters; and employee health, dental, and accident benefits. Commercial insurance coverage is purchased for claims arising from such matters other than medical malpractice and workers' compensation claims. Settled claims have not exceeded this commercial coverage in any of the three preceding years.

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

Note 2 – Summary of Significant Accounting Policies (continued)

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

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

Shared risk revenue
PH and its affiliated medical groups have agreements with various third-party payors to provide medical services to subscribing participants. Under some of these agreements, PH and its affiliated medical groups receive monthly capitation payments based on the number of members for each payor, regardless of services actually performed by PH. Under these agreements, after deduction of costs incurred by providers outside these agreements for care provided to subscribing participants, PH participates in shared risk pools with medical groups, through which it earns reimbursement or pays additional amounts to the medical groups. In conjunction with the shared risk pools, PH estimates incurred but not reported (IBNR) claims for medical services provided to patients. IBNR of $10,966 and $10,544 are included in other accrued liabilities in the accompanying consolidated statements of net position as of June 30, 2017 and 2016, respectively.

Activity in PH's liability for IBNR claims for medical services provided to patients as of and for the years ended June 30, 2017 and 2016 is summarized as follows (in thousands):

	2017	2016
Balance, beginning of the year	$ 10,544	$ 10,129
Current year claims incurred and changes in estimates	43,148	35,532
Claims and expenses paid	(42,726)	(35,117)
Balance, end of the year	$ 10,966	$ 10,544

Note 2 – Summary of Significant Accounting Policies (continued)

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.

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 (G.O.) Bonds are based on assessed property values and are set annually by the Board of Directors. Property tax revenue for the years ended June 30, 2017 and 2016, consists of the following (in thousands):

	2017	2016
To support operations - unrestricted use	$ 15,910	$ 15,145
For debt service on G.O. bonds - restricted use	20,077	18,923
Total	$ 35,987	$ 34,068

Income taxes
PH is a governmental subdivision of the State of California and is exempt from federal income and state franchise taxes. Arch is exempt from income taxes under Section 501(c)(3) of the Internal Revenue Code (IRC) and Section 23701(d) of the California Revenue and Taxation Code.

Accordingly, no provision for income taxes has been included in the accompanying consolidated financial statements.

Recent accounting pronouncements
The GASB issued GASB Statement No. 72, *Fair Value Measurement and Application,* in February 2015. The standard provides guidance related to applying fair value to certain investments and disclosures related to fair value measurements. PH adopted this standard effective July 1, 2015.

The GASB issued GASB Statement No. 73, *Accounting and Financial Reporting for Pensions and Related Assets That Are Not within the Scope of GASB Statement 68*, and *Amendments to Certain Provisions in GASB Statement 67 and 68* in June 2015. The standard provides clarification to guidance provided in GASB Statement 68. The standard was effective for the District as of July 1, 2015 and had no impact to the consolidated financial statements.

Note 2 – Summary of Significant Accounting Policies (continued)

In June 2015, the GASB issued Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*. The primary objective of this Statement is to improve accounting and financial reporting by state and local governments for postemployment benefits other than pensions (other postemployment benefits or OPEB. This guidance is effective for PH in the year ended June 30, 2018. PH is evaluating the impact of adopting this standard on the consolidated financial statements.

In June 2015, the GASB issued Statement No. 76, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*. The objective of this Statement is to identify the hierarchy of generally accepted accounting principles (GAAP). The “GAAP hierarchy” consists of the sources of accounting principles used to prepare financial statements of state and local governmental entities in conformity with GAAP and the framework for selecting those principles. The District implemented this standard effective July 1, 2015.

In December 2015, the GASB issued Statement No. 79, *Certain External Investment Pools and Pool Participants*. This Statement provides guidance on accounting and financial reporting for investment pools and pool participants including establishing criteria for an external investment pool to qualify for making the election to measure all of its investments at amortized cost for financial reporting purposes. The standard is effective for PH as of July 1, 2016. PH has reviewed and evaluated this Statement and has determined there is no material impact to the consolidated financial statements for the fiscal year ended June 30, 2017.

In June 2017, the GASB issued Statement No.87 establishing a single approach to the accounting for and reporting of leases by state and local governments. Under the new guidance, PH must recognize a lease liability and an intangible asset in the financial statements. The statement is effective July 1, 2020. PH is evaluating the impact of adopting this standard on the consolidated financial statements.

Note 3 – Net Patient Service Revenue, Third-Party Reimbursement Programs, and Non-Operating Revenue

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.

Note 3 – Net Patient Service Revenue, Third-Party Reimbursement Programs, and Non-Operating Revenue (continued)

Revenue from the Medicare and Medi-Cal programs inclusive of risk (capitated) and non-risk managed care programs, accounted for approximately 53% and 56% of PH's net patient service revenue for the years ended June 30, 2017 and 2016, respectively.

Third-party cost reports for the Medicare program have been settled through the year ended June 30, 2014 with the exception of PMC Escondido's fiscal years 2011 and 2013 reports which are pending administrative review by Centers for Medicare & Medicaid Services (CMS). The cost reports for Medi-Cal programs have been settled through the year ended June 30, 2014. Results of cost report settlements as well as estimates for settlements of all years through 2016 have been reflected in the accompanying consolidated financial statements.

As of June 30, 2017 and 2016, estimated third-party settlements resulted in a receivable of $16,943 and $6,012, respectively, and a liability of $3,896 and $3,997, respectively. During the years ended June 30, 2017 and 2016, PH settled various prior-year cost reports and appeal issues. These settlements resulted in approximately $54,155 and $29,171 of additional revenues for the years ended June 30, 2017 and 2016, respectively, which are included in net patient service revenue in the accompanying consolidated statements of revenue, expenses, and changes in net position.

The following table summarizes amounts recognized as net patient service revenue from the various state supplemental funding programs and transfer agreements available to PH for the years ended June 30, 2017 and 2016, respectively (in thousands):

	2017	2016
PRIME	$ 19,020	$ -
Managed Care Rate Range IGT	13,175	3,295
Quality Assurance Supplement	3,691	3,019
Medi-Cal Rate Stabilization	5,264	-
Outpatient Supplemental Payment	2,004	2,001
Medi-Cal Expansion	5,008	2,171
Totals	$ 48,162	$ 10,486

Note 3 – Net Patient Service Revenue, Third-Party Reimbursement Programs, and Non-Operating Revenue (continued)

Public Hospital Redesign and Incentives in Medi-Cal Program (PRIME or the Program)
The program was approved via the California's Section 1115(a) demonstration waiver, titled "California's Medi-Cal 2020 Demonstration". The PRIME program intends to close the gap by incentivizing hospitals to identify critical objectives to improve delivery of care for Medi-Cal beneficiaries. The program is effective beginning January 1, 2016 and is a five-year program. The program has both reporting metrics as well as performance metrics. Revenue is recognized based on approval from CMS for the achievement of reporting metrics and when metrics are achieved for the performance metrics component.

Medi-Cal Managed Care Rate Range Intergovernmental Transfer (IGT)
The Affordable Care Act (ACA) recognized the formation and maintenance of a network of primary care providers to service Medi-Cal Managed Care plans would require funding assistance. IGT is a payment methodology to partially fund the gap between what Medi-Cal Managed Care plans pay and the full cost of providing the service.

Senate Bill 239 Quality Assurance Fee Supplemental Payment
A state-legislated supplemental program that distributed funds to hospitals based on the volume of care to Medi-Cal funded patients. The intention is to strengthen the ability of hospitals to meet the increased demand resulting from implementing programs, service, and capital required by ACA.

Assembly Bill 113 Medi-Cal Rate Stabilization
A state-legislated program which provides a cost supplement for Medi-Cal Managed Care Seniors and Persons with Disabilities.

Assembly Bill 915 Outpatient Supplement Payment Program
PH provides care for those patients who are of low-income and the uninsured population. The state legislated a supplemental reimbursement for uncompensated Medi-Cal Fee-For-Service (FFS) outpatients. PH receives 50% of reported uncompensated costs.

QAF Managed Care Funds – Part of the Hospital Quality Assurance Fee (QAF)
Under the California Hospital Fee Program, PH receives net supplemental funds under a managed care methodology.

With respect to the above described programs, revenue is recognized when management is reasonably assured all information necessary to determine the amount of revenue is available and has been considered in estimating the amount of revenue to be recognized.

Note 3 – Net Patient Service Revenue, Third-Party Reimbursement Programs, and Non-Operating Revenue (continued)

Meaningful Use Incentive Payments

The American Recovery & Reinvestment Act of 2009 (ARRA) established incentives under the Medicare and Medicaid programs for certain professionals and hospitals that meaningfully use certified electronic health record (EHR) technology. The Medicare incentive payments will be paid out to qualifying hospitals over four consecutive years on a transitional schedule. To qualify for Medicare incentives, hospitals and physicians must meet EHR meaningful use criteria that became more stringent over three states designated by CMS. Medicaid programs and payment schedules vary from state to state. The Medi-Cal program requires hospitals to register for the program prior to 2016, to engage in efforts to adopt, implement or upgrade certified EHR technology in order to qualify for the initial year of participation, and to demonstrate meaningful use of certified EHR technology in order to qualify for payment for up to three additional years. These incentives are recognized following the grant accounting model, recognizing income ratably over the applicable reporting period as management becomes reasonably assured of meeting the required criteria. PH received incentive payments of $1,196 and $1,762 for the years ended June 30, 2017 and 2016, respectively, which is recognized in other revenue in the consolidated statements of revenue, expenses and changes in net position.

Note 4 – 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 $65,000 of unrestricted monies in the fund and an unlimited amount of qualified bond proceeds. PH had invested $64,260 and $64,780 of unrestricted funds in this fund as of June 30, 2017 and 2016, respectively. PH also had invested $9,880 and $9,843 in jointly managed funds under an escrow agreement with the City of Escondido as of June 30, 2017 and 2016, respectively. Investments in the LAIF are highly liquid, as deposits can be converted to cash within 24 hours without loss of interest. PH is a voluntary participant in the LAIF. The fair value of PH's investments in the LAIF is reported in the accompanying consolidated statements of net position based on PH's pro rata share of the fair value provided by LAIF for the entire LAIF portfolio.

Note 4 – Cash and Cash Equivalents and Investments (continued)

As of June 30, 2017 and 2016, PH had the following investments (in thousands):

	2017	2016
Investments - current	$ 157,181	$ 158,094
Restricted cash and investments - current	30,184	23,999
Restricted cash and investments - noncurrent	53,700	54,427
Total	$ 241,065	$ 236,520

As of June 30 2017 and 2016, PH had investments by type and maturity as follows (in thousands):

	2017		
		Investment Maturities (in Years)	
Investment Type	Fair Value	Less Than 1	1-5
External investment pool - LAIF	$ 74,140	$ 74,140	$ -
U.S. government bonds	42,068	2,295	39,773
U.S. treasury bills	23,127	6,999	16,128
Corporate bonds	26,697	3,638	23,059
Money market mutual funds	75,033	75,033	-
Total	$ 241,065	$ 162,105	$ 78,960

	2016		
		Investment Maturities (in Years)	
Investment Type	Fair Value	Less Than 1	1-5
External investment pool - LAIF	$ 74,623	$ 74,623	$ -
U.S. government bonds	40,744	-	40,744
U.S. treasury bills	24,181	7,215	16,966
Corporate bonds	26,986	2,632	24,354
Money market mutual funds	69,986	69,986	-
Total	$ 236,520	$ 154,456	$ 82,064

Note 4 – Cash and Cash Equivalents and Investments (continued)

GASB Statement No. 72, *Fair Value Measurement and Application,* defines fair value as the price that would be received upon sale of an asset or paid upon transfer of a liability in an orderly transaction between market participants at the measurement date and in the principal or most advantageous market for that asset or liability.

The fair value should be calculated based on assumptions that market participants would use in pricing the asset or liability, not on assumptions specific to the entity. In addition, the fair value of liabilities should include consideration of non-performance risk.

In addition to defining fair value, this guidance expands the disclosure requirements around fair value and establishes a fair value hierarchy for valuation inputs. The hierarchy prioritizes the inputs into three levels based on the extent to which inputs used in measuring fair value are observable in the market. Each fair value measurement is reported in one of the three levels which are determined by the lowest level input that is significant to the fair value measurement in its entirety. These levels are:

Level 1 – Quoted prices are available in active markets for identical assets or liabilities as of the measurement date.

Level 2 – Pricing inputs are based on quoted market prices for similar instruments in active markets, quoted prices for identical or similar instruments in inactive markets, and model-based valuation techniques for which all significant assumptions are observable in the market or can be corroborated by observable market data for substantially the full term of the assets or liabilities. Financial assets and liabilities in this category generally include asset-backed securities, corporate bonds and loans, municipal bonds and interest rate swap instruments.

Level 3 – Pricing inputs are generally unobservable for the assets or liabilities and include situations where there is little, if any, market activity for the investment. The inputs into the determination of the fair value require management’s judgment or estimation of assumptions that market participants would use in pricing the assets or liabilities. The fair values are therefore determined using factors that involve considerable judgment and interpretations, including but not limited to private and public comparables, third party appraisals, discounted cash flow models, and fund manager estimates.

Note 4 – Cash and Cash Equivalents and Investments (continued)

The following table summarizes PH's assets and liabilities measured at fair value on a recurring basis as of June 30, 2017 and 2016 (in thousands):

	2017			
	Total	Level 1	Level 2	Level 3
Investments				
Money market mutual funds	$ 75,033	$ 75,033	$ -	$ -
External investment pool - LAIF	74,140	-	74,140	-
U.S. government bonds	42,068	-	42,068	-
U.S. treasury bills	23,127	23,127	-	-
Corporate bonds	26,697	-	26,697	-
Total Investments	$ 241,065	$ 98,160	$ 142,905	$ -
Liabilities				
Interest rate swap	$ (26,473)	$ -	$ (26,473)	$ -

	2016			
	Total	Level 1	Level 2	Level 3
Investments				
Money market mutual funds	$ 69,986	$ 69,986	$ -	$ -
External investment pool - LAIF	74,623	-	74,623	-
U.S. government bonds	40,744	-	40,744	-
U.S. treasury bills	24,181	24,181	-	-
Corporate bonds	26,986	-	26,986	-
Total Investments	$ 236,520	$ 94,167	$ 142,353	$ -
Liabilities				
Interest rate swap	$ (38,740)	$ -	$ (38,740)	$ -

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

Interest rate risk

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

Note 4 – Cash and Cash Equivalents and Investments (continued)

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, 2017 and 2016, PH's investments, excluding U.S. government obligations, consisted of the following: corporate bond investments rated "A" or better by Standard & Poor's (S&P) and Moody's Investors Service (Moody's), U.S. Government Agency investments rated "AA+" by S&P and "AAA" by Moody's, and PH's investments in the LAIF, which were not rated.

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

Investments in any one issuer (other than U.S. treasury securities and external investment pools) that represent 5% or more of the total investments as of June 30, 2017 and 2016, are as follows (in thousands):

		2017		2016	
	Investment Type	Fair Value	Percentage of Total Investments	Fair Value	Percentage of Total Investments
Federal National Mortgage Association	Federal Agency Securities	$ 25,009	16%	$ 27,205	17%
Federal Home Loan Mortgage Corp.	Federal Agency Securities	17,059	11%	13,539	9%
U.S. Bank, Trustee	U.S. Bank Money Market	24,988	16%	44,446	28%
U.S. Bank, Trustee	First American Govt Oblig Fund CL D	18,665	12%		
Wells Fargo Advantage Government Money Market	U.S. Government Money Market Funds	30,007	19%	23,794	15%

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.

Note 4 – Cash and Cash Equivalents and Investments (continued)

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, 2017 and 2016, PH's bank balances totaled $67,413 and $62,780, respectively, and were not exposed to custodial credit risk, as the uninsured deposits are with financial institutions that are individually required by state law to have government deposits collateralized at a rate of 110% of the deposits. Such collateral is considered to be held in PH's name. Arch maintains bank deposit accounts that are insured by the Federal Deposit Insurance Corporation (FDIC) up to a limit of $250 per depositor. Arch had a cash balance of $852 and $690 that was above the insured limit at June 30, 2017 and 2016, respectively.

Investment income
Investment income for the years ended June 30 consisted of the following (in thousands):

	2017	2016
Interest, dividends, and realized gains on sale of investments	$ 3,189	$ 2,035
Net increase (decrease) in fair value of investments	(1,809)	461
Total	$ 1,380	$ 2,496

Note 5 – Concentrations of Credit Risk

PH grants credit without collateral to its patients, most of who are local residents and are insured under third-party payor agreements. The mix of gross receivables from patients and third-party payors as of June 30, 2017 and 2016, is as follows:

	2017	2016
Medicare	16%	17%
Medi-Cal	12%	8%
HMO/PPO/commercial	63%	59%
Patient	4%	10%
Others	5%	6%
Total	100%	100%

Note 6 – Capital Assets

A summary of changes in capital assets for the years ended June 30, 2017 and 2016, is as follows (in thousands):

	Beginning Balance June 30, 2016	Additions	Disposals	Transfers	Ending Balance June 30, 2017
Land improvements	$ 80,350	$ -	$ (8)	$ -	$ 80,342
Buildings and leasehold improvements	1,126,663	279	(5,807)	1,360	1,122,495
Equipment	293,646	6,019	(4,849)	343	295,163
Land	62,770	-	(858)	-	61,912
Construction in progress	28,322	14,679	(7,890)	(1,703)	33,408
	1,591,751	20,977	(19,412)	-	1,593,320
Less accumulated depreciation and amortization	(478,021)	(51,425)	10,157	-	(519,289)
Capital assets - net	$ 1,113,730	$ (30,448)	$ (9,255)	$ -	$ 1,074,031

	Beginning Balance June 30, 2015	Additions	Disposals	Transfers	Ending Balance June 30, 2016
Land improvements	$ 75,421	$ -	$ -	$ 4,929	$ 80,350
Buildings and leasehold improvements	1,113,541	5,651	(137)	7,608	1,126,663
Equipment	292,186	2,984	(967)	(557)	293,646
Land	62,770	-	-	-	62,770
Construction in progress	35,084	5,694	(476)	(11,980)	28,322
	1,579,002	14,329	(1,580)	-	1,591,751
Less accumulated depreciation and amortization	(424,725)	(54,273)	977	-	(478,021)
Capital assets - net	$ 1,154,277	$ (39,944)	$ (603)	$ -	$ 1,113,730

During the construction of PMC, PH was insured under an Owner Controlled Insurance Program (OCIP) and the insurance premiums for the OCIP were capitalized as part of the cost of construction. PH received $130 during the year ended June 30, 2017 and $1,142 during the year ended June 30, 2016, as a result of a favorable loss experience. The remaining $728 and $858 is included in other assets in the accompanying consolidated statements of net position at June 30, 2017 and 2016, respectively.

Construction commitments outstanding as of June 30, 2017, were $3,350.

Note 7 – Investment in and Amounts Due from Affiliated Entities

During fiscal year 2007, PH entered into a partnership agreement with PDP Pomerado, LLC in exchange for a ground lease agreement. During fiscal year 2010, the partnership with PDP Pomerado, LLC was terminated and the ground lease agreement was transferred to NHP/PMP Pomerado, LLC. In conjunction with the termination of the partnership, PDP Pomerado, LLC was dissolved and its assets were liquidated. PH received proceeds of $9,672 for its interest in PDP Pomerado, LLC, which was recorded as unearned revenue as it was attributed to the difference in contractual lease payments and the fair value of lease payments. Unamortized unearned revenue of $7,222 and $7,328 in the accompanying consolidated statements of net position as of June 30, 2017 and 2016, respectively, will be recognized as income over the remaining term of the ground lease agreement, which expires in April 2061 and has two, ten year options to renew at $1 per year. Thus renewal is considered inevitable.

PH's investment in affiliated entities, which are generally accounted for under the equity method because PH does not control the entities, was $5,760 and $3,792 at June 30, 2017 and 2016, respectively. The total income from PH’s investment in affiliates was $1,604 and $1,298 for the years ended June 30, 2017 and 2016, respectively.

Note 8 – Related Organizations

Palomar Health Foundation

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

The Foundation provides a funding source for various programs on behalf of PH. Funding for these programs provided by the Foundation totaled $1,244 and $2,089 for the years ended June 30, 2017 and 2016, respectively.

PH has entered into a management services agreement (MSA) with the Foundation, whereby PH provides administrative support to the Foundation. Support provided to the Foundation totaled $1,997 and $1,713 for the years ended June 30, 2017 and 2016, respectively. Under the management services agreement renewed on December 31, 2016 and expiring on June 30, 2017, PH provided a line of credit to the Foundation with a $5,000 limit with interest at 2.5% above LIBOR. The amount outstanding on the line of credit was $2,759 and $1,862 as of June 30, 2017 and 2016, respectively. The Ninth Amendment to the MSA was signed on June 30, 2017, extending the LOC through June 30, 2018 and increasing the credit limit to $8,000.

Note 8 – Related Organizations (continued)

An unaudited summary of the Foundation's assets, liabilities, and net assets as of June 30, 2017 and 2016, is as follows:

	2017	2016
Assets	$ 11,726	$ 7,921
Liabilities	$ 4,038	$ 2,170
Net assets	7,688	5,751
Total liabilities and net assets	$ 11,726	$ 7,921

PIMG, Inc.
In April 2010, Arch entered into a 25-year professional services agreement with PIMG, Inc. (PIMG) under which PIMG provides professional medical services to patients seeking services from and enrolled with Arch. For the years ended June 30, 2017 and 2016, PIMG provided professional services to Arch in the amounts of $12,674 and $13,947 respectively. The amount advanced is to be repaid upon Arch's request and does not bear interest. There are no outstanding amounts at June 30, 2017 and 2016, respectively.

Note 9 – Long-term Debt

The following is a summary of long-term debt transactions for PH for the years ended June 30, 2017 and 2016 (in thousands):

	Beginning Balance June 30, 2016	Additions	Reductions	Ending Balance June 30, 2017	Amounts Due within One Year
Bonds payable:					
Series 2016 Refunding Revenue Bonds	$ -	$ 276,460	$ -	$ 276,460	$ 5,360
Series 2016A&B General Obligation Bonds	-	242,245	-	242,245	3,790
Series 2010 Certificates of Participation	157,784	-	2,213	155,571	2,530
Series 2010A General Obligation Bonds	65,628	-	31	65,597	-
Series 2009 Certificates of Participation	225,946	-	225,946	-	-
Series 2009A General Obligation Bonds	113,736	-	222	113,514	-
Series 2007A General Obligation Bonds	237,030	-	180,599	56,431	3,317
Series 2006 Certificates of Participation	166,525	-	5,460	161,065	5,625
Series 2005A General Obligation Bonds	60,978	-	60,978	-	-
Accrued interest on capital appreciation bonds	129,564	22,437	-	152,001	1,231
Note payable	87	-	11	76	12
Capital leases	418	-	277	141	135
Total long-term debt	$ 1,157,696	$ 541,142	$ 475,737	$ 1,223,101	$ 22,000

	Beginning Balance June 30, 2015	Additions	Reductions	Ending Balance June 30, 2016	Amounts Due within One Year
Bonds payable:					
Series 2010 Certificates of Participation	$ 159,844	$ 195	$ (2,255)	$ 157,784	$ 2,405
Series 2010A General Obligation Bonds	65,659	-	(31)	65,628	-
Series 2009 Certificates of Participation	229,217	244	(3,515)	225,946	3,620
Series 2009A General Obligation Bonds	113,958	-	(222)	113,736	-
Series 2007A General Obligation Bonds	239,739	-	(2,709)	237,030	2,899
Series 2006 Certificates of Participation	171,781	44	(5,300)	166,525	5,500
Series 2005A General Obligation Bonds	62,618	-	(1,640)	60,978	1,590
Accrued interest on capital appreciation bonds	108,091	21,473	-	129,564	1,231
Note payable	97	-	(10)	87	11
Capital leases	731	-	(313)	418	283
Total long-term debt	$ 1,151,735	$ 21,956	$ (15,995)	$ 1,157,696	$ 17,539

Note 9 – Long-term Debt (continued)

The terms and due dates of PH's long-term debt as of June 30, 2017 and 2016, are as follows:

- Series 2016 Refunding Revenue Bonds, interest at 3.0% to 5.0% due semiannually, principal due in annual amounts ranging from $5,360 in fiscal 2018 to $27,440 in fiscal 2040, net of unamortized original issue premium of $29,710 collateralized by PH revenues as defined in the indenture agreement. The net of unamortized loss on refunding is $40,188 at June 30, 2017.

- Series 2016A G.O. Bonds, interest at 2.0% to 5.0% due semiannually, principal due in annual amounts ranging from $1,520 in fiscal 2019 to $4,345 in fiscal 2035, net of unamortized original issue premium of $9,778 at June 30, 2017.

- Series 2016B G.O. Bonds, interest at 2.0% to 5.0% due semiannually, principal due in annual amounts ranging from $1,615 in fiscal 2018 to $19,305 in fiscal 2038, net of unamortized original issue premium of $19,497. The net unamortized loss on refunding is $4,090 at June 30, 2017.

- Series 2010 Certificates of Participation (COP), interest at 5.25% to 6% due semiannually, principal due in annual amounts ranging from $2,405 in fiscal 2017 to $20,725 in fiscal 2042, net of unamortized original issue discount of $3,134 and $3,326 at June 30, 2017 and 2016, respectively, collateralized by PH revenues as defined in the indenture agreement.

- Series 2010A G.O. Bonds, accreted interest compounds at 6.84% to 7.85% on $14,917 Capital Appreciation Bonds (CABs) with the first payment to bondholders on August 1, 2034. Accreted interest compounds at 6.75% on $49,999 Convertible CABs with the first payment to bondholders also due on August 1, 2034. Principal amounts due in annual amounts ranging from $1,476 in fiscal 2038 to $33,159 in fiscal 2041, net of unamortized premium of $680 and $711 at June 30, 2017 and 2016, respectively.

- The Series 2009 COP was advance refunded on October 20, 2016 with proceeds from the issuance of the 2016 Refunding Revenue Bonds, after payment of underwriting fee and issuance costs, plus additional 2009 COP reserves were deposited in an escrow trust account held with the escrow agent to provide for all future debt service payments. As a result, Series 2009 COP is considered to be defeased and the liability for these bonds has been removed from the consolidated statement of net position. PH refunded the Series 2009 COP to reduce its total debt service payments over the next 23 years by $48,600 and to obtain an economic gain of $33,200.

- Series 2009A G.O. Bonds, accreted interest compounds at 6.84% to 9% on $50,001 CABs with the first payment to bondholders on August 1, 2019. Accreted interest compounds at 7% on $59,999 Convertible CABs with the first payment to bondholders on August 1, 2033. Principal amounts due in annual amounts ranging from $327 in fiscal 2021 to $18,868 in fiscal 2039, net of unamortized premium of $3,514 and $3,736 at June 30, 2017 and 2016, respectively.

Note 9 – Long-term Debt (continued)

- Series 2007A G.O. Bonds, $66,083 CABs is compounded at 3.67% to 4.92% with the first payment to bondholders on August 1, 2011. Principal amounts due in annual amounts ranging from $2,899 in fiscal 2017 to $21,585 in fiscal 2038, net of unamortized premium of $852 and $3,551 at June 30, 2017 and 2016, respectively. A portion of the 2007A G.O. Bonds, the current interest bonds, was advance refunded on October 27, 2016 with proceeds from the issuance of the Series 2016B G.O. Bonds, after payment of underwriting fee, issuance costs and funding a reserve account deposited in an escrow trust account held with the escrow agent to provide for all future debt service payments. As a result, Series 2007A G.O. Bonds is considered to be defeased and the liability for these bonds has been removed from the consolidated statement of net position. PH refunded the 2007A G.O. Bonds to reduce its total debt service payments over the next 21 years by $50,200 and to obtain an economic gain of $38,200.

- Series 2006 COP, a portion of which refunded the Series 1993 Insured Refunding Revenue Bonds. This series was issued as auction rate securities, whereby the interest rate for each series is generally determined during successive seven-day auction periods. In addition, PH entered into an interest rate swap agreement with Citibank, N.A., New York, with respect to the Series 2006 COP in a notional amount of $180,000 (the Swap Agreement) (see Note 10). Interest on the Series 2006 COP is 3.218%, which is the fixed rate to be paid by PH under the Swap Agreement, due semiannually, principal due annually in amounts ranging from $5,500 in fiscal 2017 to $12,350 in fiscal 2037, net of unamortized loss on refunding of $135 and $175 at June 30, 2017 and 2016, respectively, collateralized by PH revenues as defined in the indenture agreement.

- The 2005A G.O. Bonds, were redeemed on October 27, 2016 with proceeds from the issuance of the Series 2016B G.O. Bonds, after payment of underwriting fee and issuance costs. The liability for these bonds has been removed from the consolidated statement of net position as of June 30, 2017.

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

PH is required to maintain certain debt covenants (Days Cash on Hand, Maximum Annual Debt Service, and Cushion Ratio) under its indenture agreements for COP. The covenants stipulate 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.

Note 9 – Long-term Debt (continued)

At June 30, 2017 and 2016, long-term capital leases, net of current portion, amounted to $0 and $135, respectively. Related net book value of leased equipment totaled $135 and $412, and depreciation expense totaled $243 and $278 for the years ended June 30, 2017 and 2016, respectively.

The estimated fair value of PH's long-term debt was approximately $1,385,790 and $1,403,310 as of June 30, 2017 and 2016 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, 2017, are as follows (in thousands):

Years Ending June 30	Principal	Interest	Total
2018	$ 20,763	$ 59,232	$ 79,995
2019	19,294	65,918	85,212
2020	23,735	70,149	93,884
2021	21,732	75,401	97,133
2022	23,179	79,031	102,210
2023 - 2027	138,378	405,644	544,022
2028 - 2032	219,670	388,128	607,798
2033 - 2037	291,237	305,849	597,086
2038 - 2042	252,273	170,175	422,448
Sub-total	1,010,261	1,619,527	2,629,788
Net premium on bonds	60,839	-	60,839
Accrued interest on capital appreciation bonds	152,001	-	152,001
Total	$ 1,223,101	$ 1,619,527	$ 2,842,628

Note 10 – Interest Rate Swap

In 2006, PH entered into the Swap Agreement as a means to lower its borrowing costs on the Series 2006 COP (see Note 9) when compared against fixed-rate bonds at the time of issuance. The Swap Agreement was effective December 28, 2006, with an initial notional amount of $180,000 for the Series 2006 COP and terminates on November 1, 2036 simultaneously with the maturity of the 2006 COP.

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

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

The significant terms of the Swap Agreement are as follows:

Corresponding bond series	Series 2006 Certificate of Participation bonds
Swap type	Fixed income
Initial notional amount	$180,000
Notional amount as of June 30, 2017	$161,200
Notional amount as of June 30, 2016	$166,700
Effective date	December 28, 2006
Termination date	November 1, 2036
Final bond maturity	November 1, 2036
PH pays	3.218 %
Cash payments remitted by PH for year ended June 30, 2017	$4,261
PH receives	56% of 30-day LIBOR + 0.23%
Swap fair value as of June 30, 2017	($26,473)
Change in fair value for the year ended June 30, 2017	$12,267
Classification	Liability

Note 10 – Interest Rate Swap (continued)

Fair value
As of June 30, 2017 and 2016, the swap had a negative fair value of $26,473 and $38,740, respectively, developed by a mark-to-market pricing service using the zero-coupon method. This method calculates the future net settlement payments required by the swap, assuming that the current forward rates implied by the yield curve correctly anticipate future spot interest rates. These payments are then discounted using the spot rates implied by the current yield curve for hypothetical zero-coupon bonds due on the date of each future net settlement of the swap. The negative fair value of the swap is reported in the accompanying consolidated statements of net position as a long-term liability. The change in the fair value of the swap is reported in the accompanying consolidated statements of revenue, expenses, and changes in net position as unrealized gain (loss) on interest rate swap.

Credit risk
PH seeks to limit its counterparty risk by contracting only with highly rated entities. As of June 30, 2017, the counterparty of the interest rate swap was rated "A1" by Moody's, "A" by S&P, and “A” by Fitch. To mitigate the potential for credit risk, under the terms of the Swap Agreement, if the counterparty's credit quality falls below (1) Moody's rating of Baa2, (2) S&P's rating of BBB, or (3) Fitch's rating of BBB, the fair value of the swap will be collateralized by the counterparty with cash and/or treasury securities.

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

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

The negative swap fair value in the accompanying consolidated statements of net position approximates the termination payment that would be owed by PH to the swap counterparty if the swap was terminated. The payments from PH to the swap counterparty are insured by Assured Guaranty. This insurance provides protection to the swap counterparty in the event PH fails to make payments due under the swap. Under the terms of the Swap Agreement, an "insurer event" will occur if both Moody's and S&P's ratings for Assured Guaranty fall below the A category. If an insurer event happens, PH would be required to post collateral by a first priority perfected security interest in the gross revenues of PH. Assured Guaranty was rated A2 by Moody's with a stable outlook effective August 2016.

Note 11 – Operating Leases

PH leases certain office space and equipment under operating leases. Lease expense on all such leases for the years ended June 30, 2017 and 2016, totaled $18,167 (including $378 in non-operating expense) and $18,952 (including $379 in non-operating expense), respectively. PH also leases office space to others which qualify as operating leases. Future minimum lease payments and receipts under office space and equipment leases as of June 30, 2017, are as follows (in thousands):

Consolidated Years Ending June 30	Lease Payments	Lease Receipts
2018	$ 9,326	$ 428
2019	9,268	261
2020	9,244	224
2021	8,986	88
2022	8,112	118
2023-2027	21,593	381
2028-2032	4,215	112
2033-2037	3,874	-
2038-2081	23,778	-
Total	$ 98,395	$ 1,612

Note 12 – Deferred Annuity Contracts

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

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

Note 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 participating employees, plus earnings thereon. Generally, all employees with one year of service are eligible to participate. Contributions under the retirement plan by PH for the year ended June 30, 2016 were 7% of covered employees' basic compensation. For the year ended June 30, 2017 the rate changed effective January 1, 2017 from 7% to 6%. Contributions are funded as accrued. Total PH contributions expensed for the years ended June 30, 2017 and 2016, were $19,080 and $19,520, respectively.

Note 14 – Postemployment Healthcare Plan

The Company accounts for its postemployment healthcare plan under GASB Codification Section P50, *Postemployment Benefits Other Than Pensions-Employer Reporting*. The required annual contribution was $383 for 2017 and 2016, and is included in accrued compensation and related liabilities in the accompanying consolidated statements of net position.

Plan description and funding policy

PH's Postemployment Healthcare Plan (the Plan) is a single-employer defined benefit healthcare plan administered by Tri-Ad Actuaries, Inc. The Plan provides medical and dental insurance benefits to qualified postemployment participants on a gap coverage basis. Coverage is limited to those employees who have provided 10 years of consecutive service, are below the age of 65, and do not receive coverage from other sources. The contribution requirements of the Plan members and PH are established and may be amended by the Board of Directors. The required contribution is based on estimated pay-as-you-go financing requirements. For the years ended June 30, 2017 and 2016, PH contributed $77 and $102, respectively to the Plan, which consisted entirely of current premiums and included no additional contribution to prefund benefits.

Annual cost

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

Actuarial methods and assumptions

Projections of benefits for financial reporting purposes are based on the substantive plan (the Plan as understood by the employer and the Plan members) and include the types of benefits provided at the time of each valuation and the historical pattern of sharing the benefit costs between the employer and the Plan members to that point. The actuarial methods and assumptions used include techniques that are designed to reduce the effects of short-term volatility in actuarial accrued liabilities and the actuarial value of assets, consistent with the long-term perspective of the calculations. The actuarial valuations are effective for the years ended June 30, 2017 and 2016.

Note 14 – Postemployment Healthcare Plan (continued)

For the years ended June 30, 2017 and 2016, the actuarial assumptions included a 3% discount rate, which approximates PH's own rate of return on investments, and a healthcare cost trend rate of 7% declining by 1% annually to stabilize at 3% per year for the year ended June 30 2016, and thereafter. The unfunded actuarial accrued liability (UAAL) of $2,840 is being amortized over the maximum permissible authorization period of 30 years on an open basis. The actuarial valuation uses the projected unit credit and the entry-age normal actuarial cost methods.

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

Funded status and funding progress

As of June 30, 2017, the most recent actuarial valuation date, the plan was unfunded. The actuarial accrued liability for benefits was $2,840 and the actuarial value of assets was $0, resulting in an UAAL of $2,840. The estimated covered payroll was $240,492 and the ratio of the UAAL to the covered payroll was 1.2%.

Note 15 – 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.

Note 15 – Commitments and Contingencies (continued)

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

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

Workers' compensation program

PH is a participant in the Association of California Healthcare Districts ALPHA Fund (ALPHA Fund) that administers a self-insured workers' compensation plan for participating districts and other qualifying nonprofit entities. PH pays premiums to the ALPHA Fund that are adjusted annually. Effective July 1, 2008, PH changed its participation in the ALPHA Fund from self-insured retention to a guaranteed loss/zero deductible.

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 onward, 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 $2,427 and $2,427 as of June 30, 2017 and 2016, respectively as an asset within investment income and amounts due from affiliated entities in the accompanying consolidated statements of net position.

Effective July 1, 2016, PH withdrew its membership from Alpha Fund and has contracted with Safety National Casualty Corporation to provide workers’ compensation insurance coverage. PH is self-insured for the first $1,000 of each occurrence with a maximum limit of indemnity per occurrence of $1,000. At June 30, 2017 and 2016, estimated claims liabilities for workers' compensation recorded were $2,704 and $571, respectively

Note 15 – Commitments and Contingencies (continued)

Activity in PH’s workers’ compensation claims liability during the years ended June 30, 2017 and 2016 is summarized as follows (in thousands):

	2017	2016
Balance, beginning of the year	$ 571	$ 878
Current year claims incurred and changes in estimates for claims incurred in the prior year	3,677	3,381
Claims and expenses paid	(1,544)	(3,688)
Subtotal	2,704	571
Less current portion	(741)	(41)
Balance, end of year	$ 1,963	$ 530

Comprehensive liability insurance coverage

PH is insured for comprehensive liability (professional liability, bodily injury and property damage liability, personal injury, advertising injury and discrimination liability, and employee benefit liability) under a claims-made policy, which covers asserted claims and incidents reported to the insurance carrier, and has a per-claim deductible of $50 for professional liability. PH's comprehensive liability insurance was renewed effective July 1, 2015, and the current policy expires on June 30, 2017. PH has reserved for estimated claims through 2015, including an estimate of IBNR. Such reserves totaled $2,463 and $2,963 as of June 30, 2017 and 2016, respectively, and are recorded as other accrued liabilities in the accompanying consolidated statements of net position.

Activity in PH’s comprehensive liability insurance coverage liability during the years ended June 30, 2017 and 2016 is summarized as follows (in thousands):

	2017	2016
Balance, beginning of the year	$ 2,963	$ 1,755
Current year claims incurred and changes in estimates	70	1,826
Claims and expenses paid	(570)	(618)
Balance, end of the year	$ 2,463	$ 2,963

Note 15 – Commitments and Contingencies (continued)

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 CMS on a contingent fee basis, receiving a percentage of the improper overpayments and underpayments they recover from or return to providers. There were only a few RAC audits during the year ended June 30, 2017 for a total recoupment of $110 compared to no RAC audits in year ending June 30, 2016. There are currently no RAC audits in process nor any reserves recorded at June 30, 2017 or 2016. PH will establish a reserve to account for potential negative settlements when improper payments are identified by RAC.

Seismic compliance

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

Union contract

PH and the two unions, the California Nurses Association (CNA) and the California Healthcare Employee Union (CHEU) have not reached an agreement on a new four-year contract. On May 31, 2017, the parties negotiated a 30-day extension of both contracts. On June 22, 2017, both contracts expired with no additional extension. Active negotiations are still underway covering pay rates, benefits, staffing levels and health and safety issues; however, no assurance can be given regarding the outcome of such negotiations. In the event of a strike, PH is prepared to bring in temporary replacement staff in order to provide ongoing patient care and plans to reduce elective surgeries and outpatient procedures.

Note 16 – Subsequent Events

Arch Membership of Obligated Group

On August 31, 2017, PH, Arch and US Bank National Association, as Master Trustee, entered into a Supplemental Master Indenture agreement providing for addition of Arch as a member of the Obligated Group created pursuant to the Master Indenture of Trust Dated December 1, 2006. As such, Arch becomes jointly and severally liable for the repayment of PH’s revenue obligations and places its collateral under control of a master trustee for the benefit of lenders and bondholders. In consideration of the agreement of Arch to become an Obligated Group Member, PH has agreed to the extinguishment of Arch Obligations. Related eliminations can be found in Note 17.

Note 17 – Condensed Combining Information

A summary of the condensed combining information for PH and Arch as of June 30, 2017 and 2016 is as follows (in thousands):

CONDENSED COMBINING STATEMENT OF NET POSITION
AS OF JUNE 30, 2017

	PH	Arch	Eliminations	Total
ASSETS				
Current assets	$ 410,588	$ 6,760	$ -	$ 417,348
Capital assets -- net	1,068,813	5,218	-	1,074,031
Noncurrent assets	70,441	4,619	(4,133)	70,927
Other receivables	5,247	570	(5,817)	-
Line of credit and note payable Arch	82,268	-	(82,268)	-
Total assets	1,637,357	17,167	(92,218)	1,562,306
Deferred outflow of resources	44,278	-	-	44,278
TOTAL ASSETS AND DEFERRED OUTFLOW OF RESOURCES	**$ 1,681,635**	**$ 17,167**	**$ (92,218)**	**$ 1,606,584**
LIABILITIES AND NET POSITION				
Current liabilities	$ 138,270	$ 13,831	$ (678)	$ 151,423
Long-term Liabilities	1,230,705	65	-	1,230,770
Total liabilities	1,368,975	13,895	(678)	1,382,192
Deferred inflow of resources - deferred revenue	8,041	-	-	8,041
Total liabilities and deferred inflow of resources	1,377,016	13,895	(678)	1,390,233
Invested in capital assets - net of related debt	(61,297)	5,142	-	(56,155)
Restricted	31,577	-	-	31,577
Unrestricted	334,339	(1,870)	(91,540)	240,929
Total net position	304,619	3,272	(91,540)	216,351
TOTAL LIABILITIES, DEFERRED INFLOW OF RESOURCES, AND NET POSITION	**$ 1,681,635**	**$ 17,167**	**$ (92,218)**	**$ 1,606,584**

PH has provided a line of credit to Arch that bears interest at LIBOR plus 2% and is partly secured by certain assets of Arch including amounts on deposit in business bank accounts, furniture, fixtures, and equipment, and accounts receivable. The outstanding principal and related accrued interest on the line of credit as of June 30, 2016 was $63,000 and $3,649 respectively.

Note 17 – Condensed Combining Information (continued)

On July 1, 2015, the line of credit agreement was amended to increase the maximum advances available to Arch to $63,900 through June 30, 2016 and $76,900 through June 30, 2017, and to change the repayment terms to 120 equal monthly installments beginning on July 1, 2017. Arch received support of $13,000 and $14,000 for years ending June 30, 2017 and 2016, respectively.

In June, 2017 Palomar Health Board and Arch Health Partners (AHP) Board passed respective resolutions to extinguish the existing line of credit agreement, related debt currently in place between the District and Arch and any other debt of Arch. As a result, the outstanding principal and accrued interest was forgiven effective June 30, 2017. PH will continue to financially support the growth and operation of Arch for the benefit of the community.

Subsequent to June 30, 2017, Arch has drawn an additional $3,070 of operating support.

CONDENSED COMBINING STATEMENT OF REVENUE, EXPENSES, AND CHANGES IN NET POSITION
FOR THE YEAR ENDED JUNE 30, 2017

	PH	Arch	Elimination	Total
OPERATING REVENUE:				
Net patient service revenue	$ 662,784	$ 28,720	$ -	$ 691,503
Shared risk revenue	65,143	14,654	-	79,798
Other revenue	12,777	3,127	(678)	15,226
PH Program revenue	-	2,455	(2,258)	197
Total operating revenue	740,704	48,956	(2,936)	786,724
OPERATING EXPENSES	669,235	62,967	(2,936)	729,266
DEPRECIATION AND AMORTIZATION	49,762	1,664	-	51,425
Total operating expenses	718,997	64,630	(2,936)	780,691
INCOME (LOSS) FROM OPERATIONS	21,707	(15,675)	-	6,033
NONOPERATING INCOME (EXPENSE):				
Investment income	4,019	-	(2,639)	1,380
Unrealized loss on interest rate swap	12,267	-	-	12,267
Interest expense	(69,164)	(12)	12	(69,164)
Property tax revenue	35,987	-	-	35,987
Other - net	(805)	(48)	(3,433)	(4,287)
Total nonoperating expense - net	(17,697)	(60)	(6,060)	(23,817)
CHANGE IN NET POSITION	4,011	(15,735)	(6,060)	(17,784)
Interfund - Arch	(2,422)	90,834	(88,412)	-
NET POSITION - Beginning of year	303,029	(71,827)	2,933	234,135
NET POSITION - End of year	$ 304,618	$ 3,272	$ (91,539)	$ 216,351

Note 17 – Condensed Combining Information (continued)

CONDENSED COMBINING STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED JUNE 30, 2017

	PH	Arch	Elimination	Total
CASH FLOWS FROM:				
Operating activities	$ 49,416	$ (13,882)	$ 16,621	$ 52,155
Noncapital financing activities	12,458	-	-	12,458
Capital and related financing activities	(51,069)	(2,380)	-	(53,449)
Investing activities	(4,202)	16,610	(16,621)	(4,213)
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	6,603	348	-	6,951
CASH AND CASH EQUIVALENTS - Beginning of year	59,475	112	-	59,587
CASH AND CASH EQUIVALENTS - End of year	$ 66,078	$ 460	$ -	$ 66,538

CONDENSED COMBINING STATEMENT OF NET POSITION
AS OF JUNE 30, 2016

	PH	Arch	Elimination	Total
ASSETS				
Current assets	$ 393,762	$ 6,673	$ -	$ 400,435
Capital assets - net	1,109,234	4,496	-	1,113,730
Noncurrent assets	68,532	-	-	68,532
Other receivables	1,977	-	(1,977)	-
Line of credit and note receivable - PH	66,649	-	(66,649)	-
TOTAL ASSETS	$ 1,640,154	$ 11,169	$ (68,626)	$ 1,582,697
LIABILITIES AND NET POSITION				
Current liabilities	$ 148,384	$ 11,361	$ -	$ 159,745
Long-term liabilities	1,188,741	76	-	1,188,817
Other payables	-	4,910	(4,910)	-
Line of credit and note payable Arch	-	66,649	(66,649)	-
Total liabilities	1,337,125	82,996	(71,559)	1,348,562
Invested in capital assets - net of related debt	188	-	-	188
Restricted	24,056	-	-	24,056
Unrestricted	278,785	(71,827)	2,933	209,891
Total net position	303,029	(71,827)	2,933	234,135
TOTAL LIABILITIES AND NET POSITION	$ 1,640,154	$ 11,169	$ (68,626)	$ 1,582,697

Note 17 – Condensed Combining Information (continued)

CONDENSED COMBINING STATEMENT OF REVENUE, EXPENSES, AND CHANGES IN NET POSITION
FOR THE YEAR ENDED JUNE 30, 2016

	PH	Arch	Elimination	Total
OPERATING REVENUE:				
Net patient service revenue	$ 636,810	$ 30,434	$ -	$ 667,244
Shared risk revenue	56,348	15,032	-	71,380
Other revenue	18,129	4,180	-	22,309
PH Program revenue	-	2,887	(2,887)	-
Total operating revenue	711,287	52,533	(2,887)	760,933
OPERATING EXPENSES	637,486	66,007	(2,887)	700,606
DEPRECIATION AND AMORTIZATION	52,608	1,665	-	54,273
Total operating expenses	690,094	67,672	(2,887)	754,879
INCOME (LOSS) FROM OPERATIONS	21,193	(15,139)	-	6,054
NONOPERATING INCOME (EXPENSE):				
Investment income	4,268	-	(1,772)	2,496
Unrealized loss on interest rate swap	(10,076)	-	-	(10,076)
Interest expense	(67,281)	(1,793)	1,772	(67,302)
Property tax revenue	34,068	-	-	34,068
Other - net	(2,348)	1,219	2,933	1,804
Total nonoperating expense - net	(41,369)	(574)	2,933	(39,010)
CHANGE IN NET POSITION	(20,176)	(15,713)	2,933	(32,956)
NET POSITION - Beginning of year	323,205	(56,114)	-	267,091
NET POSITION - End of year	$ 303,029	$ (71,827)	$ 2,933	$ 234,135

Note 17 – Condensed Combining Information (continued)

CONDENSED COMBINING STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED JUNE 30, 2016

	PH	Arch	Elimination	Total
CASH FLOWS FROM:				
Operating activities	$ 77,298	$ (14,998)	$ -	$ 62,300
Noncapital financing activities	15,004	1,283	-	16,287
Capital and related financing activities	(47,808)	12,727	(14,000)	(49,081)
Investing activities	(29,202)	-	14,000	(15,202)
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	15,292	(988)	-	14,304
CASH AND CASH EQUIVALENTS - Beginning of year	44,183	1,100	-	45,283
CASH AND CASH EQUIVALENTS - End of year	$ 59,475	$ 112	$ -	$ 59,587