VISTA HOSPITAL SYSTEMS, INC.
FRENCH HOSPITAL MEDICAL CENTER
VISTA MEDICAL FOUNDATION

COMBINED FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 1999 AND 1998

CONTENTS

Stonefield Josephson, Inc.

Stonefield Josephson, Inc.
CERTIFIED PUBLIC ACCOUNTANTS
BUSINESS & PERSONAL ADVISORS
Member of The Leading Edge Alliance

INDEPENDENT AUDITORS' REPORT

Board of Directors
Vista Hospital Systems, Inc.
French Hospital Medical Center
Vista Medical Foundation

We have audited the accompanying combined statement of financial position of Vista Hospital Systems, Inc., French Hospital Medical Center and Vista Medical Foundation, Inc. (the "Group") as of December 31, 1999 and 1998, and the related combined statements of activities and changes in net deficit and cash flows for the years then ended. These financial statements are the responsibility of the Group's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the combined financial statements referred to above present fairly, in all material respects, the financial position of the Group as of December 31, 1999 and 1998, and the combined changes in their net deficit and their cash flows for the years then ended in conformity with generally accepted accounting principles.

CERTIFIED PUBLIC ACCOUNTANTS

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November 30, 2000

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VISTA HOSPITAL SYSTEMS, INC.
FRENCH HOSPITAL MEDICAL CENTER
VISTA MEDICAL FOUNDATION

COMBINED STATEMENTS OF FINANCIAL POSITION

ASSETS	December 31, 1999	December 31, 1998
Current assets:		
Cash and cash equivalents	$ 3,235,705	$ 2,364,990
Assets limited as to use	8,414,550	8,074,027
Patient accounts receivable, less uncollectibles and contractual allowances of $25,755,740 for 1999 and $35,617,564 for 1998	16,149,813	18,284,788
Other receivables	3,385,408	990,506
Inventories	3,168,382	3,179,763
Prepaid expenses and other current assets	1,030,310	2,844,603
Total current assets	35,384,168	35,738,677
Assets limited as to use, net of current portion	6,503,709	19,546,323
Property, plant and equipment, net	83,546,231	88,790,790
Deferred financing costs, net	6,340,391	6,830,266
Goodwill, net	512,779	17,774,924
Other assets	937,101	334,260
Total	$ 133,224,379	$ 169,015,240
LIABILITIES AND NET DEFICIT		
Current liabilities:		
Current maturities:		
Notes payable	$ 2,256,335	$ 389,231
Capitalized leases	920,976	984,176
Accounts and medical claims payable	6,365,521	13,239,078
Accrued payroll and benefits	4,485,708	4,934,531
Accrued interest	8,414,550	8,134,651
Accrued expenses	9,809,362	7,181,983
Due to third party payors	8,616,784	2,015,757
Net liabilities of discontinued operations	-	474,025
Total current liabilities	40,869,236	37,353,432
Long-term debt	180,234,168	180,245,551
Notes payable, net of current maturities	11,293,944	9,525,521
Capitalized leases, net of current maturities	2,549,678	3,449,480
Accrued malpractice insurance	2,427,005	2,073,577
Other liabilities, principally deferred revenue	10,111,335	11,402,131
Total liabilities	247,485,366	244,049,692
Unrestricted net deficit	(114,260,987)	(75,034,452)
Total	$ 133,224,379	$ 169,015,240

See accompanying independent auditors' report and notes to financial statements.

VISTA HOSPITAL SYSTEMS, INC.
FRENCH HOSPITAL MEDICAL CENTER
VISTA MEDICAL FOUNDATION

COMBINED STATEMENTS OF ACTIVITIES AND CHANGES IN NET DEFICIT

	Year ended December 31, 1999	Year ended December 31, 1998
Revenues:		
Net patient service revenue	$ 118,109,213	$ 118,746,954
Other revenue, net	5,917,515	8,376,614
Total revenues	124,026,728	127,123,568
Expenses:		
Salaries and temporary help	47,130,937	47,036,719
Employee benefits	12,942,350	13,480,042
Depreciation and amortization	24,006,070	8,208,268
Supplies	23,164,019	22,364,402
Purchased services and professional fees	20,100,000	26,007,023
Interest	17,548,431	14,675,813
Repairs, rent and utilities	8,447,052	7,179,481
Provision for uncollectible accounts	6,895,677	9,129,907
Insurance	2,014,537	2,784,552
Other operating expenses	2,265,605	4,963,163
Total expenses	164,514,678	155,829,370
Loss from continuing operations	(40,487,950)	(28,705,802)
Non-operating gains	787,390	152,688
Discontinued operations:		
Gain (loss) from operations of discontinued division	474,025	(35,438,317)
Gain on disposal of division	–	230,898
Total discontinued operations	474,025	(35,207,419)
Decrease in unrestricted net assets before extraordinary gain	(39,226,535)	(63,760,533)
Extraordinary gain on extinguishment of debt	–	5,848,820
Decrease in unrestricted net assets	(39,226,535)	(57,911,713)
Unrestricted net deficit, beginning of year	(75,034,452)	(17,122,739)
Unrestricted net deficit, end of year	$ (114,260,987)	$ (75,034,452)

See accompanying independent auditors' report and notes to financial statements.

VISTA HOSPITAL SYSTEMS, INC.
FRENCH HOSPITAL MEDICAL CENTER
VISTA MEDICAL FOUNDATION

COMBINED STATEMENTS OF CASH FLOWS

	Year ended December 31, 1999	Year ended December 31, 1998
Cash flows used for operating activities:		
Decrease in unrestricted net assets	$ (39,226,535)	$ (57,911,713)
Adjustments to reconcile decrease in unrestricted net assets to net cash provided by (used for) operating activities and nonoperating gains (net of effect of business acquired):		
Depreciation and amortization	24,006,070	8,208,268
Amortization of bond discount	83,617	83,615
Provision for uncollectible accounts	6,895,677	9,129,907
Gain from operations of discontinued division	(474,025)	–
Gain on extinguishment of debt	–	(5,848,820)
Gain on sale of equipment	(7,821)	(886,889)
Gain on disposal of division	–	(230,898)
Unamortized cost of goodwill for discontinued operations	–	27,773,786
Changes in assets and liabilities:		
(Increase) decrease in assets:		
Patient accounts receivable	(4,760,702)	(2,908,302)
Other receivables	(2,394,902)	1,838,363
Inventories	11,381	(4,373)
Prepaid expenses and other current assets	1,814,293	93,081
Other assets	(602,841)	(282,298)
Increase (decrease) in liabilities:		
Accounts and medical claims payable	(6,873,557)	5,992,729
Due to third party payors	6,601,027	3,710,350
Accrued payroll and benefits	(448,823)	251,678
Accrued interest	279,899	732,795
Accrued expenses (including malpractice insurance)	4,780,807	5,856,124
Other liabilities	(1,290,796)	12,945,845
Net cash provided by (used for) operating activities	(11,607,231)	8,543,246
Cash flows provided by (used for) investing activities:		
Purchase of property and equipment	(519,112)	(5,991,556)
(Increase) decrease in assets limited as to use	12,702,091	(1,135,135)
Net cash provided by (used for) investing activities	12,182,979	(7,126,691)
Cash flows provided by (used for) financing activities:		
Payments on long-term debt	(95,000)	–
Proceeds from current notes payable, net	1,835,527	1,397,236
Payments on capital lease obligations	(1,445,560)	(1,350,063)
Payments on notes payable	–	(308,341)
Net cash provided by (used for) financing activities	294,967	(261,168)
Net increase in cash and cash equivalents	870,715	1,155,387
Cash and cash equivalents, beginning of year	2,364,990	1,209,603
Cash and cash equivalents, end of year	$ 3,235,705	$ 2,364,990

See accompanying independent auditors' report and notes to financial statements.

(1) Organization:

Vista Hospital Systems, Inc. ("Vista") is a California non-profit public benefit acute care corporation consisting of Arroyo Grande Community Hospital ("AGCH") and Corona Regional Medical Center ("CRMC") located in Arroyo Grande and Corona, California, respectively. Vista has the right to appoint hospital directors, approve major hospital expenditures and approve long-term borrowings.

French Hospital Medical Center ("FHMC") is a California non-profit public benefit acute care corporation located in San Luis Obispo, California (collectively, with AGCH and CRMC, the "Hospitals").

Vista Medical Foundation, Inc. ("Foundation") is a California non-profit public benefit corporation which was formed to extend the mission of meeting the integrated health care needs of the community by providing all physician-related services. The Foundation's operations were discontinued during the year ended December 31, 1998 (Note 5). The Foundation was removed from the Group in 1999.

Vista and FHMC (collectively the "Group") are subordinates of Permian Health Care, Inc. ("Permian"), a Colorado non-profit corporation organized in 1989. Vista's president is also a director of Permian and, at all times, a majority of each entities directors are also directors of Permian, and vice-versa. Permian has had no assets or operations since its formation.

As outlined in Note 8, FHMC was acquired effective July 30, 1997. This transaction was completed using the proceeds of certificates of participation issued during 1997, together with funds available from a loan agreement entered into by another subordinate of Permian, Northside Operating Co. (Note 6). FHMC was acquired for a purchase price of approximately $42.3 million. The acquisition was accounted for using the purchase method of accounting and, accordingly, the purchase price was allocated to the assets purchased and liabilities assumed based upon their estimated fair values on the date of acquisition. The excess of the purchase price over the estimated fair values of the net assets acquired was approximately $17.9 million and was recorded as goodwill, which is being amortized over 30 years. In 1999, the goodwill was deemed impaired and written off to operations (Note 2).

In March 1998, FHMC and an unrelated party became members of Hospice Partners of the Central Coast, Inc., a non-profit corporation organized solely to purchase assets from the County of San Luis Obispo for $250,000 cash and provide hospice services in the County. The acquisition was accounted for using the equity method of accounting. Profits and losses are allocated equally between FHMC and the unrelated party.

In December 1998, AGCH and FHMC sold the operations and assets relating to home health agencies, which owned and operated in Arroyo Grande and San Luis Obispo, California, respectively, for $250,000 cash, resulting in a gain of approximately $220,000.

In January 1999, FHMC sold a portion of its assets (known as the Pacific Medical Plaza medical office building) to an unrelated party for $3,500,000 cash, resulting in a loss of approximately $151,000.

(2) Summary of Significant Accounting Policies:

Basis of Presentation:

The accompanying financial statements include the combined results of activities of the Group, the members of which are jointly obligated on the Certificates of Participation described in Note 8. All intercompany accounts and transactions have been eliminated in the combination.

Cash and Cash Equivalents:

Cash and cash equivalents consist of checking, savings and certificate of deposit accounts. The Group considers investments with initial maturities of three months or less that are not held as collateral to be cash equivalents.

Concentrations of Credit Risk:

The Group holds significant funds with various financial institutions in checking and money market accounts, certificates of deposit and fixed-income securities. Their funds are exposed to credit loss for the amount of the investments in excess of federally insured levels in the event of nonperformance by the other parties to the investment transactions. They maintain the majority of their cash accounts in a number of commercial banks, which are insured by the Federal Deposit Insurance Corporation ("FDIC") limits of $100,000 each. At various times throughout the year, they may have cash in financial institutions which exceed the FDIC insurance limit. They do not anticipate, nor have they incurred, any losses in any of the above accounts.

Assets Limited As To Use:

Certain proceeds of the Certificates of Participation (Note 8) held by trustees are limited as to use in accordance with the requirements of the trust agreements (Note 3).

Assets limited as to use are recorded at fair market value.

Inventories:

Inventories are recorded at the lower of cost (principally on a first-in, first-out basis) or market.

(2) Summary of Significant Accounting Policies, Continued:

Property, Plant and Equipment:

Property, plant and equipment is stated on a historical cost basis, except for donated property which is valued at fair market value at the date of the gift. Major renewals are charged to the property accounts, while expenditures for replacements, maintenance and repairs, which do not improve or extend the respective lives of the assets, are charged to operations as incurred. Depreciation is calculated using the straight-line method over the estimated useful lives of the related assets, as follows:

Building and maintenance	5 to 30 years
Equipment	5 to 15 years

Deferred Financing Costs:

Deferred financing costs are amortized over the period the obligation is outstanding, using a method which approximates the effective interest method. Amortization of deferred financing costs totaled $489,875 and $540,514 for 1999 and 1998, respectively.

Bond Discount:

Bond discount is amortized over the period the obligation is outstanding, using a method which approximates the effective interest method. Amortization of bond discount totaled $83,617 and $83,615 for 1999 and 1998, respectively, and is included in interest expense.

Goodwill:

The Group amortizes cost, in excess of the fair value of the net assets of businesses acquired, using the straight-line method over the period of estimated benefit, generally 10 to 30 years.

The Group periodically evaluates whether events or circumstances have occurred that may affect the estimated useful life or the recoverability of the remaining balance of goodwill. Impairment of goodwill is triggered when the estimated future undiscounted cash flows do not exceed the carrying amount of the intangible assets. If the events or circumstances indicate that the remaining balance of the goodwill may be permanently impaired, such potential impairment will be measured based upon the difference between the carrying amount of the goodwill and the fair value of such assets, determined using the estimated future discounted cash flows generated.

Accordingly, during 1999, the Group adjusted the carrying value of FHMC's long-lived assets (including goodwill) to their estimated fair value of approximately $27 million resulting in a noncash impairment loss of approximately $16 million. The estimated fair value was based on anticipated future cash flows discounted at a rate commensurate with the risk involved.

(2) Summary of Significant Accounting Policies, Continued:

Goodwill, Continued:

The Foundation's operations were discontinued during the year ended December 31, 1998, resulting in a write off of $27,773,786, which represented all of the remaining unamortized goodwill (Note 5).

Amortization charged to operations totaled $17,012,257 and $1,483,050 for 1999 and 1998, respectively.

Deferred Revenue:

The Group has entered into monetization agreements with an outside company whereby they have received the present value of the future earnings from assets limited to use. These earnings are being recognized into revenue using the straight-line method of accounting over the term of the agreements, which runs concurrent with the terms of the various debt obligations. The agreements are collateralized (second position) by the assets and earnings related to the monetization agreements.

The Group defaulted on the monetization agreements as a result of the Certificates of Participation ("COPs") defaults (Notes 9 and 15). The Group has notified the monetization agreement beneficiaries of such default and the beneficiaries have taken no action as a result of such default. Based on advice of legal counsel, management believes there is no financial effect or recourse as a result of the monetization agreement defaults.

Net Patient Service Revenue:

Vista and FHMC

Net patient service revenue is recorded at the respective Hospital's established rates on an accrual basis, net of the provision for contractual allowances. Contractual allowances include differences between established billing rates and amounts estimated by management as reimbursable from third-party payors and others for services rendered, including estimated retroactive adjustments (principally the Medicare program). Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods when final settlements are determined. The provision for uncollectible accounts is included in operating expenses.

(2) Summary of Significant Accounting Policies, Continued:

Net Patient Service Revenue, Continued:

Vista and FHMC, Continued

Vista and FHMC have agreements with third-party payors that provide for payments to the Hospitals at amounts different from established rates. A summary of the payment arrangements with major third-party payors follows:

- Medicare. Inpatient acute care services rendered to Medicare program beneficiaries are paid at prospectively determined rates per discharge. These rates vary according to a patient classification system that is based on clinical, diagnostic and other factors. Effective January 1, 1992, capital costs are reimbursed on a prospective rate per discharge (excluding exempt programs). Outpatient, geri-psychiatric, skilled nursing and rehabilitation services are currently exempt from the prospective system and are reimbursed based on the cost of providing the services, subject to overall cost limits per procedure or discharge. Each hospital is reimbursed at a tentative rate with final settlement determined after submission of annual cost reports by each hospital and audits thereof by the Medicare fiscal intermediary.

- Medi-Cal. Services rendered to Medi-Cal program beneficiaries are reimbursed at prospectively determined per diem rates for inpatients and fee schedules for outpatients, which are not subject to retroactive adjustment.

- Contracts. Inpatient services under other third-party insurance contracts are reimbursed at prospectively determined per diem rates or discounts from established rates, which are not subject to retroactive adjustment. Revenues under capitated contracts are recognized based upon an established premium per enrollee. All health care costs are accrued, including estimates for services rendered by other entities but not reported.

Receivables from governmental programs represent a credit risk for the Group based on their respective level of concentration; however, management does not believe that there are any credit risks associated with these governmental agencies. Commercial and private receivables consist of receivables from various payors, including individuals, who are involved in diverse activities subject to differing economic conditions, and do not represent any concentrated credit risks to the Group. Furthermore, management continually monitors and adjusts its reserves and allowances associated with these receivables.

Funds received from third-party cost reimbursement programs, primarily Medicare, are subject to audit, which could result in retroactive adjustments. At December 31,1999, Medicare cost reports for the years 1999 and 1998 have not been audited by the intermediary, and there are appeals open on prior years. Management believes that adequate provisions for the estimated final settlements have been reflected in the accompanying financial statements.

(2) Summary of Significant Accounting Policies, Continued:

Net Patient Service Revenue, Continued:

Foundation

The Foundation's net patient service revenue is comprised of revenue earned for medical services provided under fee-for-service and capitation arrangements. For revenue earned under fee-for-service arrangements, the Foundation reports revenue at the estimated net realizable amount from patients, third-party payors and others in the period in which services are rendered. Capitation revenue under Health Maintenance Organization ("HMO") contracts is prepaid monthly to the Foundation based on the number of enrollees electing the Foundation as their primary health care provider. HMO contracts also include provisions to share in the risk for hospitalization and other resource utilization whereby the Foundation can earn additional incentive revenue or incur penalties based upon the utilization of hospital services. The HMOs retain a portion of capitation for a risk-sharing fund. The HMOs also retain a portion of capitation for stop-loss premiums. Estimated shared-risk amounts due from the HMOs are recorded based upon hospital utilization and other costs incurred by HMO enrollees, compared to budgeted costs. Differences between actual contract settlements and estimated receivables relating to HMO risk-sharing arrangements are recorded in the year of final settlement.

All Foundation revenue is included in discontinued operations for the year ended December 31, 1998 (Note 5).

Charity Care:

The Group provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than established rates. Because the Group does not pursue collections of amounts determined as charity care, these amounts are not reported as patient service revenue.

The Group maintains records to identify and monitor the level of charity care it provides. The amount of charges foregone for the years ended December 31, 1999 and 1998 totaled approximately $2,519,000 and $1,876,000, respectively.

Investment Income:

Investment income earned on the proceeds of tax-exempt borrowings, held by a trustee, is reported as other revenue. Investment income from all other investments is included in nonoperating gains.

Donated Services:

Various services are performed by volunteers. The services donated are not reflected in the accompanying financial statements as expense and income from donations, as no objective basis is available to measure the value of such services.

(2) Summary of Significant Accounting Policies, Continued:

Malpractice Insurance:

The Hospitals maintain medical malpractice insurance under a claims-made policy. There is a deductible of $25,000 per incident, with a periodic aggregate deductible of $200,000 for August 1997 to October 1998 and $200,000 for November 1998 to December 2000. A claims-made policy covers only claims that occur and are filed in the period during which the policy is in force. As of December 31, 1999 and 1998, the Hospitals accrued for potential claims loss incurred but not yet reported. Accruals for claims incurred but not yet reported for 1999 and 1998 were estimated to be the cost of the purchase of tail insurance coverage.

Medical Service Cost Recognition:

The Group contracts with various physicians and/or other health care providers to provide medical services to enrollees under full or shared risk contracts between the Group and various third-party payors. The Group compensates the providers on a capitated or other fee-for-service basis. Health care services are accrued as services are rendered, including an estimate for claims incurred but not yet reported, which is determined based on historical claims payment experience and other statistics. The liability for medical claims payable includes claims in process and a provision for incurred but not yet reported claims.

Purchased Services:

An outside management company manages the Hospitals' operations. The management company receives an annual fixed fee, payable ratably on a monthly basis, plus a percent of net patient service revenue (capped at a pre-determined percentage of the annual fixed fee). The management contracts cover a ten-year term, include adjustments based on the consumer price index, and expire in periods ending through July 30, 2007.

Pursuant to the Forbearance Agreement (Notes 9 and 15), the Group and the management company modified the terms of their management agreement to provide that, commencing on October 1, 1999, the management company shall be entitled to receive 60% of the management fees otherwise payable under their management agreement as payment in full of all fees otherwise payable. The Group also executed a promissory note (Note 6) in the amount of $1,800,000, payable to the management company, with respect to all management fees earned, but not paid, prior to October 1, 1999 (Notes 6 and 15).

Self-Insurance Program:

The Group is self-insured for employee health care insurance for the years ended December 31, 1999 and 1998.

(2) Summary of Significant Accounting Policies, Continued:

Income Taxes:

The members of the Group are non-profit public benefit corporations as described in Section 501 (c)(3) of the Internal Revenue Code of 1986, as amended (the "Code"). They are exempt from federal income taxes on related income pursuant to Section 501(a) of the Code, by virtue of their inclusion in a Group Exemption recognized with respect to Permian.

The members of the Group have been granted tax-exempt status from the State of California for income taxes.

Management's Estimates:

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the dates of the financial statements and the reported amounts of revenues and expenses during the reporting periods. While management believes that the estimates are adequate as of December 31, 1999 and 1998, actual results could differ from those estimates.

Fair Value of Financial Instruments:

The following methods and assumptions were used to estimate the fair value of each class of financial instruments for which it is practicable to estimate that value.

Cash and Cash Equivalents

The carrying amount approximates fair value because of the short maturity of those instruments.

Assets Limited as to Use

The fair value of investments are based upon the fair value as reported by the respective Group member's trustees and investment managers.

Long-Term Debt

The tax-exempt bonds are not actively traded and do not have quoted market prices. The interest rates on the bonds are similar to tax-exempt bonds currently being issued in the market. Accordingly, the carrying amount approximates fair value.

Notes Payable

The fair value of notes payable is estimated based on the current rates offered to the respective Group member for debt of the same remaining maturities. The carrying amount approximates fair value.

(2) Summary of Significant Accounting Policies, Continued:

Union Contract:

Arroyo Grande Community Hospital and French Hospital Medical Center have contracts with the California Nurses Association for the period of November 1, 1999 through October 31, 2002 and May 1, 2000 through August 30, 2003, respectively. Employee benefits provided by the contracts include paid time off and health benefits. The contracts also specify compensation rates and hours of work and overtime. The effect of a labor or contract problem of any kind has not been determined and has not been reflected in these financial statements.

(3) Assets Limited As To Use:

Assets limited as to use are comprised of the following:

	1999	1998
Reserve fund	$ 12,576,195	$ 18,192,415
Interest	2,330,136	8,074,032
Project fund	11,378	789,010
Revenue fund	550	564,893
Total assets held by trustee	14,918,259	27,620,350
Less current portion	8,414,550	8,074,027
Total assets limited as to use under indenture, net of current portion	$ 6,503,709	$ 19,546,323

These funds, which are under indenture agreements held by the trustee, are comprised of the following assets:

	1999	1998
Cash equivalents	$ 12,039	$ 2,252,379
Fixed-income securities	14,906,220	25,367,971
	$ 14,918,259	$ 27,620,350

See accompanying independent auditors' report.

(4) Property, Plant and Equipment:

Property, plant and equipment are comprised of the following:

	1999	1998
Building and improvements	$ 63,219,560	$ 61,026,807
Equipment	29,227,524	27,453,267
Equipment under capital leases	10,209,435	10,057,094
	102,656,519	98,537,168
Less accumulated depreciation and amortization	37,327,700	31,074,495
	65,328,819	67,462,673
Land	17,941,513	18,726,013
Construction-in-progress	275,899	2,602,104
Property, plant and equipment, net	$ 83,546,231	$ 88,790,790

Depreciation and amortization expense totaled $6,253,205 and $5,475,753 for the years ended December 31, 1999 and 1998, respectively.

(5) Discontinued Operations:

On December 15, 1998 the Foundation sought protection under the Federal bankruptcy laws.

On December 31, 1998, the Foundation, with the approval of the bankruptcy trustee, sold substantially all of its assets and liabilities under an asset purchase agreement, resulting in a gain of $230,898. The loss from operations totaled $35,438,317, net of revenues of $22,280,000 for the year ended December 31, 1998. The Foundation's results of operations have been classified as discontinued operations for the year ended December 31, 1998.

Summarized information as of December 31, 1998 on the discontinued operation of the Foundation is as follows:

Current assets	$ 3,139,894
Current liabilities	(3,613,919)
Net liabilities of discontinued operations	$ (474,025)

In 1999, the Foundation was removed from the Group and the net unpaid liabilities was shown as a gain from discontinued operations.

VISTA HOSPITAL SYSTEMS, INC.
FRENCH HOSPITAL MEDICAL CENTER
VISTA MEDICAL FOUNDATION

NOTES TO COMBINED FINANCIAL STATEMENTS (CONTINUED)

YEARS ENDED DECEMBER 31, 1999 AND 1998

(6) Notes Payable:

A summary is as follows:

	1999	1998
Prime plus one and three quarters percent note payable, factor, secured by accounts receivable. Borrowings limited to 85% of eligible accounts receivable, up to $8,000,000, through August 2000 (Note 15). Subsequent to year end, events of default relating to the Master Indenture of Trust (Note 8) caused events of default under this agreement (Notes 9 and 15).	$ 5,272,907	$ 5,160,743
7% note payable, Northside Operating Co., the remaining balance of which, at any given time, is subordinated to the senior debt holders (Note 8) and the respective Cities and trustees, thereof. In October 1998, the group entered into a modification agreement to forgive approximately $5,848,000 of principal and accrued interest through October 1998 (extraordinary gain). Annual interest payments commence November 1, 1998, with the remaining principal and any accrued interest due by July 31, 2007 (payments made only if FHMC satisfies certain financial covenants).	4,000,000	4,000,000
Notes payable, insurance policies, payable in aggregate monthly installments approximating $29,000, including interest ranging from 8% to 9%, maturing through September 2000.	2,117,513	233,669
Note payable, management company, subordinated to the senior debt holders (Note 8) and the respective Cities and trustees thereof. Interest at 9% commencing July 1, 2002, payable subject to the provisions in the Forbearance Agreement (Notes 9 and 15).	1,800,000	-
Various notes payable, collateralized by respective Group member's assets, bearing interest ranging from 7% to 9%. Payments due through July 2003.	359,859	520,340
	13,550,279	9,914,752
Less current maturities	2,256,335	389,231
	$ 11,293,944	$ 9,525,521

See accompanying independent auditors' report.

Stonefield Josephson, Inc.

(6) Notes Payable, Continued:

The amounts due on these notes, by year, are as follows:

Year ending December 31,	
2000	$ 2,256,335
2001	5,357,867
2002	1,887,834
2003	48,243
2004	–
Thereafter	4,000,000
	$ 13,550,279

(7) Capital Lease Obligations:

The Group is the lessee of equipment under capital leases expiring through 2004. The assets and liabilities recorded under these capital leases were valued at fair market value totaling approximately $10,209,000 and $10,057,000 at December 31, 1999 and 1998, respectively. The assets are being depreciated over their estimated useful lives ranging from three to seven years. Accumulated amortization approximated $6,400,000 and $3,100,000 at December 31, 1999 and 1998, respectively, and is included in the amounts in Note 4.

Obligations under capitalized equipment leases are as follows:

Year ending December 31,	
2000	$ 1,210,485
2001	1,062,644
2002	853,607
2003	791,450
2004	148,278
Thereafter	100,223
	4,166,687
Less amounts representing interest	(696,033)
Present value of net minimum lease payments under capital leases	3,470,654
Less current maturities	920,976
	$ 2,549,678

(8) Long-Term Debt:

All of the Certificates of Participation referred to below are collateralized by the pledge and assignment of the Group's revenues pursuant to the Master Indenture of Trust, as amended "Master Indenture", as well as an executed deed of trust on the health facilities. The Master Indenture contains covenants, the most restrictive of which govern limits on future additional indebtedness, maintenance of certain debt coverage financial ratios and minimum days cash on hand requirements.

A. Certificates of Participation - 1997 Series A:

In July 1997, the Group entered into an agreement with the City of San Luis Obispo, California (the "City") for the sale and subsequent repurchase of FHMC for $53,160,000. In consideration for the repurchase of FHMC, the Group will make payments directly to the trustee, as assignee to the City, in amounts which meet all obligations to the holders of the 1997 Certificates. The members of the Group are jointly obligated on the 1997 A, Certificates of Participation ("Certificates"). The proceeds from the sale of the Certificates were ultimately used to purchase the stock of FHMC, fund the Certificate Reserve Accounts, provide working capital and funds for improvements at the health facility and pay for the costs of issuance.

Interest at a rate of 8.375% is payable semiannually on January 1 and July 1 of each year.

The 1997 Certificates are redeemable at the option of the Group on any interest payment date on or after July 1, 2017, in whole or in part, at a redemption price which varies with maturity: from July 1, 2017 through June 30, 2018 at 102%; July 1, 2018 through July 1, 2019 at 101%; and 100% thereafter.

In conjunction with the issuance of the 1997 Certificates, the Master Indenture was amended by the First Supplemental Master Indenture dated July 15, 1997.

Future principle maturities of the 1997 Series A Certificates are as follows:

Year ending December 31,	
2002	$ 515,000
2003	555,000
2004	605,000
Thereafter	51,485,000
	53,160,000
Less unamortized bond discount	621,720
	52,538,280
Less current maturities	-
	$ 52,538,280

See accompanying independent auditors' report.

Stonefield Josephson, Inc.

(8) Long-Term Debt, Continued:

B. Certificates of Participation - 1996 Series A, B and C:

In February 1996, Vista and the Foundation entered into Installment Purchase Agreements ("Purchase Agreements") with the Cities of Arroyo Grande and Corona, California (the "Cities") for the sale and subsequent repurchase of the health facilities for $45,500,000. The proceeds from the sale of the Certificates were used to defease the 1993A Certificates, purchase the stock of a medical service organization, fund the Certificate Reserve Accounts, provide working capital and funds for improvements at the health facilities and pay for the costs of issuance.

Simultaneously, Vista and the Foundation entered into an Installment Sale Agreement ("Sale Agreement") to repurchase the health facilities from the Cities, in consideration for which the Group will make payments directly to the trustee, as assignee to the Cities, in amounts which meet all obligations to the holders of the 1996 Certificates.

Interest at a rate of 8.375% is payable semiannually on January 1 and July 1 of each year.

The 1996 Certificates are redeemable at the option of the Group on any interest payment date on or after July 1, 2011, in whole or in part, at a redemption price which varies with maturity: July 1, 2011 through June 30, 2012 at 102%; July 1, 2012 through June 30, 2013 at 101%, and 100% thereafter.

In conjunction with the issuance of the 1996 Certificates, the Master Indenture was amended and restated.

Future principle maturities of the 1996 Certificates are as follows:

Year ending December 31,	
2002	$ 1,800,000
2003	2,100,000
2004	2,400,000
Thereafter	39,200,000
	45,500,000
Less unamortized bond discount	134,704
	45,365,296
Less current maturities	-
	$ 45,365,296

See accompanying independent auditors' report.

Stonefield Josephson, Inc.

(8) Long-Term Debt, Continued:

C. Certificates of Participation - 1992 Series A, B and C:

In October 1992, Vista entered into Purchase Agreements with the Cities for the sale and subsequent repurchase of health facilities for $83,000,000. The proceeds from the sale of the 1992A and 1992B Certificates of Participation (the "Certificates"), together with other sources of funds, were used to fund an escrow account ($50,000,000) for the purpose of defeasing the 1990A and 1990B Certificates ("Prior Certificates"), fund the Certificate Reserve Accounts and pay for costs of issuance. The majority of the proceeds from the sale of the 1992C Certificates were used for the purchase of Corona Community Hospital ("CCH"). The remainder of the proceeds financed costs of issuance, provided working capital and funded the Corona Certificate Reserve Account.

Simultaneously, Vista entered into a Sale Agreement to repurchase the health facilities from the Cities by making installment payments in amounts sufficient to meet all obligations to the holders of the 1992 Certificates.

Interest at a rate of 9.50% is payable semiannually on January 1 and July 1 of each year.

On February 15, 1996, Vista and the respective Cities restructured the principal maturities of the 1992 Series Certificates outstanding by amending the related Purchase Agreements. Mandatory principal payments under the restructured Certificates are deferred until July 1, 2012.

The 1992 Certificates are redeemable at the option of the Group on any interest payment date on or after July 1, 2011, in whole or in part, at a redemption price which varies with maturity:July 1, 2011 through June 30, 2012 at 102%; July 1, 2012 through June 30, 2013 at 101%, and 100% thereafter.

The 1992 Certificates are general obligations of the Group and, pursuant to the Installment Sale Agreement, they have agreed to pay the principal of, and the interest on, the 1992 Certificates in accordance with their terms.

Future principal maturities of the 1992 Certificates at December 31, 1999 are as follows:

After the year 2004	$ 82,900,000
Less unamortized bond discount	569,408
	82,330,592
Less current maturities	-
	$ 82,330,592

In 1998, the Master Indenture Agreement was amended to waive certain financial covenants for the year ending December 31, 1998. In March 1999, the obligated group defaulted on its long-term debt. A Forbearance Agreement was negotiated effective in July 1999.

(8) Long-Term Debt, Continued:

Subsequently, in May 2000, the obligated Group defaulted on its forbearance agreement and a tolling agreement was negotiated through February 2001 (Note 15).

(9) Forbearance Agreement:

The Group and the Bondholders entered into a Memorandum of Understanding ("MOU") dated as of September 1, 1999, which sets forth the terms of a 3-year agreement, including the Bondholders' commitment to forbear from exercising their rights and remedies as a result of all existing defaults and certain ongoing defaults, and to accept reduced interest payments and a postponement of certain principal payments, in return for certain restrictions on the Group's operations and cash flow. The MOU terms were incorporated into a Forbearance Agreement, which made the revised Certificates of Participation ("COPs") terms effective as of July 1, 1999 through June 30, 2002. The Forbearance Agreement was executed in March 2000 and included provisions for renegotiating a permanent restructuring, which the Group expected to implement at the end of the 3-year forbearance period (Note 15).

(10) Pension Plans:

The members of the Group maintain deferred compensation annuity plans (defined as an IRC Section 403(b) plan) which cover the respective eligible employees who elect to participate. Employees may contribute between 1% and 18% of their earnings under the various plans, subject to annual limits set by the Internal Revenue Service. Vista will make a matching contribution up to 25% of the first 8% of each participant's contribution (limited to 2% of earnings), the Foundation will make a matching contribution up to 25% of the first 4% of each participant's contribution (limited to 1% of earnings), and FHMC will make a matching contribution up to 50% of the first 4% of each participant's contribution (limited to 2% of earnings). Contributions for the years ended December 31, 1999 and 1998 were $377,280 and $391,121, respectively.

(11) Functional Expenses:

Functional expenses for the years ended December 31 were as follows:

	1999	1998
Patient care	$ 113,570,631	$ 127,217,150
General and administrative	50,944,047	28,612,220
	$ 164,514,678	$ 155,829,370

(12) Supplemental Cash Flow Information:

Supplemental cash flow information and noncash investing and financing activities for the years ended December 31, are as follows:

	1999	1998
Supplemental cash flow information:		
Cash paid during the year:		
Interest	$ 17,268,532	$ 14,705,838
Supplemental noncash investing and financing activities:		
Issuance of note payable and recognition of prepaid expense for financing of insurance	$ 2,117,513	$ 223,669
Issuance of note payable for services provided	$ 1,800,000	$ –
Capital lease obligation incurred for new equipment	$ 241,279	$ 3,732,141
Gain on extinguishment of debt	$ –	$ 5,848,820
Issuance of note payable for purchase of assets	$ –	$ 464,461

(13) Commitments:

Obligations Under Operating Leases:

The members of the Group lease office space under noncancellable operating leases with terms ranging from 1 to 27 years. Future minimum lease payments on noncancellable operating leases at December 31, 1999 are as follows:

Year ending December 31,	
2000	$ 4,404,860
2001	4,184,894
2002	3,825,207
2003	3,680,377
2004	3,362,218
Thereafter	56,139,690
	75,597,246
Income – sublease	(56,467,452)
Net commitments	$ 19,129,794

See accompanying independent auditors' report.

Stonefield Josephson, Inc.

(13) Commitments, Continued:

Obligations Under Operating Leases, Continued:

Rent expense for all operating leases for 1999 and 1998 (net of sublease income of $2,139,913 and $1,908,736, respectively) amounted to $1,808,503 and $1,513,149, respectively.

Obligations Under Management Services Agreement:

In July 1998, the members of the group entered into a three-year management services agreement with an unrelated party. The management service agreement fees and payment terms were amended (Note 9). Future minimum payments at December 31, 1999 are as follows:

Year ending December 31,	
2000	$ 759,600
2001	379,800
	$ 1,139,400

Management service expense totaled $759,600 and $379,800 for the years ended December 31, 1999 and 1998, respectively.

Subsequent to year-end, the management services agreement was terminated (Note 15).

(14) Contingencies:

Capital Improvements

The Group plans to make capital improvements to comply with California legislation for Hospital Seismic Retrofit ("SB 1953"). The cost of the capital improvements for all hospitals in the group is estimated to be $18,000,000, excluding capitalized interest. The construction is expected to be completed by 2008. No commitment for the construction has been made by the Group at December 31, 1999.

Legal Proceedings

The members of the Group are parties to various legal proceedings arising from the normal conduct of operations. Although the ultimate disposition of these proceedings is not determinable, management, based on advice of legal counsel, does not believe that adverse determinations in any or all of such proceedings would have a material adverse effect on the financial position of the Group. Accruals for settlements have been made where the Company is potentially liable. No amounts have been accrued for recoveries or gain contingencies.

(15) Subsequent Events:

Effective March 3, 2000, the Group entered into a Loan and Security Agreement (the "Agreement") with Heller HealthCare Finance, Inc. The loan is a revolving line of credit with borrowings up to $13,000,000. The base rate on the loan is 1% above the prime rate, provided that in no event shall the base rate fall below 9.75% as long as this Agreement is in effect. The maturity date is May 31, 2002, unless terminated or extended as provided for in the terms of the Agreement. Certain assets of the Group are assigned as collateral as outlined in the Agreement. The line was used to pay off the Group's previous line of credit.

Subsequent to year-end, the Group defaulted on its COPs and the Forbearance Agreement. As a result of such default, the interest payment reduction provision was nullified. After this default, the Group entered into a tolling agreement with the holders of the COPs ("Bondholders") wherein the COPs agreed to wait until February 2001 to pursue their remedies for default.

Also subsequent to year-end, the three year management services agreement was terminated by the management group. Accordingly, all future commitments, including the $1,800,000 note payable (Note 6) were cancelled effective the date of termination.

The Group also defaulted on its credit line as a result of the COPs defaults. The Group has notified the credit line provider of such default, which provider has taken no action as a result of such default. The Group is in the process of negotiating with a replacement credit line provider, and expects to have a replacement line of credit in place concurrent with the execution of the Forbearance Agreement.

See accompanying independent auditors' report.

VISTA HOSPITAL SYSTEMS, INC.
FRENCH HOSPITAL MEDICAL CENTER

COMBINED FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2002 AND 2001

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STONEFIELD
JOSEPHSON, Inc.

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CERTIFIED PUBLIC ACCOUNTANTS
BUSINESS ADVISORS

INDEPENDENT AUDITORS' REPORT

Board of Directors
Vista Hospital Systems, Inc.
French Hospital Medical Center

We have audited the accompanying combined statements of financial position of Vista Hospital Systems, Inc. and French Hospital Medical Center (the "Group") as of December 31, 2002 and 2001, and the related combined statements of activities and changes in net deficit and cash flows for the years then ended. These financial statements are the responsibility of the Group's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with accounting principles generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the combined financial statements referred to above present fairly, in all material respects, the financial position of the Group as of December 31, 2002 and 2001, and the combined changes in their net deficit and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The accompanying financial statements for the year ended December 31, 2002 have been prepared assuming that the Group will continue as a going concern, which contemplates continuity of business, realization of assets and liquidation of liabilities in the ordinary course of business. As discussed in Note 15 to the financial statements, the Group, subsequent to year-end, filed voluntary petitions for reorganization under Chapter 11 of the United States Bankruptcy Code. This filing has raised substantial doubt about the Group's ability to continue as a going concern. These financial statements do not include any adjustments that might result from the outcome of this uncertainty.

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June 25, 2003

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VISTA HOSPITAL SYSTEMS, INC.
FRENCH HOSPITAL MEDICAL CENTER

COMBINED STATEMENTS OF FINANCIAL POSITION

	Year ended December 31, 2002	2001
ASSETS		
Current assets:		
Cash and cash equivalents	$ 4,459,258	$ 2,721,744
Assets limited as to use	5,557,323	5,730,111
Patient accounts receivable, less uncollectible and contractual allowances of $48,448,850 for 2002 and $30,178,189 for 2001	24,060,604	19,919,325
Other receivables	1,144,918	1,448,206
Inventory	3,070,369	2,912,213
Prepaid expenses and other current assets	2,039,664	1,188,067
Total current assets	40,332,136	33,919,666
Other assets:		
Property, plant and equipment, net	74,506,224	75,843,148
Deferred financing costs, net	5,126,828	5,619,946
Goodwill, net	463,353	463,353
Other	458,889	828,508
Total other assets	80,555,294	82,754,955
Total	$ 120,887,430	$ 116,674,621
LIABILITIES AND NET DEFICIT		
Current liabilities:		
Current maturities:		
Notes payable	$ 24,207	$ 771,828
Capitalized leases	1,216,111	951,906
Certificates of participation	180,475,145	-
Accounts and medical claims payable	15,484,256	11,308,576
Accrued payroll and benefits	4,611,868	4,501,332
Accrued interest, current	42,641,436	2,172,000
Accrued expenses	1,790,423	9,222,643
Due to third-party payors	3,879,950	7,948,140
Total current liabilities	250,123,396	36,876,425
Long-term liabilities:		
Certificates of participation	-	180,392,942
Notes payable, net of current maturities	4,027,140	4,089,506
Capitalized leases, net of current maturities	2,038,377	1,707,220
Accrued interest, net of current portion	-	26,222,025
Accrued malpractice insurance	3,474,000	2,165,680
Other liabilities, principally deferred revenue	8,380,246	8,892,063
Total long-term liabilities	17,919,763	223,469,436
Total liabilities	268,043,159	260,345,861
Unrestricted net deficit	(147,155,729)	(143,671,240)
Total	$ 120,887,430	$ 116,674,621

The accompanying notes are an integral part of these financial statements.

VISTA HOSPITAL SYSTEMS, INC.
FRENCH HOSPITAL MEDICAL CENTER

COMBINED STATEMENTS OF ACTIVITIES AND CHANGES IN NET DEFICIT

	Year ended December 31, 2002	2001
Revenues:		
Net patient service revenue	$ 176,158,772	$ 156,488,350
Other revenue, net	5,833,065	4,848,768
Total revenues	181,991,837	161,337,118
Expenses:		
Salaries and temporary help	62,465,465	58,282,959
Employee benefits	16,612,092	12,682,454
Supplies	28,712,061	26,270,467
Purchased services and professional fees	24,876,547	20,280,097
Interest	16,950,559	14,299,277
Depreciation and amortization	6,680,348	7,345,717
Provision for uncollectible accounts	14,817,765	15,668,723
Repairs, rent and utilities	8,903,064	6,921,440
Insurance	3,474,225	1,523,087
Other operating expenses	2,724,057	2,566,379
Total expenses	186,216,183	165,840,600
Loss from continuing operations before Bond interest rate restatement	(4,224,346)	(4,503,482)
Bond interest rate restatement (Note 8)	–	7,469,801
Loss from continuing operations	(4,224,346)	(11,973,283)
Non-operating revenue	739,857	609,305
Decrease in unrestricted net assets	(3,484,489)	(11,363,978)
Unrestricted net deficit, beginning of year	(143,671,240)	(132,307,262)
Unrestricted net deficit, end of year	$ (147,155,729)	$ (143,671,240)

The accompanying notes are an integral part of these financial statements.

VISTA HOSPITAL SYSTEMS, INC.
FRENCH HOSPITAL MEDICAL CENTER

COMBINED STATEMENTS OF CASH FLOWS

	Year ended December 31, 2002	2001
Cash flows used for operating activities:		
Decrease in unrestricted net assets	$ (3,484,489)	$ (11,363,978)
Adjustments to reconcile decrease in unrestricted net assets to net cash provided by operating activities and nonoperating gains:		
Depreciation and amortization	6,680,348	7,345,717
Provision for uncollectible accounts	14,817,765	15,668,723
Gain on sale of equipment	–	105,851
Changes in assets and liabilities:		
(Increase) decrease in assets:		
Patient accounts receivable	(18,959,044)	(13,632,340)
Other receivables	303,288	(480,693)
Inventory	(158,156)	217,600
Prepaid expenses and other current assets	(851,597)	1,248,135
Other assets	344,907	(63,642)
Increase (decrease) in liabilities:		
Accounts and medical claims payable	4,175,680	(1,951,078)
Accrued payroll and benefits	110,536	428,703
Accrued interest	14,247,411	15,338,346
Accrued expenses	(6,123,900)	(765,915)
Due to third-party payors	(4,068,190)	(3,793,466)
Other liabilities	(511,817)	(380,759)
Net cash provided by operating activities	6,522,742	7,921,204
Cash flows provided by (used for) investing activities:		
Purchase of property and equipment	(2,949,806)	(2,201,378)
Decrease in assets limited as to use	172,788	5,108,468
Net cash provided by (used for) investing activities	(2,777,018)	2,907,090
Cash flows used for financing activities:		
Payments on current notes payable, net	(809,987)	(8,511,726)
Payments on capital lease obligations, net	(1,198,223)	(929,617)
Net cash used for financing activities	(2,008,210)	(9,441,343)
Net increase (decrease) in cash and cash equivalents	1,737,514	1,386,951
Cash and cash equivalents, beginning of year	2,721,744	1,334,793
Cash and cash equivalents, end of year	$ 4,459,258	$ 2,721,744

The accompanying notes are an integral part of these financial statements.

(1) Organization:

Vista Hospital Systems, Inc. is a California nonprofit public benefit acute care corporation consisting of Arroyo Grande Community Hospital ("AGCH") and Corona Regional Medical Center ("CRMC") located in Arroyo Grande and Corona, California, respectively ("Vista"). Vista has the right to appoint hospital directors, approve major hospital expenditures and approve long-term borrowings.

French Hospital Medical Center ("FHMC") is a California nonprofit public benefit acute care corporation located in San Luis Obispo, California (collectively, with AGCH and CRMC, the "Hospitals").

Vista and FHMC (collectively the "Group") are subordinate to the authority of Permian Health Care, Inc. ("Permian"), a Colorado nonprofit corporation organized in 1989. Vista's president is also a director of Permian, and at all times a majority of each entities directors are also directors of Permian and vice versa. Permian has had no assets or operations since its formation.

In March 1998, FHMC and an unrelated party each acquired a 50% interest in Hospice Partners of the Central Coast, Inc., a nonprofit corporation organized solely to purchase assets from the County of San Luis Obispo, for $250,000 cash, and provide hospice services in the County. The acquisition was accounted for using the equity method of accounting. Profits and losses are allocated equally between FHMC and the unrelated party. The interest was terminated by FHMC, who received a cash payment of $328,000, on November 29, 2002. The $78,000 difference is included in other revenue.

(2) Summary of Significant Accounting Policies:

Basis of Presentation:

The accompanying financial statements include the combined results of activities of the Group, the members of which are jointly obligated on the Certificates of Participation described in Note 7. All intercompany accounts and transactions have been eliminated in the combination.

Management's Estimates:

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the dates of the financial statements and the reported amounts of revenues and expenses during the reporting periods. While management believes that the estimates are adequate as of December 31, 2002 and 2001, actual results could differ from those estimates.

(2) Summary of Significant Accounting Policies, Continued:

Cash and Cash Equivalents:

Cash and cash equivalents consist of checking, savings and certificate of deposit accounts. The Group considers investments with initial maturities of three months or less that are not held as collateral to be cash equivalents.

Concentrations of Credit Risk:

The Group holds funds with various financial institutions in checking and money market accounts, certificates of deposit and fixed-income securities. Their funds are exposed to credit loss for the amount of the investments in excess of federally insured levels in the event of nonperformance by the other parties to the investment transactions. They maintain the majority of their cash accounts in a number of commercial banks, which are insured by the Federal Deposit Insurance Corporation ("FDIC") with limits of $100,000 each. At various times throughout the year, they may have cash in financial institutions that exceed the FDIC insurance limit. They do not anticipate, nor have they incurred, any losses in any of the above accounts.

Assets Limited As To Use:

Assets limited as to use are comprised of assets set aside per the requirements of the certificates of participation trust agreements.

These investments consist primarily of money market funds and U.S. Agency Securities meeting the definition of cash and cash equivalents and are stated at fair value.

Inventory:

Inventory consists primarily of pharmaceuticals and medical supplies and is stated at the lower of cost (determined using the first-in, first-out (FIFO) method) or market.

Property, Plant and Equipment:

Property, plant and equipment is stated on a historical cost basis, except for donated property, which is valued at fair market value at the date of the gift. Major renewals are charged to the property accounts, while expenditures for replacements, maintenance and repairs, which do not improve or extend the respective lives of the assets, are charged to operations as incurred. Depreciation is calculated using the straight-line method over the estimated useful lives of the related assets as follows:

Buildings and improvements	5 to 30 years
Equipment and furniture	5 to 15 years
Equipment under capital lease	5 to 15 years

(2) Summary of Significant Accounting Policies, Continued:

Deferred Financing Costs:

Deferred financing costs are amortized over the period the obligation is outstanding, using a method that approximates the effective interest method. Amortization of deferred financing costs totaled $493,118 and $474,898 for 2002 and 2001, respectively.

Bond Discount:

Bond discount is amortized over the period the obligation is outstanding, using a method that approximates the effective interest method. Amortization of bond discount totaled $82,203 and $80,253 for 2002 and 2001, respectively, and is included in interest expense.

Goodwill:

The Group periodically evaluates whether events or circumstances have occurred that may affect the estimated useful life or the recoverability of the remaining balance of goodwill. Impairment of goodwill is triggered when the estimated future undiscounted cash flows do not exceed the carrying amount of the intangible assets. If the events or circumstances indicate that the remaining balance of the goodwill may be permanently impaired, such potential impairment will be measured based upon the difference between the carrying amount of the goodwill and the fair value of such assets, determined using the estimated future discounted cash flows generated.

Deferred Revenue:

The Group has entered into monetization agreements with an outside group whereby they have received the present value of the future earnings from assets limited as to use. These earnings are being recognized as revenue using the straight-line method of amortization over the term of the agreements, which run concurrent with the terms of the various debt obligations. The agreements are collateralized (second position to Certificate of Participation holders, Note 7) by the assets and earnings related to the monetization agreements.

The Group defaulted on the monetization agreements as a result of the Certificates of Participation ("COPs") defaults (Notes 7 and 8). The Group has notified the monetization agreement beneficiaries of such default and the beneficiaries have taken no action as a result of such default. Based on advice of legal counsel, management believes there will be no financial effect or recourse taken by the beneficiaries as a result of the monetization agreement defaults.

(2) Summary of Significant Accounting Policies, Continued:

Net Patient Service Revenue:

The Group has agreements with third-party payors that provide for payments to the Group at amounts different from its established rates. Payment arrangements include prospectively determined rates per discharge, reimbursed costs, discounted charges, and per diem payments. Net patient services revenue is reported at the estimated net realizable amounts from patients and third-party payors. Adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined.

Receivables from governmental programs represent a credit risk for the Group based on their respective level of concentration; however, management does not believe that there are any credit risks associated with these governmental agencies. Commercial and private receivables consist of receivables from various payors, including individuals, who are involved in diverse activities subject to differing economic conditions, and do not represent any concentrated credit risks to the Group. Furthermore, management continually monitors and adjusts its reserves and allowances associated with these receivables.

Funds received from third-party cost reimbursement programs, primarily Medicare, are subject to audit, which could result in retroactive adjustments. At December 31, 2002, Medicare cost reports for the years 2002, 2001, and 2000 have not been audited by the intermediary. In addition, there are appeals open on prior years as well as notifications by the intermediaries of their intent to reopen prior closed years. Management believes that adequate provisions for the estimated final settlements have been reflected in the accompanying financial statements.

Capitation Revenue:

Historically, the Group has agreements with various health maintenance organizations ("HMO's") to provide medical services to subscribing participants. Under these arrangements, the Group receives monthly capitation payments based on the number of each HMO's participants, regardless of services performed by the Group. In addition, the HMOs make fee-for-service payments to the Hospital for certain covered services based upon discounted fee schedules, per diem rates, and case rates. The Group terminated all its capitation agreements by December 31, 2002.

(2) Summary of Significant Accounting Policies, Continued:

Charity Care:

The Group provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than established rates. Because the Group does not pursue collections of amounts determined as charity care, these amounts are not reported as patient service revenue.

The Group maintains records to identify and monitor the level of charity care it provides. The amount of gross charges foregone for the years ended December 31, 2002 and 2001 totaled approximately $1,045,000 and $1,163,000, respectively.

Investment Income:

Investment income earned on the proceeds of tax-exempt borrowings, held by a trustee, is reported as other revenue. Investment income from all other investments is included in non-operating revenue.

Donated Services:

Volunteers perform various services. The services donated are not reflected in the accompanying financial statements as expense and income from donations, as no objective basis is available to measure the value of such services.

Malpractice Insurance:

The Hospitals maintain medical malpractice insurance under a claims-made policy. A claims-made policy covers only claims that occur and are filed in the period during which the policy is in force.

For claims made during 2001, there is a deductible of $25,000 per incident with an annual aggregate deductible of $200,000. Effective for the short period December 31, 2001, the Hospitals entered into a new policy. For claims made from December 31, 2001 through June 30, 2002, and for the twelve month period July 1, 2002 through June 30, 2003, the Hospitals are responsible for the first $250,000 per incident (including all legal fees) with an annual aggregate Group amount of $750,000 per policy year. In addition, effective for the July 1, 2002 through June 30, 2003 policy year, there is a Group aggregate limit of $10 million of coverage; in the prior period there was no aggregate limit.

As of December 31, 2002 and 2001, the Hospitals accrued for both incurred and reported as well as for potential claim losses incurred but not yet reported. This accrual was estimated based on historical information and an analysis of open claims.

(2) Summary of Significant Accounting Policies, Continued:

Medical Service Cost Recognition:

Historically, the Group contracted with various physicians and/or other health care providers to provide medical services to enrollees under full or shared risk contracts between the Group and various third-party payors. The Group compensated the providers on a capitated or other fee-for-service basis. Health care services were accrued as services were rendered, including an estimate for claims incurred but not yet reported, which was determined based on historical claims payment experience and other statistics. The liability for medical claims payable includes claims in process and a provision for incurred but not yet reported claims. The Group terminated all its capitation agreements by December 31, 2002.

Purchased Services and Obligations Under Management Services Agreement:

The Group has a three-year management services agreement with an unrelated party. Pursuant to the agreement, the unrelated party shall be paid $180,000 per month, plus direct non-salary expenses not to exceed $50,000 per month, and incentive payments through January 2002. From February 2002 through October 2003, the unrelated party shall be paid $88,000 per month, plus direct non-salary expenses not to exceed $35,000 per month, and incentive payments.

The Group also has executed an agreement with the same party to provide investment-banking services to the Group as required in its June 10, 2002 forbearance agreement. Fees for the investment banking services per the agreement are as follows: $50,000 initial fee, $40,000 monthly fee, $75,000 fee for a definitive sales agreement, and a $400,000 success fee.

Self-Insurance Program:

The Group became fully insured February 2001. Prior to then the Group was self-insured for employee health care insurance.

Income Taxes:

The members of the Group are nonprofit public benefit corporations as described in Section 501(c)(3) of the Internal Revenue Code of 1986, as amended (the "Code"). They are exempt from federal income taxes on related income pursuant to Section 501(a) of the Code by virtue of their inclusion in a Group Exemption recognized with respect to Permian.

The members of the Group have been granted tax-exempt status from the State of California for income taxes.

(2) Summary of Significant Accounting Policies, Continued:

Fair Value of Financial Instruments:

The fair values of all reported assets and liabilities which represent financial instruments approximate the carrying value of such amounts, except for the fair value of long-term debt (tax-exempt bonds), which management is not practically able to determine the fair value of as of December 31, 2002 and 2001.

Union Contract:

Arroyo Grande Community Hospital and French Hospital Medical Center have contracts with the California Nurses Association for the periods of November 1, 1999 through October 31, 2004, and May 1, 2000 through April 30, 2003, respectively. Employee benefits provided by the contracts include paid time off and health benefits. The contracts also specify compensation rates and hours of work and overtime. The effect of a labor or contract problem of any kind has not been determined, is not contemplated, and has not been reflected in these financial statements.

New Accounting Pronouncements:

In April 2002, the FASB issued Statement No. 145, "Rescission of FASB Statements No. 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Corrections." This Statement rescinds FASB Statement No. 4, "Reporting Gains and Losses from Extinguishment of Debt," and an amendment of that Statement, FASB Statement No. 64, "Extinguishments of Debt Made to Satisfy Sinking-fund Requirements" and FASB Statement No. 44, "Accounting for Intangible Assets of Motor Carriers." This Statement amends FASB Statement No. 13, "Accounting for Leases," to eliminate an inconsistency between the required accounting for sale-leaseback transactions and the required accounting for certain lease modifications that have economic effects that are similar to sale-leaseback transactions. The adoption of FASB Statement No. 145 did not have a material impact to the Group's financial position or results of operations.

In June 2002, the FASB issued Statement No. 146, "Accounting for Costs Associated with Exit or Disposal Activities." This Statement addresses financial accounting and reporting for costs associated with exit or disposal activities and nullifies Emerging Issues Task Force (EITF) Issue No. 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)." The provisions of this Statement are effective for exit or disposal activities that are initiated after December 31, 2002, with early application encouraged. The adoption of this Statement did not have a material impact on the Groups financial position or results of operations.

(2) Summary of Significant Accounting Policies, Continued:

New Accounting Pronouncements, Continued:

In November 2002, the FASB issued FASB Interpretation No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others" ("FIN 45"). FIN 45 requires that the guarantor recognize, at the inception of certain guarantees, a liability for the fair value of the obligation undertaken in issuing such guarantee. FIN 45 also requires additional disclosure requirements about the guarantor's obligations under certain guarantees that it has issued. The initial recognition and measurement provisions of this interpretation are applicable on a prospective basis to guarantees issued or modified after December 31, 2002 and the disclosure requirements are effective for financial statement periods ending after December 15, 2002. The adoption of FIN 45 did not have a material impact on the Groups financial position, results of operations or cash flows.

In April 2003, the FASB issued SFAS No. 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities". This Statement amends and clarifies financial accounting and reporting for derivative instruments, including certain derivative instruments embedded in other contracts (collectively referred to as derivatives) and for hedging activities under SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities". This Statement amends Statement 133 for decisions made (1) as part of the Derivatives Implementation Group process that effectively required amendments to Statement 133, (2) in connection with other Board projects dealing with financial instruments, and (3) in connection with implementation issues raised in relation to the application of the definition of a derivative, in particular, the meaning of an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors, the meaning of underlying, and the characteristics of a derivative that contains financing components. The Group does not anticipate that the adoption of this pronouncement will have a material effect on the financial statements.

(2) Summary of Significant Accounting Policies, Continued:

New Accounting Pronouncements, Continued:

In May 2003, the FASB issued SFAS No. 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity". This Statement establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. It requires that an issuer classify a financial instrument that is within its scope as a liability (or an asset in some circumstances). Many of those instruments were previously classified as equity. Some of the provisions of this Statement are consistent with the current definition of liabilities in FASB Concepts Statement No. 6, Elements of Financial Statements. The remaining provisions of this Statement are consistent with the Board's proposal to revise that definition to encompass certain obligations that a reporting entity can or must settle by issuing its own equity shares, depending on the nature of the relationship established between the holder and the issuer. While the Board still plans to revise that definition through an amendment to Concepts Statement 6, the Board decided to defer issuing that amendment until it has concluded its deliberations on the next phase of this project. That next phase will deal with certain compound financial instruments including puttable shares, convertible bonds, and dual-indexed financial instruments. The Group does not anticipate that the adoption of this pronouncement will have a material effect on the financial statements.

In January 2003, the FASB issued Interpretation No. 46, "Consolidation of Variable Interest Entities." Interpretation 46 changes the criteria by which one company includes another entity in its consolidated financial statements. Previously, the criteria were based on control through voting interest. Interpretation 46 requires a variable interest entity to be consolidated by a company if that company is subject to a majority of the risk of loss from the variable interest entity's activities or entitled to receive a majority of the entity's residual returns or both. A company that consolidates a variable interest entity is called the primary beneficiary of that entity. The consolidation requirements of Interpretation 46 apply immediately to variable interest entities created after January 31, 2003. The consolidation requirements apply to older entities in the first fiscal year or interim period beginning after June 15, 2003. Certain of the disclosure requirements apply in all financial statements issued after January 31, 2003, regardless of when the variable interest entity was established. The Group does not expect the adoption to have a material impact to the Company's financial position or results of operations.

Reclassification:

Certain amounts in the 2001 financial statements have been reclassified to conform to the 2002 presentation.

(3) Assets Limited As To Use:

Assets limited as to use are comprised of the following:

	2002	2001
Reserve fund	$ 3,834,749	$ 3,818,025
Interest	1,722,574	1,905,630
Revenue fund	-	6,456
Total assets held by trustee, all current	$ 5,557,323	$ 5,730,111

These funds, which are under indenture agreements held by the trustee, are comprised of all cash equivalents.

(4) Property, Plant and Equipment:

Property, plant and equipment are comprised of the following:

	2002	2001
Building and improvements	$ 65,765,686	$ 65,605,177
Equipment and furniture	33,577,055	31,505,210
Equipment under capital leases	12,400,221	10,428,218
	111,742,962	107,538,605
Less accumulated depreciation and amortization	56,487,399	50,449,875
	55,255,563	57,088,730
Land	17,941,513	17,941,513
Construction-in-progress	1,309,148	812,905
Property, plant and equipment, net	$ 74,506,224	$ 75,843,148

Depreciation and amortization expense related to property, plant and equipment totaled $6,292,278 and $6,775,300 for the years ended December 31, 2002 and 2001, respectively.

(5) Notes Payable:

A summary is as follows:

	2002	2001
7% note payable, Northside Operating Company, the remaining balance of which, at any given time, is subordinated to the senior debt holders (Note 7) and the respective Cities and trustees, thereof. Interest commenced accruing August 1, 1998, with the principal balance and unpaid accrued interest due by July 31, 2007, the maturity date. Unless certain covenants are met, neither the outstanding principal balance nor the accrued interest will be due on the maturity date. The President of the Group was previously a board member of Northside Operating Company.	$ 4,000,000	$ 4,000,000
Various notes payable, collateralized by respective Group assets, bearing interest ranging from 7% to 9%. Payments due through 2005.	51,347	249,421
Prime plus 1% note payable, factor, secured by accounts receivable. Borrowings limited to 85% of eligible accounts receivable, up to $10,000,000, maturity date of May 31, 2004. There has been no balance outstanding since May 8, 2002.	–	611,913
	4,051,347	4,861,334
Less current maturities	24,207	771,828
	$ 4,027,140	$ 4,089,506

The amounts due on these notes, by year, are as follows:

Year ending December 31,	
2003	$ 24,207
2004	15,565
2005	11,575
2006	-
2007	4,000,000
	$ 4,051,347

(6) Capital Lease Obligations:

The Group is the lessee of equipment under capital leases expiring through 2004. Assets held under capital leases are recorded at the lower of the net present value of the minimum lease payments or the fair value of the leased asset at the inception of the lease. The assets are being depreciated over the shorter of the estimated useful lives of the assets or the period of the related lease. Accumulated amortization approximated $9,400,000 and $7,500,000 at December 31, 2002 and 2001, respectively, and is included in the amount in Note 4.

Obligations under capitalized equipment leases are as follows:

Year ending December 31,	
2003	$ 1,646,794
2004	734,216
2005	617,606
2006	373,935
Thereafter	586,112
	3,958,663
Less amounts representing interest	704,175
Present value of net minimum lease payments under capital leases	3,254,488
Less current maturities	1,216,111
	$ 2,038,377

(7) Certificates of Participation:

All of the Certificates of Participation referred to below are collateralized by the pledge and assignment of the Group's revenues pursuant to the Master Indenture of Trust, as amended "Master Indenture", as well as an executed deed of trust on the health facilities. The Master Indenture contains covenants, the most restrictive of which govern limits on future additional indebtedness, maintenance of certain debt coverage financial ratios and minimum days cash on hand requirements.

Certain events of default have arisen under the Master Indenture. On June 10, 2002, the Group and the holders of the Certificates entered into a New Forbearance Agreement (Note 8), which superceded the previous Forbearance Agreement dated as of August 7, 2001, between the Group and the holders of the Certificates. Pursuant to the New Forbearance Agreement, the holders of the Certificates have agreed to forbear from taking remedial actions permitted under the various agreements securing the Certificates until the earlier of January 1, 2003, or the date on which an event of default occurs as defined in the New Forbearance Agreement. As no events of default arose during 2002, the forbearance agreement expired January 1, 2003, and the Group is again in default under the Master Indenture Agreement.

(7) Certificates of Participation, Continued:

A. Certificates of Participation - 1997 Series A:

In July 1997, the Group entered into an agreement with the City of San Luis Obispo, California (the "City") for the sale and subsequent repurchase of FHMC for $53,160,000. In consideration for the repurchase of FHMC, the Group will make payments directly to the trustee, as assignee to the City, in amounts which meet all obligations to the holders of the 1997 Certificates. The members of the Group are jointly obligated on the 1997 Series A Certificates of Participation ("Certificates"). The proceeds from the sale of the Certificates were ultimately used to purchase the stock of FHMC, fund the Certificate Reserve Accounts, provide working capital and funds for improvements at the health facility, and pay for the costs of issuance.

Interest at a rate of 8.375% is payable semiannually on January 1 and July 1 of each year. The interest rate was temporarily reduced to 6.45% in 2000, but was restated during 2001 to its original rate with retroactive treatment (Note 8).

The 1997 Certificates are redeemable at the option of the Group on any interest payment date on or after July 1, 2017, in whole or in part, at a redemption price which varies with maturity: from July 1, 2017, through June 30, 2018, at 102%; July 1, 2018, through June 30, 2019, at 101%; and 100% thereafter.

In conjunction with the issuance of the 1997 Certificates, the Master Indenture was amended by the First Supplemental Master Indenture dated July 15, 1997.

Balance of principle maturities of the 1997 Series A Certificates as of December 31, 2002	$ 53,160,000
Less unamortized bond discount	531,559
	$ 52,628,441

B. Certificates of Participation - 1996 Series A, B and C:

In February 1996, Vista entered into Installment Purchase Agreements ("Purchase Agreements") with the Cities of Arroyo Grande and Corona, California (the "Cities") for the sale and subsequent repurchase of the health facilities for $45,400,000. The proceeds from the sale of the Certificates were used to defease the 1993A Certificates, purchase the stock of a medical service organization, fund the Certificate Reserve Accounts, provide working capital and funds for improvements at the health facilities, and pay for the costs of issuance.

Simultaneously, Vista entered into an Installment Sale Agreement ("Sale Agreement") to repurchase the health facilities from the Cities, in consideration for which the Group will make payments directly to the trustee, as assignee to the Cities, in amounts which meet all obligations to the holders of the 1996 Certificates.

(7) Certificates of Participation, Continued:

B. Certificates of Participation - 1996 Series A, B and C, Continued:

Interest at a rate of 8.375% is payable semiannually on January 1 and July 1 of each year. The interest rate was temporarily reduced to 6.45% in 2000, but was restated during 2001 to its original rate with retroactive treatment (Note 8).

The 1996 Certificates are redeemable at the option of the Group on any interest payment date on or after July 1, 2011, in whole or in part, at a redemption price which varies with maturity: July 1, 2011, through June 30, 2012, at 102%; July 1, 2012, through June 30, 2013, at 101%, and 100% thereafter.

In conjunction with the issuance of the 1996 Certificates, the Master Indenture was amended and restated.

Balance of the principle maturities of the 1996 Certificates as of December 31, 2002	$ 45,400,000
Less unamortized bond discount	80,449
	$ 45,319,551

C. Certificates of Participation - 1992 Series A, B and C:

In October 1992, Vista entered into Purchase Agreements with the Cities for the sale and subsequent repurchase of health facilities for $83,000,000. The proceeds from the sale of the 1992A and 1992B Certificates of Participation (the "Certificates"), together with other sources of funds, were used to fund an escrow account ($51,750,000 fair value at December 31, 2001) for the purpose of defeasing the 1990A and 1990B Certificates ("Prior Certificates"), fund the Certificate Reserve Accounts and pay for costs of issuance. The majority of the proceeds from the sale of the 1992C Certificates were used for the purchase of Corona Community Hospital ("CCH"). The remainder of the proceeds financed costs of issuance, provided working capital and funded the Corona Certificate Reserve Account.

Simultaneously, Vista entered into a Sale Agreement to repurchase the health facilities from the Cities by making installment payments in amounts sufficient to meet all obligations to the holders of the 1992 Certificates.

Interest at a rate of 9.50% is payable semiannually on January 1 and July 1 of each year. The interest rate was temporarily reduced to 7.315% in 2000, but was restated in 2001 to its original rate with retroactive treatment (Note 8).

(7) Certificates of Participation, Continued:

C. Certificates of Participation - 1992 Series A, B and C, Continued:

On February 15, 1996, Vista and the respective Cities restructured the principal maturities of the 1992 Series Certificates outstanding by amending the related Purchase Agreements. Mandatory principal payments under the restructured Certificates are deferred until July 1, 2012.

The 1992 Certificates are redeemable at the option of the Group on any interest payment date on or after July 1, 2011, in whole or in part, at a redemption price which varies with maturity: July 1, 2011, through June 30, 2012, at 102%; July 1, 2012, through June 30, 2013, at 101%; and 100% thereafter.

The 1992 Certificates are general obligations of the Group and, pursuant to the Installment Sale Agreement, they have agreed to pay the principal of and the interest on the 1992 Certificates in accordance with their terms.

Balance of the principal maturities of the 1992 Certificates at December 31, 2002	$ 83,000,000
Less unamortized bond discount	472,847
	$ 82,527,153

(8) Forbearance Agreements:

In March 1999, the obligated group defaulted on its long-term debt. A Forbearance Agreement was negotiated effective in July 1999. In March 2000, the Group defaulted on this Forbearance Agreement. The forbearance agreement included a commitment from the bondholders to forbear from exercising their rights and remedies as a result of all existing and ongoing defaults and to accept reduced interest payments and postpone certain principal payments. After the default of the forbearance agreement, the group entered into a tolling agreement with the bondholders wherein the bondholders agreed to wait to pursue their remedies while negotiating with the Group.

The Group and the bondholders then entered into a new Forbearance Agreement dated as of August 7, 2001, which superceded the prior Forbearance Agreement. As of March 2002, the Group defaulted on the August 7, 2001 forbearance agreement.

On June 10, 2002, the Group and the holders of the Certificates entered into a New Forbearance Agreement, which superceded the Forbearance Agreement dated as of August 7, 2001, between the Group and the holders of the Certificates. The Revised Forbearance Agreement set forth the following provisions:

(8) Forbearance Agreements, Continued:

Interest rates, which had been previously reduced as detailed by Series above, are reinstated to their original interest rates retroactively back to the date of their reduction (March 1, 2000). Accordingly, interest expense was increased $7,469,801 for the year ended December 31, 2001, of which $3,966,471 relates to the period corresponding to the year ending December 31, 2000.

- The Bondholders will forbear from accelerating principal and interest payments during the forbearance period.
- Interest and principal payments during the forbearance period will be deferred.
- The Group has agreed during the forbearance period to engage an investment banker and pursue the sale of the Group. There are certain key dates for this process to insure that the Group is actively pursuing this option.
- The Group also has the right during the forbearance period to attempt to refinance the Bondholders debt at a discounted amount. The Bondholders are under no obligation to accept the refinance offer but are open to an offer in the interest of receiving the maximum amount of funds for the repayment of their obligations.
- The Group has agreed to not enter into certain type of lease and severance agreements during the term of the Forbearance Agreement.
- Certain restrictions on the disbursement of cash and the limits on capital expenditures have also been put in place.

Pursuant to the New Forbearance Agreement, the holders of the Certificates have agreed to forbear from taking remedial actions permitted under the various agreements securing the Certificates until the earlier of January 1, 2003, or the date on which an event of default occurs as defined in the New Forbearance Agreement. The Group, as a result of this agreement, is actively pursuing the refinancing of the Hospitals with various government and private funding sources. Subsequent to year-end, the Group has accepted an offer to sell the Hospitals, see Note 15. As this offer was after the expiration of the last Forbearance Agreement, they are in default to the holders of the Certificates.

(9) Non-operating Revenue:

Non-operating revenue for both years is composed of contributions received.

(10) Pension Plans:

The members of the Group maintain deferred compensation annuity plans (defined as an IRC Section 403(b) Plan), which cover the respective eligible employees who elect to participate. Employees may contribute between 1% and 18% of their earnings under the various plans, subject to annual limits set by the Internal Revenue Service. Vista will make a matching contribution up to 25% of the first 8% of each participant's contribution (limited to 2% of earnings) and FHMC will make a matching contribution up to 50% of the first 4% of each participant's contribution (limited to 2% of earnings). Contributions for the years ended December 31, 2002 and 2001, were $556,758 and $505,131, respectively.

(11) Functional Expenses:

Functional expenses for the years ended December 31 were as follows:

	2002	2001
Patient care	$ 143,851,055	$ 130,572,056
General and administrative, including bond interest restatement of $7,469,801 in 2001	42,365,128	42,738,345
	$ 186,216,183	$ 173,310,401

(12) Supplemental Cash Flow Information:

Supplemental cash flow information and noncash investing and financing activities for the years ended December 31 are as follows:

	2002	2001
Supplemental cash flow information:		
Cash paid during the year for interest	$ 2,703,148	$ 6,362,979
Supplemental noncash investing and financing activities:		
Capital lease obligation incurred for new equipment	$ 1,793,585	$ 857,084
Gain (loss) on sale of equipment	$ –	$ 105,851

(13) Commitments:

Obligations Under Operating Leases:

The members of the Group lease office space under noncancellable operating leases with original terms ranging from 1 to 36 years. Future minimum lease payments on noncancellable operating leases at December 31, 2002, are as follows:

Year ending December 31,	
2003	$ 3,454,108
2004	3,463,340
2005	3,518,817
2006	3,586,415
Thereafter	96,903,976
	110,926,656
Income – sublease for commitments in place through 2003	2,053,103
Net commitments	$ 108,873,553

Rent expense for all operating leases for 2002 and 2001 (net of sublease income of $2,053,103 and $2,299,948, respectively) amounted to $1,265,683 and $1,218,949, respectively.

(14) Contingencies:

Capital Improvements

The Group plans to make capital improvements to comply with California legislation for Hospital Seismic Retrofit ("SB 1953"). The cost of the capital improvements for all hospitals in the Group is estimated to be $18,000,000, excluding capitalized interest. Per SB 1953, the construction is expected to be completed by 2008. The Group has made no commitment for the construction at December 31, 2002.

Legal Proceedings

The members of the Group are parties to various legal proceedings arising from the normal conduct of operations. Although the ultimate disposition of these proceedings is not determinable, management, based on advice of legal counsel, does not believe that adverse determinations in any or all of such proceedings would have a material adverse effect on the financial position of the Group. Accruals for settlements have been made where the Group is potentially liable. No amounts have been accrued for recoveries or gain contingencies.

(15) Subsequent Events:

Agreement to Sell Certain Group Assets and Liabilities

Subsequent to year-end, on April 3, 2003, the Group signed an agreement with a National Health Services Organization (Buyer) to sell certain of the Hospitals' assets and have certain of the Hospitals' liabilities assumed. The sales price will be $120.6 million less certain specified adjustments. Buyer will buy all hospitals, AGCH, CRMC and FHMC unless the Group obtains exit financing and working capital funds for AGCH and FHMC. The sales prices will be reduced accordingly for the Hospitals not purchased. There is a $1 million breakup fee due the Buyer if the sale closing does not occur before December 31, 2003, and the Buyer elects to terminate the agreement. There is a $5 million breakup fee if the Hospitals are sold to another buyer or if the Group pursues another transaction.

The Group is required to commence a voluntary bankruptcy filing within sixty days from the signed Asset Purchase Agreement ("APA"). An extension was granted on the sixty-day requirement. Approval for the sale is required from the California Attorney General, as the Buyer is a "For-Profit" organization.

Voluntary Bankruptcy Filing

Also subsequent to year-end, on June 10, 2003, the Group (Debtor) filed a voluntary petition for re-organization (the "Filing") under Chapter 11 of the United State Bankruptcy Code in the United States Bankruptcy Court for the Central District of California. Under Chapter 11, the Debtor expects to continue to operate as a debtor-in-possession under court protection from their creditors and claimants, while using the Chapter 11 process to develop and implement a plan to reorganize in order to address the previously identified operating problems.

Background of Filing

The Group has certificates of participation (the "Bonds") (Note 7) totaling approximately $180,000,000, which are secured by a first priority lien on substantially all of the Group's assets. The Bonds were issued to finance the Group's acquisitions of CRMC, AGCH, FHMC, as well as the acquisition of Vista Medical Foundation ("VMF"). VMF accounts for approximately $32,000,000 of the Bonds. VMF, in 1998, withdrew from the Group with the consent of the master trustee and the bondholders, but the Group remained obligated for the Bonds. In addition, shortly after the acquisition of FHMC, which accounted for approximately $53,000,000 of the Bonds, a significant revenue-producing program of FHMC was found to be not in compliance with applicable law. With the loss of revenue from this FHMC revenue program and the added obligation of the VMF Bonds without any offsetting revenue, the Group could not generate sufficient cash flow to pay the interest on the Bonds, resulting in a monetary default under the Master Indenture Agreement.

(15) Subsequent Events, Continued:

Background of Filing, Continued

While new management was brought in at the end of 2000 to evaluate the operations of the Hospitals and plan for its continued operations, in an economically sound environment, the prior depletion of working capital and the inability to renegotiate the debt service on $180 million of Bonds, with interest rates higher than current market conditions, necessitated the search for a buyer; even with an approximate combined increase of earnings before interest, depreciation and amortization of $27 million for years 2002 and 2001 over the year 2000.

As mentioned above, the Group has found a buyer for the Hospitals and part of that agreement necessitated the Filing.

Consequence of Filing

As a consequence of the Filing, all pending litigation and prior creditor claims are stayed and no party may take action to realize its pre-petition claims except pursuant to an order of the Bankruptcy Court. It is the Debtor's intention to address all pre-petition claims in a plan of reorganization. However, it is currently impossible to predict with any degree of certainty how the plan will treat pre-petition claims and the impact the Filing will have on the reorganization and continued operations of the Hospital. The formulation and implementation of a plan of reorganization could take a significant period of time.

The accompanying financial statements have been prepared on a going concern basis, which contemplates continuity of operations, realization of assets and liquidation of liabilities in the ordinary course of business. However, as a result of the Filing, such realization of certain Debtor's assets and liquidation of certain Debtor's liabilities are subject to significant uncertainty. Further, a plan of reorganization could materially change the amounts and classifications reported in the financial statements, which do not give effect to any adjustments to the carrying value or classification of assets or liabilities that might be necessary as a consequence of a plan of reorganization.

All of the Debtor's pre-petition debt is now in default due to the Filing. Accordingly, the unaudited proforma Statement of Financial Position as of December 31, 2002, as presented below, reflects the classification of the Debtor's pre-petition debt as current.

The Debtor has received approval from the Bankruptcy Court to pay or otherwise honor certain of its pre-petition obligations, including claims for employee wages and benefits payable in the ordinary course of business. The Debtor has not yet received approval from the Bankruptcy Court for the breakup fees to the potential Buyer of the Hospitals.

(15) Subsequent Events, Continued:

Accounting Impact

As a result of the Filing, the Debtor will be required to follow Statement of Position 90-7 ("SOP 90-7"), "Financial Reporting by Entities in Reorganization under the Bankruptcy Code." Pursuant to SOP 90-7, the Debtor's pre-petitions liabilities that are subject to compromise will be reported separately on the Statement of Financial Position at the estimated amount that will ultimately be allowed by the Bankruptcy Court. SOP 90-7 also requires separate reporting of certain expenses, realized gains and losses, and provisions for losses related to the Filing as reorganization items.

Proforma Statement of Financial Position (*Unaudited*)

The condensed unaudited proforma statement of financial position of the Debtor as if the Debtor had filed petitions for reorganization under Chapter 11 at December 31, 2002, is as follows:

Proforma Condensed Combined Statement of Financial Position of Vista Hospital Systems, Inc. and French Hospital Medical Center:

	(Unaudited)
Current assets:	
Cash and cash equivalents	$ 4,459,258
Assets limited as to use	5,557,323
Patient accounts receivable, less uncollectible and Contractual allowances of $48,448,850	24,060,604
Other receivables	1,144,918
Inventory	3,070,369
Prepaid expenses and other current assets	2,039,664
Total current assets	40,332,136
Property, plant and equipment, net	74,506,224
Deferred financing costs, net	5,126,828
Goodwill	463,353
Other assets	458,889
Total	$ 120,887,430
Liabilities subject to compromise:	
Debt	184,526,492
Other liabilities	83,516,667
Total liabilities	268,043,159
Fund deficit	(147,155,729)
Total	$ 120,887,430

VISTA HOSPITAL SYSTEMS INC.
FRENCH HOSPITAL MEDICAL CENTER
CONSOLIDATED INCOME STATEMENT
TWELVE MONTHS ENDING DECEMBER 31, 2002

	AGCH	VISTA CORPORATE	CRMC	FHMC	COMBINED
Revenue					
Net patient service revenue	$ 32,521,881	$ -	$ 88,882,216	$ 54,754,675	$ 176,158,772
Other Revenue	388,564	128,242	4,258,487	1,057,772	5,833,065
Total operating revenue	32,910,445	128,242	93,140,703	55,812,447	181,991,837
Expense					
Salaries and temporary help	10,835,698	1,194,697	34,594,147	16,228,027	62,852,569
Employee benefits	3,318,756	113,164	8,936,305	3,925,866	16,294,091
Supplies	5,129,058	14,411	13,469,531	10,062,274	28,675,274
Purchased services and professional fees	2,992,387	2,576,191	5,591,563	5,161,778	16,321,919
Managed Care Purchased Services	0	0	0	8,554,130	8,554,130
Repairs, rent and utilities	1,162,473	47,502	6,158,164	1,534,765	8,902,904
Provision for uncollectable accounts	4,002,010	0	7,201,262	3,614,493	14,817,765
Insurance	873,127	0	2,186,072	682,745	3,741,944
Depreciation and amortization	1,269,903	159,001	2,692,277	2,559,167	6,680,348
Interest	2,354,964	3,080,928	6,848,127	4,666,540	16,950,559
Other operating expense	330,752	383,562	1,619,405	358,792	2,692,511
Total operating expense	32,269,128	7,569,456	89,296,853	57,348,577	186,484,014
Income from operations	641,317	(7,441,214)	3,843,850	(1,536,130)	(4,492,177)
Nonoperating gains	29,908	0	626,378	83,571	739,857
Net Income	$ 671,225	$ (7,441,214)	$ 4,470,228	$ (1,452,559)	$ (3,752,320)
EBIDA	$ 4,296,092	$ (4,201,285)	$ 14,010,632	$ 5,773,148	$ 19,878,587

STATISTICS

	AGCH	VISTA CORPORATE	CRMC	FHMC	COMBINED
ACUTE DISCHARGES	2,876	0	8,571	4,125	15,572
ACUTE PATIENT DAYS	10,590	0	33,346	15,281	59,217
ACUTE AVERAGE LENGTH OF STAY	3.68	0.00	3.89	3.70	3.80
SNF/SUBACUTE DISCHARGES	269	0	728	0	997
SNF/SUBACUTE DAYS	2,627	0	15,622	0	18,249
SNF/SUBACUTE AVERAGE LENGTH OF STAY	9.77	0.00	21.46	0.00	18.30
ADJUSTED PATIENT DAYS	22,365	0	76,375	24,512	123,252
INPATIENT SURGERIES	743	0	2,388	1,453	4,584
OUTPATIENT SURGERIES	1,065	0	3,886	2,696	7,647
DELIVERIES	0	0	1,981	422	2,403
OUTPATIENT VISITS	52,863	0	88,407	87,542	228,812
EMERGENCY ROOM VISITS	20,438	0	39,590	12,807	72,835
PAID FTE'S	250	69	798	334	1,452
HOME HEALTH VISITS	0	0	10,404	0	10,404

VISTA HOSPITAL SYSTEMS INC.
FRENCH HOSPITAL MEDICAL CENTER
CONSOLIDATED BALANCE SHEET
MONTH ENDED DECEMBER 31, 2002

		AGCH	VISTA CORPORATE	CRMC	FHMC	COMBINED
CURRENT ASSETS						
	Cash	($45,799)	$0	$4,702,657	($259,895)	$4,396,963
	Short Term Investment	21,230	0	0	0	21,230
	Current Assets Limited to Use	0	0	0	0	0
	Patient Receivables	19,080,292	0	30,398,616	23,030,546	72,509,454
	Allowance for Contractual Discounts/Bad Debt	(14,270,859)	0	(16,652,243)	(17,525,748)	(48,448,850)
	Net Accounts Receivable	4,809,433	0	13,746,373	5,504,798	24,060,604
	Due to/from Third Party Payors	0	0	0	0	0
	Inventories	613,595	0	1,299,719	1,157,055	3,070,369
	Prepaid Expenses	225,204	1,827	1,237,054	575,579	2,039,664
	Other Accounts Receivable	0	432,272	0	26,977	459,249
	Total Current Assets	5,623,663	434,099	20,985,803	7,004,514	34,048,079
ASSETS WHOSE USE IS LIMITED						
	Assets Limited as to Use	610,836	1,105,378	1,814,619	2,026,237	5,557,070
PROPERTY PLANT & EQUIPMENT						
	Property Plant & Equipment	31,140,747	16,754	68,952,768	30,883,354	130,993,623
	Less- Accumulated Depreciation	(15,255,392)	(7,410)	(28,284,101)	(12,940,495)	(56,487,398)
	Net Property Plant & Equipment	15,885,355	9,344	40,668,667	17,942,859	74,506,225
OTHER ASSETS						
	Deferred Financing Costs	88,890	430,991	1,963,579	2,221,953	4,705,413
	Deposits	113,236	0	0	91,964	205,200
	Other Assets, Goodwill	0	421,415	504,418	253,689	1,179,522
	Total Other Assets	202,126	852,406	2,467,997	2,567,606	6,090,135
TOTAL ASSETS		$22,321,980	$2,401,227	$65,937,086	$29,541,216	$120,201,509
CURRENT LIABILITIES						
	Current Installments on LongTerm Debt	$21,053	$0	$3,529	($375)	$24,207
	Current Capital Lease Obligatiions	68,441	0	327,135	820,535	1,216,111
	Accounts Payable	1,343,600	0	5,375,752	2,448,757	9,168,109
	Accrued Accounts Payable	1,379,996	180,000	3,474,316	1,281,836	6,316,148
	Accrued Salaries & Wages	355,234	66,061	2,600,622	656,960	3,678,877
	Accrued Paid Time Off	380,574	1,697	0	550,466	932,737
	Heller LOC	0	(685,669)	0	0	(685,669)
	Accrued Interest Payable	6,056,598	7,914,302	17,199,478	11,471,058	42,641,436
	Other Accrued Liabilities	172,891	874,162	0	743,370	1,790,423
	Due to Third Party Payors	826,915	0	2,094,907	958,129	3,879,951
	Total Current Liabilites	10,605,302	8,350,553	31,075,739	18,930,736	68,962,330
LONG TERM DEBT						
	Certificates of Participation	24,892,144	31,731,868	71,222,692	52,628,441	180,475,145
	Other Long Term Debt - Capitalized Leases	1,051,269	0	708,475	278,633	2,038,377
	Other Long Term Debt - Malpractice Insurance	811,746	0	1,806,500	855,754	3,474,000
	Other Long Term Debt - Notes Payable	20,442	0	6,698	4,000,000	4,027,140
	Other Liabilities - Deferred Revenue	1,238,195	1,141,215	3,068,665	2,932,171	8,380,246
	Intercompany	(10,114,129)	22,565,204	(15,901,577)	3,450,502	0
	Total Long Term Debt	17,899,667	55,438,287	60,911,453	64,145,501	198,394,908
UNRESTRICTED NET ASSETS (DEFICIT)		(6,182,988)	(61,387,614)	(26,050,106)	(53,535,018)	(147,155,726)
TOTAL LIABILITIES		$22,321,981	$2,401,226	$65,937,086	$29,541,219	$120,201,512