



Report of Independent Auditors
and Financial Statements for

**Public Hospital District No. 4,
King County, Washington**

December 31, 2015 and 2014

MOSS-ADAMS_{LLP}

Certified Public Accountants | Business Consultants

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REPORT OF INDEPENDENT AUDITORS

To the Board of Commissioners
Public Hospital District No. 4,
King County, Washington

Report on Financial Statements

We have audited the accompanying financial statements of Public Hospital District No. 4, King County, Washington (the District), which comprise the statements of net position as of December 31, 2015 and 2014, and the related statements of revenues, expenses, and changes in net position and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

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

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Public Hospital District No. 4, King County, Washington, as of December 31, 2015 and 2014, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the accompanying management's discussion and analysis on pages 3 through 8 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, which considers it to be an essential part of financial reporting for placing the basic financial statements in the appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Moss Adams LLP

Everett, Washington

May 27, 2016

PUBLIC HOSPITAL DISTRICT NO. 4, KING COUNTY, WASHINGTON

MANAGEMENT'S DISCUSSION AND ANALYSIS

Introduction

Our discussion and analysis provides an overview of the financial position and activities of Public Hospital District No. 4, King County, Washington, doing business as Snoqualmie Valley Hospital and Hospital District No. 4 Clinics (the District). It should be read in conjunction with the financial statements and accompanying notes that follow.

Operational Highlights

The District began construction of a new facility on a 13-acre site near the intersection of State Highway 18 and Interstate 90 in the fall of 2013. The facility is a 70,000-square-foot replacement for the District's existing 25,000-square-foot hospital facility. The new facility includes 25 inpatient rooms (versus 14 rooms in its former facility), a six-room emergency department, and rehabilitation, radiology, and pharmacy services.

The District entered into an agreement with Benaroya Capital Company LLC to build the replacement facility in July 2013. Under the terms of the agreement, the District entered into a capital lease with the developer for 30 years and purchase of the hospital for \$1.00 at the end of the lease term.

The District began the process of issuing revenue bonds to fund the purchase of the new hospital in November 2014. This process was completed in July 2015. The purchase price of the hospital from Benaroya Capital Company LLC is \$39,283,855.

Hospital operations were transferred to the new facility on May 6, 2015.

The new hospital allows the District to expand its health care services to the community. The District was constrained by the size of its existing hospital and its location. The advantages of the new facility are:

- The new facility has 25 inpatient rooms, versus the old, which had 14 inpatient rooms. The old facility limited the number of inpatients the District could accommodate to 20 or fewer. The District frequently hit its maximum inpatient capacity and had to turn away inpatients. Since moving to the new hospital, the District has averaged 22.7 inpatients per day, an increase of 20.5%.
- The new facility enjoys easier access from I-90, the major east-west freeway in the Snoqualmie area. The old facility was difficult to access for residents driving west on the freeway.
- A new, modern facility has driven an increase in emergency room and outpatient visits. See below.

**PUBLIC HOSPITAL DISTRICT NO. 4, KING COUNTY, WASHINGTON
MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)**

Operational Highlights (continued)

Since moving into the new hospital, the District has seen patient volumes increase as shown below:

Business Line	Patient Volumes January Through April 2015	Patient Volumes May Through December 2015	Percentage Increase
Inpatient days/month	548.3	660.8	20.5%
Emergency room visits/month	223.5	337.0	50.8%
Endoscopy procedures	13.0	23.8	83.1%
Outpatient service visits/month	116.5	123.5	6.0%
Rehab inpatient procedures/month	1,270.8	1,443.0	13.6%
Rehab outpatient procedures/month	879.8	1,081.6	22.9%
Laboratory tests/month	3,430.8	3,936.9	14.8%
Imaging procedures/month	245.5	325.3	32.5%
Hospital-based clinic	339.0	345.6	1.9%

The District also has non-hospital-based clinics. Patient volumes in non-hospital-based clinics increased 6.1% from 2014 to 2015.

The District continues to see growth in volumes in 2016.

In July 2014, the District entered into a Letter of Intent with Overlake Medical Center to affiliate upon completion of the new hospital. The District and Overlake decided not to enter into a formal affiliation agreement in October 2014. The District still has an active program with Overlake Medical Center to coordinate care for District residents.

**PUBLIC HOSPITAL DISTRICT NO. 4, KING COUNTY, WASHINGTON
MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)**

Statements of Revenues, Expenses, and Changes in Net Position

The following is a presentation of certain condensed financial information derived from the District's statements of revenues, expenses, and changes in net position:

	<u>2015</u>	<u>2014</u>	<u>2013</u>
Net operating revenue	\$ 29,086,183	\$ 24,830,525	\$ 23,656,053
Nonoperating income	<u>2,794,032</u>	<u>3,171,201</u>	<u>3,286,094</u>
	<u>31,880,215</u>	<u>28,001,726</u>	<u>26,942,147</u>
Total operating expenses	31,003,259	27,254,972	25,818,227
Nonoperating expense	<u>6,765,587</u>	<u>2,127,468</u>	<u>2,100,430</u>
	<u>37,768,846</u>	<u>29,382,440</u>	<u>27,918,657</u>
Change in net position	(5,888,631)	(1,380,714)	(976,510)
Net position, beginning of year	<u>(10,922,535)</u>	<u>(9,541,821)</u>	<u>(8,565,311)</u>
Net position, end of year	<u><u>\$ (16,811,166)</u></u>	<u><u>\$ (10,922,535)</u></u>	<u><u>\$ (9,541,821)</u></u>

Operating Revenue

District revenues included \$29.1 million in operating revenue adjusted for contractual allowances, bad debts, and charity care. Net operating revenue increased by \$4.3 million (+17.1%) due to the increased inpatient, emergency department, and outpatient patient volumes that were the result of the District moving into the new hospital in May 2015. The new facility has more inpatient capacity, is a modern state-of-the-art facility, and is in a better location than the old facility. All these factors led to the increase in patient volumes mentioned above.

PUBLIC HOSPITAL DISTRICT NO. 4, KING COUNTY, WASHINGTON MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

Operating Expenses

Operating expense increased by \$3.7 million (13.8%):

- Depreciation expense increased by \$1.6 million due to the depreciation expense associated with the new hospital during the last 6 months of the year.
- Lease and rental equipment increased by \$1.2 million due to:
 - ◆ Equipment leases associated with the new hospital (\$640,000).
 - ◆ The lease of the new hospital from the developer prior to the closing of financing (revenue bonds) for the new hospital (\$560,000).
- Salary expenses increased by \$544,000 due to the following factors:
 - ◆ Salary increases effective January 2015 for all staff.
 - ◆ The addition of a provider in January 2014 in the hospital clinic to provide endoscopy services.
 - ◆ Increased staffing on the inpatient unit due to the increased volumes.
- Expenses associated with increased patient volumes also increased by \$971,000. These expenses are:
 - ◆ Supply expense.
 - ◆ Purchased services.
 - ◆ Professional fees.
- Employee benefits expense decreased by \$621,000. The District moved to a fully insured benefit plan in 2015 from a self-insured plan in 2014. This change in plan structure decreased benefits expense.

Nonoperating expense is above the prior year by \$4.6 million due to:

- Bond acquisition costs of \$2.4 million.
- Revenue bond interest of \$1.3 million.
- Interest expense incurred for the new hospital project (bridge loans) of \$800,000.

The District had a change in net position of -\$5.8 million. The net change was the result of:

- Costs associated with the bond issuance (\$2.4 million).
- An increase in depreciation of \$1.5 million; the increase is due to the new hospital capital costs being depreciated starting July 2, 2016. Because the District is cost based reimbursed by Medicare, the increase in depreciation expense (a noncash expense) contributed to our increase in cash.
- Revenue bond interest of \$1.3 million that was paid from revenue bond proceeds (capitalized interest).

PUBLIC HOSPITAL DISTRICT NO. 4, KING COUNTY, WASHINGTON
MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

Statements of Net Position

The following is a presentation of certain condensed financial information derived from the District's statements of net position:

	<u>2015</u>	<u>2014</u>	<u>2013</u>
ASSETS			
Current assets	\$ 15,285,843	\$ 9,020,578	\$ 7,942,041
Capital assets, net	64,559,344	26,364,702	24,974,010
Other noncurrent assets	<u>4,888,608</u>	<u>1,940,447</u>	<u>1,989,622</u>
Total assets	84,733,795	37,325,727	34,905,673
DEFERRED OUTFLOWS OF RESOURCES	<u>801,756</u>	<u>135,132</u>	<u>200,772</u>
Total assets and deferred outflows of resources	<u>\$ 85,535,551</u>	<u>\$ 37,460,859</u>	<u>\$ 35,106,445</u>
LIABILITIES			
Current liabilities	\$ 6,713,313	\$ 8,115,989	\$ 4,254,382
Noncurrent liabilities	<u>95,633,404</u>	<u>40,267,405</u>	<u>40,393,884</u>
Total liabilities	<u>102,346,717</u>	<u>48,383,394</u>	<u>44,648,266</u>
NET POSITION			
Net investment in capital assets	12,383,375	191,093	(1,279,142)
Restricted expendable for debt service	1,513,374	406,657	397,438
Unrestricted	<u>(30,707,915)</u>	<u>(11,520,285)</u>	<u>(8,660,117)</u>
Total net position	<u>(16,811,166)</u>	<u>(10,922,535)</u>	<u>(9,541,821)</u>
Total liabilities and net position	<u>\$ 85,535,551</u>	<u>\$ 37,460,859</u>	<u>\$ 35,106,445</u>

Assets

Current assets - The District's cash balances increased in 2015 due to an increase in unrestricted cash of \$7.2 million. The increase was due to increased volumes in the new hospital, a decrease in accounts receivable, and a working capital increase of \$3.0 million from the revenue bond proceeds. With the new facility and the new capital structure, the District forecasts increases in cash in future years.

Noncurrent assets - Capital assets increased with the completion of the new hospital (\$39.3 million).

PUBLIC HOSPITAL DISTRICT NO. 4, KING COUNTY, WASHINGTON MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

Liabilities

Current liabilities - Current liabilities decreased by \$1.4 million due to a decrease in accounts payable. The District's improved cash position allowed it to become current and take advantage of discounts with its vendors.

Noncurrent liabilities - Noncurrent liabilities increased due to the issuance of revenue bonds for the new hospital transaction (\$50.1 million) and the refinancing of existing LTGO bonds. The refunded bonds carried interest rates ranging from 5.5% to 7.25%; they were refinanced with bonds carrying an average interest rate of 5.1%.

Contacting the District's Financial Management

This financial report is designed to provide the District's patients, suppliers, taxpayers, and creditors with a general overview of the District's finances and show its accountability for the money it receives. If you have questions about this report or need additional information, contact the District's finance office at Snoqualmie Valley Hospital, 9575 Ethan Wade Way SE, Snoqualmie, WA 98065-9577.

PUBLIC HOSPITAL DISTRICT NO. 4, KING COUNTY, WASHINGTON
STATEMENTS OF NET POSITION

ASSETS AND DEFERRED OUTFLOWS OF RESOURCES

	December 31,	
	2015	2014
CURRENT ASSETS		
Cash and cash equivalents	\$ 7,347,118	\$ 155,227
Assets limited as to use required for current liabilities	1,546,446	348,263
Patient accounts receivable, net of allowances for doubtful accounts of \$547,000 in 2015 and \$279,000 in 2014	6,168,470	7,003,818
Other receivables	223,809	984,268
Estimated third-party payor settlements	-	529,002
Total current assets	15,285,843	9,020,578
ASSETS LIMITED AS TO USE, net of current portion	4,888,608	1,940,447
CAPITAL ASSETS		
Land	14,631,178	13,387,400
Construction in progress	404,617	11,162,818
Depreciable capital assets, net of accumulated depreciation and amortization	49,523,549	1,814,484
Total capital assets, net of accumulated depreciation and amortization	64,559,344	26,364,702
Total assets	84,733,795	37,325,727
DEFERRED OUTFLOWS OF RESOURCES		
Deferred loss on refunding	801,756	135,132
Total assets and deferred outflows of resources	\$ 85,535,551	\$ 37,460,859
LIABILITIES AND NET POSITION		
CURRENT LIABILITIES		
Accounts payable	\$ 2,359,520	\$ 3,606,055
Accrued compensation and related liabilities	1,489,782	1,664,007
Accrued interest payable	495,137	239,263
Estimated third-party payor settlements	1,298,094	-
Line of credit	-	2,461,747
Current maturities of long-term debt	1,070,780	144,917
Total current liabilities	6,713,313	8,115,989
LONG-TERM DEBT, net of current maturities	95,633,404	40,267,405
Total liabilities	102,346,717	48,383,394
NET POSITION		
Net investment in capital assets	12,383,375	191,093
Restricted expendable for debt service	1,513,374	406,657
Unrestricted	(30,707,915)	(11,520,285)
Total net position	(16,811,166)	(10,922,535)
	\$ 85,535,551	\$ 37,460,859

PUBLIC HOSPITAL DISTRICT NO. 4, KING COUNTY, WASHINGTON
STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION

	Years Ended December 31,	
	2015	2014
OPERATING REVENUE		
Net patient service revenue (net of provision for bad debts of \$1,759,186 in 2015 and \$941,474 in 2014)	\$ 28,276,075	\$ 24,153,403
Taxation for operations	720,530	266,724
Other	89,578	410,398
Total operating revenue	<u>29,086,183</u>	<u>24,830,525</u>
OPERATING EXPENSES		
Salaries and wages	16,429,830	15,885,698
Employee benefits	3,267,140	3,887,922
Professional fees	1,197,707	772,854
Supplies	2,451,400	2,167,047
Repairs and maintenance	53,035	48,590
Utilities	668,101	510,421
Purchased services	1,734,437	1,472,734
Insurance	190,437	409,933
Leases and rentals	2,206,071	1,006,568
Depreciation and amortization	2,038,791	476,304
Other	766,310	616,901
Total operating expenses	<u>31,003,259</u>	<u>27,254,972</u>
OPERATING LOSS	<u>(1,917,076)</u>	<u>(2,424,447)</u>
NONOPERATING INCOME (EXPENSE)		
Investment income, net of accounts capitalized	27,854	14,393
Taxation for bond principal and interest	2,769,884	2,835,546
Interest expense, net of amount capitalized	(4,338,096)	(2,127,468)
Issuance and financing costs	(2,427,491)	-
Other, net	(3,706)	321,262
Nonoperating income, net	<u>(3,971,555)</u>	<u>1,043,733</u>
CHANGE IN NET POSITION	(5,888,631)	(1,380,714)
NET POSITION, beginning of year	<u>(10,922,535)</u>	<u>(9,541,821)</u>
NET POSITION, end of year	<u>\$ (16,811,166)</u>	<u>\$ (10,922,535)</u>

PUBLIC HOSPITAL DISTRICT NO. 4, KING COUNTY, WASHINGTON
STATEMENTS OF CASH FLOWS

Increase (Decrease) in Cash and Cash Equivalents

	Years Ended December 31,	
	2015	2014
CASH FLOWS FROM OPERATING ACTIVITIES		
Cash received from and on behalf of patients	\$ 30,938,519	\$ 20,537,736
Cash paid to employees	(18,912,742)	(19,184,142)
Cash paid to suppliers	(10,514,033)	(4,721,806)
Other cash receipts	89,578	410,398
Net cash from operating activities	1,601,322	(2,957,814)
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Cash from tax levies considered a noncapital financing activity	720,530	266,724
Other	(201,700)	21,262
Net cash from noncapital financing activities	518,830	287,986
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Purchase of capital assets, net of disposal	(40,233,433)	(1,866,996)
Cash from tax levies for general obligation bonds	2,774,032	2,841,230
Change in line of credit	(2,461,747)	1,316,747
Net proceeds from issuance of long-term debt	81,343,404	-
Escrow payment for refunding of general obligation bonds	(26,390,059)	-
Principal payments on long-term debt	(35,137)	(90,219)
Cash paid for issuance and financing costs	(2,427,491)	-
Interest paid on long-term debt, net of amount capitalized	(3,375,192)	(2,037,686)
Net cash from capital and related financing activities	9,194,377	163,076
CASH FLOWS FROM INVESTING ACTIVITIES		
Investment income, net of amount capitalized	27,854	14,393
NET CHANGE IN CASH AND CASH EQUIVALENTS	11,342,383	(2,492,359)
CASH AND CASH EQUIVALENTS, beginning of year	2,354,582	4,846,941
CASH AND CASH EQUIVALENTS, end of year	\$ 13,696,965	\$ 2,354,582
RECONCILIATION OF CASH AND CASH EQUIVALENTS TO STATEMENT OF NET POSITION		
Cash and cash equivalents	\$ 7,347,118	\$ 155,227
Cash and cash equivalents in assets whose use is limited	6,349,847	2,199,355
	\$ 13,696,965	\$ 2,354,582

PUBLIC HOSPITAL DISTRICT NO. 4, KING COUNTY, WASHINGTON
STATEMENTS OF CASH FLOWS (continued)

Increase (Decrease) in Cash and Cash Equivalents

	Years Ended December 31,	
	<u>2015</u>	<u>2014</u>
RECONCILIATION OF OPERATING LOSS TO		
NET CASH FROM OPERATING ACTIVITIES		
Operating loss	\$ (1,917,076)	\$ (2,424,447)
Adjustments to reconcile operating loss to net cash from operating activities		
Revenue from tax levies considered noncapital financing activity	(720,530)	(266,724)
Depreciation and amortization	2,038,791	476,304
Provision for bad debts	1,759,186	941,474
Change in assets and liabilities		
Patient accounts receivable	(923,838)	(4,025,607)
Other receivables	958,453	288,232
Prepaid expenses and other assets	-	97,498
Estimated third-party payor settlements	1,827,096	(531,534)
Accounts payable	(1,246,535)	2,185,744
Accrued compensation and related liabilities	(174,225)	301,246
	<u>1,601,322</u>	<u>(2,957,814)</u>
Net cash from operating activities	<u>\$ 1,601,322</u>	<u>\$ (2,957,814)</u>

PUBLIC HOSPITAL DISTRICT NO. 4, KING COUNTY, WASHINGTON

NOTES TO FINANCIAL STATEMENTS

Note 1 - Organization

Public Hospital District No. 4, King County, Washington, doing business as Snoqualmie Valley Hospital and as Hospital District No. 4 Clinics (the District), is organized as a municipal corporation under the laws of the state of Washington and operates a licensed 28-bed acute care hospital and primary and specialty care clinics in Eastern King County, Washington. As organized, the District is exempt from payment of federal income tax. The Board of Commissioners consists of five elected community members. The District is not considered to be a component unit of King County.

The District began construction of a new facility on a 13-acre site near the intersection of State Highway 18 and Interstate 90 in the fall of 2013. The facility is a 70,000-square-foot replacement for the District's existing 25,000-square-foot hospital facility. The new facility will include 25 inpatient rooms (versus 14 rooms in its former facility), a six-room emergency department, and rehabilitation, radiology, and pharmacy services.

The District entered into an agreement with Benaroya Capital Company LLC to build the replacement facility in July 2013. Under the terms of the agreement, the District entered into a capital lease with the developer for 30 years and purchase of the hospital for \$1.00 at the end of the lease term.

The District began the process of issuing revenue bonds to fund the purchase of the new hospital in November 2014. This process was completed in July 2015. The purchase price of the hospital from Benaroya Capital Company LLC was \$39,283,895.

Hospital operations were transferred to the new facility on May 6, 2015.

Note 2 - Summary of Significant Accounting Policies

Use of estimates - The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets, deferred outflows of resources, and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements. Estimates also affect the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Enterprise fund accounting - The District uses enterprise fund accounting. Revenues and expenses are recognized on the accrual basis using the economic resources measurement focus.

Cash and cash equivalents - Cash and cash equivalents include investments in highly liquid debt instruments with an original maturity date of three months or less, excluding amounts limited as to use by board designation, indenture agreements, or donors.

PUBLIC HOSPITAL DISTRICT NO. 4, KING COUNTY, WASHINGTON

NOTES TO FINANCIAL STATEMENTS

Note 2 - Summary of Significant Accounting Policies (continued)

Assets limited as to use - Periodically, the Board of Commissioners sets aside cash resources for the funding of future capital improvements. In addition, certain funds are restricted by bond indentures to be used solely for debt service or for the funding of future capital projects. These funds are invested in the King County Investment Pool, which is in accordance with state guidelines.

All District investments are carried at market value. Investment income is reported as nonoperating gains and losses.

Capital assets - Land, buildings, and equipment acquisitions are recorded at cost. Improvements and replacements of land, buildings, and equipment are capitalized. The District's capitalization threshold is \$5,000 per item and a useful life of at least three years. Maintenance and repairs are expensed. The cost of land, buildings, and equipment sold or retired and the related accumulated depreciation are removed from the accounts, and any resulting gain or loss is recorded.

Depreciation is recorded over the estimated useful life of each class of depreciable asset using the American Hospital Association guidelines and is computed using the straight-line method over the shorter period of the lease term or the estimated useful life of the equipment. The estimated useful lives used by the District are as follows:

Buildings and improvements	2 - 40 years
Equipment	3 - 20 years

Interest on borrowed funds less any interest earned on temporarily invested funds is capitalized on construction projects as a cost of the related project from the date of borrowing until the construction period ends and the related asset is placed in service. Capitalized interest is depreciated over the estimated useful life of the related asset.

Insurance - The District paid certain medical, dental, prescription, and vision claims for its employees on a self-insured basis in 2014. The District purchased stop-loss insurance to cover claims that exceed stated limits and recorded estimated reserves for the ultimate costs for both reported claims and claims incurred but not reported. On January 1, 2015, the District discontinued its self-insurance for certain medical, dental, prescription, and vision claims.

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

PUBLIC HOSPITAL DISTRICT NO. 4, KING COUNTY, WASHINGTON
NOTES TO FINANCIAL STATEMENTS

Note 2 - Summary of Significant Accounting Policies (continued)

Net position - Net position of the District is classified into three components. The net investment in capital assets component of net position consists of capital assets, net of accumulated depreciation, reduced by the outstanding balances of related debt that is attributable to the acquisition, construction, or improvement of those assets. The restricted component of net position represents noncapital assets that must be used for a specific purpose. The unrestricted component of net position is the remaining net amount of the assets, deferred outflows of resources, and liabilities that are not included in the determination of net investment in capital assets or the restricted components of net position.

Operating revenues and expenses - The District's statements of revenues, expenses, and changes in net position distinguish between operating and nonoperating revenues and expenses. Operating revenues, such as patient service revenue, result from exchange transactions associated with providing health care services—the District's primary business.

Nonexchange revenues, including taxes, are reported as other operating revenues. Operating expenses are all expenses incurred to provide health care services, other than financing costs. Tax levy income and debt service related to general obligation bonds and peripheral or incidental transactions, grants, and contributions received for purposes other than capital asset acquisition are reported as nonoperating income or expense.

Net patient service revenue - Patient service revenue is recorded at established rates. Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered. Preliminary settlements under reimbursement agreements with Medicare and Medicaid are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods, as final settlements are determined.

Reimbursements received from certain third-party payors are subject to audit and retroactive adjustment. Provision for possible adjustment as a result of audits is recorded in the financial statements. When reimbursement settlements are received, or when information becomes available with respect to reimbursement changes, any variations from amounts previously accrued are accounted for in the period in which the settlements are received or the change in information becomes available.

Charity care - The District provides care to indigent patients who meet certain criteria under its charity care policies. Because the District does not pursue collection of amounts determined to qualify as charity care, they are not reported as net patient service revenue. Forgone revenue for charity care provided during 2015 and 2014 measured by the District's standard charges was \$1,461,873 and \$470,707, respectively.

Federal income taxes - The District, as a political subdivision of the state of Washington, is not subject to federal income taxes under Section 115 of the Internal Revenue Code.

PUBLIC HOSPITAL DISTRICT NO. 4, KING COUNTY, WASHINGTON

NOTES TO FINANCIAL STATEMENTS

Note 2 - Summary of Significant Accounting Policies (continued)

Subsequent events - Subsequent events are events or transactions that occur after the statement of net position date but before financial statements are available to be issued. The District recognizes in the financial statements the effects of all subsequent events that provide additional evidence about conditions that existed at the date of the statement of net position, including the estimates inherent in the process of preparing the financial statements. The District's financial statements do not recognize subsequent events that provide evidence about conditions that did not exist at the date of the statement of net position but arose after the statement of net position date and before the financial statements are available to be issued.

The District has evaluated subsequent events through May 27, 2016, which is the date the financial statements are issued.

Note 3 - Net Patient Service Revenue

The District has agreements with third-party payors that provide for payments to the District at amounts different from its established rates. A summary of the payment arrangements with major third-party payors follows.

Medicare - The District converted to critical access hospital status under the Medicare program on December 1, 2005, under which inpatient, swing-bed, and outpatient services and hospital-based clinics are reimbursed on a cost basis. Inpatient acute, swing-bed, and outpatient care services rendered to Medicare program beneficiaries are paid on an interim basis at a percentage of billed charges. These interim payments will be subject to final settlement upon submission and audit of the cost report to the Medicare fiscal intermediary. The District's classification of patients under the Medicare program and the appropriateness of their admission are subject to an independent review by a peer review organization.

Net patient service revenue under the Medicare program totaled approximately \$20,673,000 and \$14,297,000 for 2015 and 2014, respectively. Net unsecured patient accounts receivable due from Medicare at December 31 was \$2,858,000 and \$2,054,000 in 2015 and 2014, respectively.

Medicaid - As a critical access hospital, the District is reimbursed for inpatient and outpatient services rendered to Medicaid program beneficiaries on a cost reimbursement methodology. Under this methodology, the District is reimbursed at a tentative rate, with final settlement determined after audits by the Medicaid fiscal intermediary of annual cost reports submitted by the District. Long-term care services are paid on a cost reimbursement basis, which may not exceed allocated costs plus state-mandated cost limits. Net patient service revenue under the Medicaid program totaled approximately \$272,000 and \$2,196,000 for 2015 and 2014, respectively. Net unsecured patient accounts receivable due from Medicaid at December 31 were \$275,000 and \$237,000 in 2015 and 2014, respectively.

PUBLIC HOSPITAL DISTRICT NO. 4, KING COUNTY, WASHINGTON
NOTES TO FINANCIAL STATEMENTS

Note 3 - Net Patient Service Revenue (continued)

The District's estimates of final settlements to or from Medicare and Medicaid for all years through 2015 have been recorded in the accompanying statements of net position. Laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term. Differences between the net amounts accrued and subsequent settlements are recorded in operations at the time of settlement. The District's Medicare cost reports have been audited by the Medicare fiscal intermediary through December 31, 2011.

The following are the components of net patient service revenue for the District for the years ended December 31:

	<u>2015</u>	<u>2014</u>
Gross patient service charges	<u>\$ 40,717,680</u>	<u>\$ 35,008,792</u>
Adjustments to patient service charges		
Contractual discounts	9,220,546	9,443,208
Provision for bad debts	1,759,186	941,474
Charity care	<u>1,461,873</u>	<u>470,707</u>
	<u>12,441,605</u>	<u>10,855,389</u>
Net patient service revenue	<u><u>\$ 28,276,075</u></u>	<u><u>\$ 24,153,403</u></u>

Note 4 - Deposits and Investments

The District makes investments in accordance with Washington State law. Eligible investments include obligations secured by the U.S. Treasury, other obligations of the United States or its agencies, certificates of deposit with approved institutions, insured money market funds, commercial paper, registered warrants of local municipalities, the Washington State Local Government Investment Pool, eligible bankers' acceptances, and repurchase agreements (up to 30 days).

As a political subdivision of the State, the District categorizes deposits and investments to give an indication of the risk assumed at year-end. Category 1 includes deposits and investments that are insured, registered, or held by the District's agent in the District's name. Category 2 includes uninsured and unregistered investments that are held by the broker's or dealer's trust department or agent in the District's name. Category 3 includes uninsured and unregistered deposits and investments for which the securities are held by the broker or dealer, or its trust department or agent, but not in the District's name.

PUBLIC HOSPITAL DISTRICT NO. 4, KING COUNTY, WASHINGTON
NOTES TO FINANCIAL STATEMENTS

Note 4 - Deposits and Investments (continued)

The Revised Code of Washington, Chapter 39, authorizes municipal governments to invest their funds in a variety of investments including federal, state, and local government certificates, notes, or bonds; the Washington State Local Government Investment Pool; savings accounts in qualified public depositories; and certain other investments. All cash and cash equivalents held by the County Treasurer’s Office are insured by the State of Washington Public Deposit Protection Commission, as provided by Chapter 39.58 of the Revised Code of Washington. Qualified public depositories pledge securities with this Commission, which are available to insure public deposits within the state of Washington.

All deposits and investments of the District are categorized as Category 1 and consist of the following at December 31:

	<u>2015</u>	<u>2014</u>
Cash and cash equivalents		
Investment in King County Investment Pool	<u>\$ 7,347,118</u>	<u>\$ 155,227</u>
Assets whose use is limited		
UTGO Bond Fund		
Investment in King County Investment Pool	298,237	290,532
Taxes receivable	1,952	2,125
LTGO Bond Fund		
Investment in King County Investment Pool	2,368,453	1,901,216
Taxes receivable	83,255	87,230
Revenue Bond Fund		
Cash and cash equivalents	3,675,188	-
Construction Fund		
Investment in King County Investment Pool	<u>7,969</u>	<u>7,607</u>
	<u>6,435,054</u>	<u>2,288,710</u>
	<u>\$ 13,782,172</u>	<u>\$ 2,443,937</u>
Total deposits and investments		

The District participates in the King County Investment Pool (KCIP). The King County Finance and Business Operations Division (FBOD) manages and operates the KCIP. Participation by local governments is voluntary. The investment policies of the KCIP are the responsibility of the FBOD, and any proposed changes are reviewed by King County’s Executive Finance Committee. The KCIP is comparable to a Rule 2a-7 money market fund recognized by the Securities and Exchange Commission (17 CFR 270.2a-7). Rule 2a-7 funds are limited to high-quality obligations with limited maximum and average maturities, the effect of which is to minimize both market and credit risk. The objectives of the FBOD’s investment practices for the KCIP, in priority order, will be safety, liquidity, and return on investment. Separate financial statements for the KCIP are available from King County. The KCIP is not subject to risk evaluation.

PUBLIC HOSPITAL DISTRICT NO. 4, KING COUNTY, WASHINGTON
NOTES TO FINANCIAL STATEMENTS

Note 4 - Deposits and Investments (continued)

Credit risk - Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. The District's investment policy limits the types of securities to those authorized by statute; therefore, credit risk is very limited.

Deposits - All of the District's deposits are either insured or collateralized. The District's insured deposits are covered by the Federal Deposit Insurance Corporation (FDIC). Collateral protection is provided by the Washington Public Deposit Protection Commission (PDPC).

Custodial credit risk - Custodial credit risk is the risk that, in the event of a failure of the counterparty, the District will not be able to recover the value of the investment or collateral securities that are in the possession of an outside party. The District is not exposed to custodial credit risk.

Concentration of credit risk - Concentration of credit risk is the risk of loss attributed to the magnitude of the District's investment in a single issuer. The District is not exposed to concentration of credit risk, because all deposits and investments are insured or collateralized.

Interest rate risk - Interest rate risk is the risk that changes in interest rates of debt instruments will adversely affect the fair value of an investment. The District is not exposed to interest rate risk.

Note 5 - Property Taxes

The County Treasurer acts as an agent to collect property taxes levied in the county for all taxing authorities. Taxes are levied annually on January 1 on property values listed as of the prior May 31. Assessed values are established by the County Assessor at 100% of the fair market value. A revaluation of all property is required every four years. Taxes are due in two equal installments on April 30 and October 31. Collections are distributed monthly to the District by the County Treasurer. Tax collections for the years ended December 31, 2015 and 2014, were 100.91% and 103.30% of the taxes levied during those respective years.

The District is permitted by law to levy up to \$0.75 per \$1,000 of assessed valuation for general District purposes. The Washington State constitution and Washington State law, RCW 84.55.010, limit the rate. The District may also levy taxes at a lower rate. Further amounts of tax need to be authorized by the vote of the people.

For 2015 and 2014, the District's regular tax levy was \$0.48 and \$0.50 per \$1,000 on a total assessed valuation of \$7,227,041,097 and \$6,006,537,557, respectively, for a total regular levy of \$3,490,414 and \$3,102,270, respectively. A portion of the tax revenue from the regular levy has been pledged toward payments of the limited tax general obligation (LTGO) bonds.

PUBLIC HOSPITAL DISTRICT NO. 4, KING COUNTY, WASHINGTON
NOTES TO FINANCIAL STATEMENTS

Note 6 - Capital Assets

Capital asset additions, retirements, and balances for the years ended December 31, 2015 and 2014, were as follows:

	Balance, December 31, 2014	Additions	Retirements	Transfers	Balance, December 31, 2015
NONDEPRECIABLE CAPITAL ASSETS					
Land	\$ 13,387,400	\$ 1,243,778	\$ -	\$ -	\$ 14,631,178
Construction in progress	11,162,818	1,882,534	-	(12,640,735)	404,617
Total nondepreciable capital assets	<u>24,550,218</u>	<u>3,126,312</u>	<u>-</u>	<u>(12,640,735)</u>	<u>15,035,795</u>
DEPRECIABLE CAPITAL ASSETS					
Land improvements	60,393	332,619	-	11,559,070	11,952,082
Buildings and improvements	1,195,807	30,404,488	-	-	31,600,295
Equipment	4,542,822	6,370,014	-	1,081,665	11,994,501
LESS ACCUMULATED DEPRECIATION					
Buildings and improvements	(993,210)	(1,466,310)	-	-	(2,459,520)
Equipment	(2,991,328)	(572,481)	-	-	(3,563,809)
Depreciable capital assets, net	<u>1,814,484</u>	<u>35,068,330</u>	<u>-</u>	<u>12,640,735</u>	<u>49,523,549</u>
Capital assets, net	<u>\$ 26,364,702</u>	<u>\$ 38,194,642</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 64,559,344</u>
	Balance, December 31, 2013	Additions	Retirements	Transfers	Balance, December 31, 2014
NONDEPRECIABLE CAPITAL ASSETS					
Land	\$ 13,387,400	\$ -	\$ -	\$ -	\$ 13,387,400
Construction in progress	9,321,645	2,181,886	(340,713)	-	11,162,818
Total nondepreciable capital assets	<u>22,709,045</u>	<u>2,181,886</u>	<u>(340,713)</u>	<u>-</u>	<u>24,550,218</u>
DEPRECIABLE CAPITAL ASSETS					
Land improvements	60,393	-	-	-	60,393
Buildings and improvements	1,169,984	25,823	-	-	1,195,807
Equipment	4,542,822	-	-	-	4,542,822
LESS ACCUMULATED DEPRECIATION					
Buildings and improvements	(807,733)	(185,477)	-	-	(993,210)
Equipment	(2,700,501)	(290,827)	-	-	(2,991,328)
Depreciable capital assets, net	<u>2,264,965</u>	<u>(450,481)</u>	<u>-</u>	<u>-</u>	<u>1,814,484</u>
Capital assets, net	<u>\$ 24,974,010</u>	<u>\$ 1,731,405</u>	<u>\$ (340,713)</u>	<u>\$ -</u>	<u>\$ 26,364,702</u>

The District capitalized interest cost of \$0 and \$974,482 during the years ended December 31, 2015 and 2014, respectively.

Depreciation expense for the years ended December 31, 2015 and 2014, was \$2,038,791 and \$476,304, respectively.

PUBLIC HOSPITAL DISTRICT NO. 4, KING COUNTY, WASHINGTON
NOTES TO FINANCIAL STATEMENTS

Note 7 - Line of Credit

The District has a line of credit with a bank totaling \$4,600,000. The interest rate at December 31, 2015, was 5.25% and is payable semiannually. The line of credit expires in 2025. Changes in the District's line of credit for the years ended December 31, 2015 and 2014, are as follows:

Balance, January 1, 2015	Additions	Reductions	Balance December 31, 2015
\$ 2,461,747	\$ -	\$ (2,461,747)	\$ -
Balance, January 1, 2014	Additions	Reductions	Balance December 31, 2014
\$ 1,145,000	\$ 11,032,619	\$ (9,715,872)	\$ 2,461,747

Note 8 - Long-Term Debt and Other Noncurrent Liabilities

Interest rates and maturities of long-term debt at December 31, 2015 and 2014, for the District consisted of the following:

	2015	2014
Limited tax general obligation bonds, series 2011, 6.50% to 7.00%, due semiannually on June 1 and December 1, maturing in 2040, with annual amounts ranging from \$15,000 to \$4,335,000.	\$ 15,360,000	\$ 15,360,000
Limited tax general obligation and refunding bonds, series 2015, 4.25% to 5.00%, due semiannually on June 1 and December 1, maturing in 2038, with annual amounts ranging from \$420,000 to \$2,880,000, net of unamortized discount of \$644,374.	32,502,406	-
Revenue bonds, series 2015, 5.00% to 6.25%, due semiannually on June 1 and December 1, maturing in 2045, with annual amounts ranging from \$650,000 to \$3,455,000, net of unamortized discount of \$1,232,222.	48,840,998	-
Limited tax general obligation bonds, series 2009, defeased during 2015.	-	21,127,072
Limited tax general obligation and refunding bonds, series 2005A, defeased during 2015.	-	3,889,333
Capital lease obligation, stated at present value of future minimum lease payments.	780	35,917
	96,704,184	40,412,322
Less current portion	(1,070,780)	(144,917)
	\$ 95,633,404	\$ 40,267,405

PUBLIC HOSPITAL DISTRICT NO. 4, KING COUNTY, WASHINGTON
NOTES TO FINANCIAL STATEMENTS

Note 8 - Long-Term Debt and Other Noncurrent Liabilities (continued)

Under the terms of the revenue and refunding bonds, the District has agreed to maintain certain financial ratios and meet certain covenants.

During 2015, the District issued the 2015 limited tax general obligation and refunding bonds to carry out a tax-exempt refunding of the 2005A limited tax general obligation and refunding bonds, as well as the 2009 limited tax general obligation bonds. The refunding resulted in the recognition of an accounting loss of \$857,506, which will be deferred and amortized over the life of the 2005A and 2009 bonds, which were set to mature in 2025 and 2038, respectively, and is classified as a deferred outflow of resources on the statement of net position. The refunding decreased the District's aggregate debt service payments by \$6,778,000 over the next 23 years and resulted in an economic gain (difference between the present values of the old and new debt service payments) of \$4,061,000.

Changes in the District's long-term liabilities and line of credit during the years ended December 31, 2015 and 2014, are summarized below:

	Balance, December 31, 2014	Additions	Reductions	Balance, December 31, 2015	Amounts Due Within One Year
Bonds payable					
2015 Revenue bonds	\$ -	\$ 48,840,998	\$ -	\$ 48,840,998	\$ 650,000
2015 LTGO bonds	-	32,502,406	-	32,502,406	420,000
2011 LTGO bonds	15,360,000	-	-	15,360,000	-
2009 LTGO bonds	21,127,072	-	(21,127,072)	-	-
2005A LTGO bonds	3,889,333	-	(3,889,333)	-	-
Capital lease obligation	35,917	-	(35,137)	780	780
Total noncurrent liabilities	<u>\$ 40,412,322</u>	<u>\$ 81,343,404</u>	<u>\$(25,051,542)</u>	<u>\$ 96,704,184</u>	<u>\$ 1,070,780</u>
	Balance, December 31, 2013	Additions	Reductions	Balance, December 31, 2014	Amounts Due Within One Year
Bonds payable					
2011 LTGO bonds	\$ 15,360,000	\$ -	\$ -	\$ 15,360,000	\$ -
2009 LTGO bonds	21,105,783	-	21,289	21,127,072	-
2005A LTGO bonds	3,941,333	-	(52,000)	3,889,333	109,000
Capital lease obligation	74,136	-	(38,219)	35,917	35,917
Total noncurrent liabilities	<u>\$ 40,481,252</u>	<u>\$ -</u>	<u>\$(68,930)</u>	<u>\$ 40,412,322</u>	<u>\$ 144,917</u>

PUBLIC HOSPITAL DISTRICT NO. 4, KING COUNTY, WASHINGTON
NOTES TO FINANCIAL STATEMENTS

Note 8 - Long-Term Debt and Other Noncurrent Liabilities (continued)

Scheduled principal and interest repayments on long-term debt are as follows:

	<u>Principal</u>	<u>Interest</u>
2016	\$ 1,070,780	\$ 5,717,351
2017	1,180,000	5,657,826
2018	1,300,000	5,592,651
2019	1,445,000	5,521,288
2020	1,595,000	5,442,613
Amounts due 2021 - 2025	9,980,000	25,841,140
Amounts due 2026 - 2030	14,710,000	22,826,652
Amounts due 2031 - 2035	21,490,000	18,045,326
Amounts due 2036 - 2040	30,450,000	10,862,450
Amounts due 2041 - 2045	<u>15,360,000</u>	<u>2,996,563</u>
	98,580,780	<u>108,503,860</u>
Less amount representing unamortized discount	<u>1,876,596</u>	
	<u>\$ 96,704,184</u>	

Note 9 - Retirement Plans

Deferred compensation plan - In 2006, the District began offering its employees a deferred compensation plan, the Public Hospital District No. 4, King County, Washington, 457 Plan, created in accordance with Internal Revenue Code (IRC) Section 457. The plan, available to all eligible employees, permits them to defer a portion of their salary until future years. The District makes no contributions to this plan. The deferred compensation is payable to employees upon termination, retirement, death, or unforeseen emergency.

The plan is administered by CPI Qualified Plan Consultants, Inc., and the District has limited administrative involvement and does not perform the investing function for the plan. The District does not hold the assets of the plan in a trustee capacity and does not perform fiduciary accountability for the plan. Therefore, the District employees' deferred compensation plan created in accordance with IRC 457 is not reported on the financial statements of the District. Contributions made by employees to the 457 Plan totaled approximately \$203,000 and \$196,000 in 2015 and 2014, respectively.

Defined contribution plan - In 2006, the District also began sponsoring a defined contribution plan in accordance with Internal Revenue Code Section 403(b) covering substantially all qualified employees. Plan provisions and contribution requirements are established by the District and may be amended by the District's Board of Commissioners. Active participants meeting hourly and employee contribution criteria receive an employer matching contribution based on a percentage of the employees' base salary, subject to certain limitations. The employer contribution fully vests upon completion of two qualified years or upon the occurrence of death, disability, or attainment of age 65 for qualified employees. Forfeited contributions, if any, are applied against future employer obligations.

PUBLIC HOSPITAL DISTRICT NO. 4, KING COUNTY, WASHINGTON
NOTES TO FINANCIAL STATEMENTS

Note 9 - Retirement Plans (continued)

The District's liability under the plan, which is also administered by CPI Qualified Plan Consultants, Inc., is limited to its annual contribution. The District's contributions to the employee benefit plan totaled approximately \$138,000 and \$141,000 in 2015 and 2014, respectively. Contributions made by employees to the benefit plan totaled approximately \$766,000 and \$715,000 in 2015 and 2014, respectively. For more information on the plans, contact the District's human resources office.

Note 10 - Concentrations of Credit Risk

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

	<u>2015</u>	<u>2014</u>
Medicare	34%	26%
Medicaid	17%	17%
Other commercial	36%	48%
Patient and self-pay	<u>13%</u>	<u>9%</u>
	<u><u>100%</u></u>	<u><u>100%</u></u>

Note 11 - Commitments and Contingencies

Operating leases - The District leases certain facilities and equipment under operating lease arrangements. The following is a schedule by year of future minimum lease payments as of December 31, 2015:

2016	\$ 796,524
2017	796,524
2018	669,232
2019	425,476
2020	<u>101,558</u>
	<u><u>\$ 2,789,314</u></u>

Rent expense on operating leases for 2015 and 2014 was \$2,206,071 and \$1,006,568, respectively.

Litigation - The District is involved in litigation and regulatory investigations arising in the course of business. After consultation with legal counsel, management estimates that these matters will be resolved without material adverse effect on the District's future financial position or results from operations.

PUBLIC HOSPITAL DISTRICT NO. 4, KING COUNTY, WASHINGTON
NOTES TO FINANCIAL STATEMENTS

Note 11 - Commitments and Contingencies (continued)

Compliance with laws and regulations - The health care industry is subject to numerous laws and regulations from federal, state, and local governments. These laws and regulations include, but are not necessarily limited to, matters such as licensure, accreditation, government health care program participation requirements, reimbursement for patient services, and Medicare and Medicaid fraud and abuse. Government activity with respect to investigations and allegations regarding possible violations of these laws and regulations by health care providers, including those related to medical necessity, coding, and billing for services, has increased substantially. Violations of these laws and regulations could result in expulsion from government health care programs, together with the imposition of significant fines and penalties, as well as significant repayments for patient services previously billed. Management believes that the District is in compliance with the fraud and abuse regulations, as well as other applicable government laws and regulations. Compliance with such laws and regulations can be subject to future government review and interpretation, as well as regulatory actions unknown or unasserted at this time.

Insurance - The District has its professional liability insurance coverage with Washington Casualty Company (WCC). This policy provides protection on a "claims-made" basis whereby claims filed in the current year are covered by the current policy. If there are occurrences in the current year, they will be covered in the year the claim is filed only if claims-made coverage is obtained in that year or if the District purchases insurance to cover "prior acts." Current coverage with no deductible is for \$1,000,000 per occurrence subject to a \$5,000,000 annual limit. No liability has been accrued for future claims for acts occurring in the current or prior years. Also, it is possible that claims may exceed coverage obtained in any given year.