



REPORT OF INDEPENDENT AUDITORS
AND FINANCIAL STATEMENTS

PUBLIC HOSPITAL DISTRICT NO. 4,
KING COUNTY, WASHINGTON

December 31, 2018 and 2017

Table of Contents

	PAGE
Report of Independent Auditors	1–2
Management’s Discussion and Analysis	3–7
Financial Statements	
Statements of net position	8
Statements of revenues, expenses, and changes in net position	9
Statements of cash flows	10–11
Notes to financial statements	12–22
Report of Independent Auditors on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards	23–24

Report of Independent Auditors

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

Report on the Financial Statements

We have audited the accompanying financial statements of Public Hospital District No. 4, King County, Washington (the District), as of and for the years ended December 31, 2018 and 2017, and the related notes to the financial statements, which collectively comprise the District's financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express 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 and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the 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, 2018 and 2017, 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.

Other Matter

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 7 be presented to supplement the 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 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 financial statements, and other knowledge we obtained during our audit of the financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated May 22, 2019, on our consideration of the District's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is solely to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the District's internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the District's internal control over financial reporting and compliance.

Moss Adams LLP

Everett, Washington
May 22, 2019

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 completed its third year in its new facility in 2018 after relocating in May 2015.

The District implemented a number of programs in 2018 designed to improve our long-term financial results. These programs were implemented in 2018; the total financial improvement from these programs will be recognized in 2019:

- **Expansion of the District's Federal 340B Drug Pricing Program to include Kroger Pharmacies.** The anticipated annual financial benefit from the inclusion of Kroger in this program is \$220,000. Kroger was budgeted to be included in the program in 2018, but there was an internal hold on new participants in 2018. This "late" implementation led to a negative budget variance in revenue of \$220,000 in 2018.

The proceeds from the 340B program are used to offset the cost of charity care the District provides to patients.

- **Obtaining Rural Health Clinic status for our clinics.** The District's service area was certified as a Health Provider Shortage Area (HPSA) in 2018. With that certification, our clinics became eligible for Rural Health Clinic Status. The program, which was implemented in October 2018, provides enhanced revenue for clinic operations. The additional financial benefit of this program being in effect for the entire year of 2019 is estimated to be \$290,000.

In March 2019, the District entered into a letter of intent with Overlake Medical Center for Overlake's lease and operation of the District's Snoqualmie Valley Hospital (The Hospital), Snoqualmie Valley Hospital Clinic, and the Snoqualmie Ridge Medical Clinic. The District is currently in active negotiations with Overlake Medical Center regarding this agreement. We anticipate these negotiations will take the remainder of 2019 to complete. The specific terms of the proposed agreement have not been finalized at this time (May 2019).

Public Hospital District No. 4, King County, Washington Management's Discussion and Analysis (continued)

Operational Highlights (continued)

Patient Volumes

Patient volumes compared to budget for 2018 are shown below:

Business Line	Patient Volumes Budget January Through December 2018	Patient Volumes Actual January Through December 2018	Percentage Change
Inpatient days	8,113	8,363	3.1%
Emergency room visits	3,936	3,818	-3.0%
Outpatient service visits	792	761	-3.9%
Rehab inpatient procedures	21,943	21,898	-0.2%
Rehab outpatient procedures	9,600	7,633	-20.5%
Laboratory tests	40,300	41,523	3.0%
Imaging procedures	4,007	4,032	0.6%
Clinic visits	17,807	18,052	1.4%

Statement of Revenues, Expenses, and Changes in Net Position

	2018	2017	2016
Net operating revenue	\$ 34,241,961	\$ 34,155,766	\$ 32,349,281
Nonoperating income	3,404,436	3,251,462	3,215,415
	37,646,397	37,407,228	35,564,696
Total operating expenses	32,619,578	31,867,738	32,426,625
Nonoperating expense	5,678,146	5,816,449	5,771,271
	38,297,724	37,684,187	38,197,896
Change in net position	(651,327)	(276,959)	(2,633,200)
Net position, beginning of year	(19,721,325)	(19,444,366)	(16,811,166)
Net position, end of year	\$ (20,372,652)	\$ (19,721,325)	\$ (19,444,366)

Public Hospital District No. 4, King County, Washington Management's Discussion and Analysis (continued)

Comments on Statement of Revenues, Expenses and Changes in Net Position

Operating Revenue

Operating revenue increased by 0.3% from 2017 to 2018. The increase was due to an increase in tax revenue used for operations and a small increase in investment income (shown as "other" revenue).

A decrease in outpatient service revenues was offset by the implementation of two programs in mid-2018: the federal 340B pharmaceutical program and the implementation of rural health clinic status for our clinics. Both of these programs increased operating revenue. The net effect of both of these changes led to net patient service revenue being "flat".

As referenced above, The District expects an increase in operating revenue in 2019 due to the full year of participation in the 340B program and the Rural Health Clinic program.

Operating Expenses

Operating expenses increased by 2.4% in 2018 compared to 2017. The increase was due to:

- Wage increases of 2.6%—the result of salary increases for District staff in 2018.
- Benefit cost increases of 4.2%—the result of an increase in the cost of health insurance the District provides to employees.
- Repairs and maintenance increased 51% in 2018 compared to 2017. The increase was due to repairs on our MRI machine during the year.
- Purchased services are above prior year due to consulting in the Information Technology Department and an increase in patient transport charges.

Change in Net Position

Change in net position decreased from 2017 due to the increase in expense and lower than anticipated revenue. As mentioned above, outpatient revenue decreased in 2018 due to lower than budgeted volumes. The decreases in relation to plan for outpatient services were in the outpatient rehabilitation department and the emergency room.

The District is putting a number of programs in place in 2019 that are expected to increase revenue in 2019. These include:

- A full year of rural health clinic status for outpatient clinics. Rural health status for the clinics results in increased Medicare and Medicaid reimbursement for clinic visits.
- The addition of Kroger to the 340B program.
- Implementation of reference lab services.

Public Hospital District No. 4, King County, Washington Management's Discussion and Analysis (continued)

Balance Sheet

	<u>2018</u>	<u>2017</u>	<u>2016</u>
ASSETS			
Current assets	\$ 15,754,632	\$ 15,938,515	\$ 13,321,474
Capital assets, net	55,011,500	58,196,812	61,523,284
Other noncurrent assets	<u>6,339,765</u>	<u>5,780,410</u>	<u>5,630,256</u>
Total assets	77,105,897	79,915,737	80,475,014
DEFERRED OUTFLOWS OF RESOURCES			
Total assets and deferred outflows of resources	<u>\$ 77,781,752</u>	<u>\$ 80,631,736</u>	<u>\$ 81,236,627</u>
LIABILITIES			
Current liabilities	\$ 6,293,860	\$ 7,116,530	\$ 6,211,505
Noncurrent liabilities	<u>91,860,544</u>	<u>93,236,531</u>	<u>94,469,488</u>
Total liabilities	<u>98,154,404</u>	<u>100,353,061</u>	<u>100,680,993</u>
NET POSITION			
Net investment in capital assets	5,312,297	7,860,200	9,897,600
Restricted expendable for debt service	3,461,498	2,762,149	2,147,098
Unrestricted	<u>(29,146,447)</u>	<u>(30,343,674)</u>	<u>(31,489,064)</u>
Total net position	<u>(20,372,652)</u>	<u>(19,721,325)</u>	<u>(19,444,366)</u>
Total liabilities and net position	<u>\$ 77,781,752</u>	<u>\$ 80,631,736</u>	<u>\$ 81,236,627</u>

Commentary on Balance Sheet

Capital Assets

Capital assets decreased due to depreciation expense. The District did not make any significant capital asset purchases in 2018.

Current Liabilities

Current Liabilities decreased due to a lower Medicare cost report settlement in 2018 compared to 2017.

Long-Term Debt

Long-term debt decreased due to the payment of bond principal as required for the District's revenue and LTGO (tax-backed) bond debt.

Public Hospital District No. 4, King County, Washington Management's Discussion and Analysis (continued)

Net Investment in Capital Assets

Net investment in capital assets decreased in 2018 due to depreciation being higher than the purchase of capital assets in 2018.

Revenue Bond Covenant Compliance

The schedule of revenue bond covenant compliance is shown below. The District is in compliance with all its revenue bond covenants.

SCHEDULE OF BOND COVENANT COMPLIANCE

Coverage Requirement	DECEMBER 2018 Amount
Change in net position	\$ (651,327)
Add	
Interest expense	5,568,989
Depreciation and amortization expense	3,287,635
Extraordinary Expense; Bond Issuance and financing costs	-
	8,856,624
Less	
Taxation for bond principal and interest	(3,219,463)
	Available for debt service
	\$ 4,985,834
Maximum annual debt service	\$ 3,675,188
Actual Coverage Ratio	1.36
Coverage Requirement	1.20
Available for debt service required by covenant	\$ 4,410,226
Reserve Requirement For the Bonds	
Max annual debt service on all bonds	\$ 3,675,188
125% of average annual debt service	4,492,886
10% of proceeds on all bonds	5,007,500
Reserve Requirement	\$ 3,675,188
Hospital reserve fund	\$ 3,675,188
Liquidity Requirement for the Bonds	
Cash and cash equivalents	\$ 7,533,526
Total operating expenses	\$ 32,619,578
Less depreciation and amortization expense	3,287,635
	\$ 29,331,943
Days cash on hand	93.75
Liquidity Requirement for Bond Covenant	60.00
Cash and cash equivalents required for bond covenants	\$ 4,821,689

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, 9801 Frontier Avenue SE, Snoqualmie, WA 98065.

Public Hospital District No. 4, King County, Washington

Statements of Net Position

ASSETS AND DEFERRED OUTFLOWS OF RESOURCES

	December 31,	
	2018	2017
CURRENT ASSETS		
Cash and cash equivalents	\$ 7,533,526	\$ 7,652,805
Assets limited as to use required for current liabilities	1,905,108	1,766,055
Patient accounts receivable, net of allowances for doubtful accounts of \$538,000 in 2018 and \$778,000 in 2017	5,904,143	6,016,793
Other receivables	277,977	335,535
Inventory	133,878	167,327
Total current assets	<u>15,754,632</u>	<u>15,938,515</u>
ASSETS LIMITED AS TO USE, net of current portion	<u>6,339,765</u>	<u>5,780,410</u>
CAPITAL ASSETS		
Land	14,631,178	14,631,178
Construction in progress	-	255,056
Depreciable capital assets, net of accumulated depreciation and amortization	<u>40,380,322</u>	<u>43,310,578</u>
Total capital assets, net of accumulated depreciation and amortization	<u>55,011,500</u>	<u>58,196,812</u>
Total assets	<u>77,105,897</u>	<u>79,915,737</u>
DEFERRED OUTFLOWS OF RESOURCES		
Deferred loss on refunding	<u>675,855</u>	<u>715,999</u>
Total assets and deferred outflows of resources	<u>\$ 77,781,752</u>	<u>\$ 80,631,736</u>
LIABILITIES AND NET POSITION		
CURRENT LIABILITIES		
Accounts payable	\$ 813,446	\$ 979,969
Accrued compensation and related liabilities	1,959,335	1,924,510
Accrued interest payable	199,628	260,271
Estimated third-party payor settlements	1,876,451	2,651,780
Current maturities of long-term debt	<u>1,445,000</u>	<u>1,300,000</u>
Total current liabilities	6,293,860	7,116,530
LONG-TERM DEBT, net of current maturities	<u>91,860,544</u>	<u>93,236,531</u>
Total liabilities	<u>98,154,404</u>	<u>100,353,061</u>
NET POSITION		
Net investment in capital assets	5,312,297	7,860,200
Restricted expendable for debt service	3,461,498	2,762,149
Unrestricted	<u>(29,146,447)</u>	<u>(30,343,674)</u>
Total net position	<u>(20,372,652)</u>	<u>(19,721,325)</u>
	<u>\$ 77,781,752</u>	<u>\$ 80,631,736</u>

Public Hospital District No. 4, King County, Washington
Statements of Revenues, Expenses, and Changes in Net Position

	Years Ended December 31,	
	2018	2017
OPERATING REVENUE		
Net patient service revenue (net of provision for bad debts of \$674,787 in 2018 and \$1,678,054 in 2017)	\$ 33,346,254	\$ 33,347,088
Taxation for operations	566,142	507,359
Other	329,565	301,319
	<u>34,241,961</u>	<u>34,155,766</u>
OPERATING EXPENSES		
Salaries and wages	17,120,676	16,680,366
Employee benefits	3,427,428	3,288,404
Professional fees	1,020,873	1,063,173
Supplies	2,460,918	2,466,670
Repairs and maintenance	147,258	97,267
Utilities	451,448	453,995
Purchased services	2,073,954	1,750,124
Insurance	142,969	177,931
Leases and rentals	1,933,094	1,988,411
Depreciation and amortization	3,287,635	3,336,615
Other	553,325	564,782
	<u>32,619,578</u>	<u>31,867,738</u>
	<u>1,622,383</u>	<u>2,288,028</u>
OPERATING INCOME		
NONOPERATING INCOME (EXPENSE)		
Investment income	114,758	46,851
Taxation for bond principal and interest	3,219,463	3,166,513
Interest expense	(5,568,989)	(5,700,042)
Issuance and financing costs	(109,157)	(116,407)
Other, net	70,215	38,098
	<u>(2,273,710)</u>	<u>(2,564,987)</u>
	<u>(651,327)</u>	<u>(276,959)</u>
CHANGE IN NET POSITION		
NET POSITION, beginning of year	<u>(19,721,325)</u>	<u>(19,444,366)</u>
NET POSITION, end of year	<u>\$ (20,372,652)</u>	<u>\$ (19,721,325)</u>

Public Hospital District No. 4, King County, Washington

Statements of Cash Flows

Increase (Decrease) in Cash and Cash Equivalents

	Years Ended December 31,	
	2018	2017
CASH FLOWS FROM OPERATING ACTIVITIES		
Cash received from and on behalf of patients	\$ 32,683,575	\$ 33,652,922
Cash paid to employees	(20,455,721)	(19,856,576)
Cash paid to suppliers	(8,916,913)	(8,898,769)
Other cash receipts	329,565	301,319
Net cash from operating activities	<u>3,640,506</u>	<u>5,198,896</u>
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Cash from tax levies considered a noncapital financing activity	566,142	507,359
Other	70,215	(159,896)
Net cash from noncapital financing activities	<u>636,357</u>	<u>347,463</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Purchase of capital assets	(102,323)	(10,143)
Cash from tax levies for general obligation bonds	3,251,845	3,167,548
Principal payments on long-term debt	(1,300,000)	(1,181,970)
Cash paid for issuance and financing costs	(109,157)	(116,407)
Interest paid on long-term debt	(5,520,475)	(5,576,669)
Net cash used in capital and related financing activities	<u>(3,780,110)</u>	<u>(3,717,641)</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Investment income	<u>114,758</u>	<u>46,851</u>
NET CHANGE IN CASH AND CASH EQUIVALENTS	<u>611,511</u>	<u>1,875,569</u>
CASH AND CASH EQUIVALENTS, beginning of year	<u>15,083,953</u>	<u>13,208,384</u>
CASH AND CASH EQUIVALENTS, end of year	<u>\$ 15,695,464</u>	<u>\$ 15,083,953</u>
RECONCILIATION OF CASH AND CASH EQUIVALENTS TO STATEMENT OF NET POSITION		
Cash and cash equivalents	\$ 7,533,526	\$ 7,652,805
Cash and cash equivalents in assets whose use is limited	<u>8,161,938</u>	<u>7,431,148</u>
	<u>\$ 15,695,464</u>	<u>\$ 15,083,953</u>

Public Hospital District No. 4, King County, Washington
Statements of Cash Flows (continued)

Increase (Decrease) in Cash and Cash Equivalents

	Years Ended December 31,	
	2018	2017
RECONCILIATION OF OPERATING INCOME TO NET CASH FROM OPERATING ACTIVITIES		
Operating income	\$ 1,622,383	\$ 2,288,028
Adjustments to reconcile operating income to net cash from operating activities		
Revenue from tax levies considered noncapital financing activity	(566,142)	(507,359)
Depreciation and amortization	3,287,635	3,336,615
Provision for bad debts	674,787	1,678,054
Change in assets and liabilities		
Patient accounts receivable	(562,137)	(2,546,314)
Other receivables	57,558	125,882
Inventory	33,449	47,711
Estimated third-party payor settlements	(775,329)	1,174,094
Accounts payable	(166,523)	(384,127)
Accrued compensation and related liabilities	34,825	(13,688)
	<u>\$ 3,640,506</u>	<u>\$ 5,198,896</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.

Note 2 – Summary of Significant Accounting Policies

Use of estimates – The preparation of financial statements in accordance 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.

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 income and expense.

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

Public Hospital District No. 4, King County, Washington Notes to Financial Statements

Note 2 – Summary of Significant Accounting Policies (continued)

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.

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 four preceding years.

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 and revenue 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 2018 and 2017 measured by the District's standard charges was \$592,414 and \$830,074, respectively.

Public Hospital District No. 4, King County, Washington

Notes to Financial Statements

Note 2 – Summary of Significant Accounting Policies (continued)

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.

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 22, 2019, 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 \$24,623,296 and \$23,572,216 for 2018 and 2017, respectively. Net unsecured patient accounts receivable due from Medicare at December 31 was \$4,198,000 and \$4,053,000 in 2018 and 2017, 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 \$3,040,000 and \$2,960,000 for 2018 and 2017, respectively. Net unsecured patient accounts receivable due from Medicaid at December 31 were \$310,000 and \$286,000 in 2018 and 2017, 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 2018 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, 2015.

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

	2018	2017
Gross patient service charges	\$ 48,170,373	\$ 46,628,755
Adjustments to patient service charges		
Contractual discounts	13,556,918	10,773,539
Provision for bad debts	674,787	1,678,054
Charity care	592,414	830,074
	14,824,119	13,281,667
Net patient service revenue	\$ 33,346,254	\$ 33,347,088

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>2018</u>	<u>2017</u>
Cash and cash equivalents		
Investment in King County Investment Pool	<u>\$ 7,533,526</u>	<u>\$ 7,652,805</u>
Assets whose use is limited		
Board and other restricted funds		
Investment in King County Investment Pool	412,708	305,249
Taxes receivable	682	682
LTGO Bond Fund		
Investment in King County Investment Pool	4,074,042	3,450,711
Taxes receivable	82,253	79,969
Revenue Bond Fund		
Cash and cash equivalents	<u>3,675,188</u>	<u>3,675,188</u>
	<u>8,244,873</u>	<u>7,511,799</u>
Total deposits and investments	<u>\$ 15,778,399</u>	<u>\$ 15,164,604</u>

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, 2018 and 2017, were 99.89% and 100.04% 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 2018 and 2017, the District's regular tax levy was \$0.40 and \$0.44 per \$1,000 on a total assessed valuation of \$9,333,926,213 and \$8,221,747,943, respectively, for a total regular levy of \$3,747,665 and \$3,636,980, 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, 2018 and 2017, were as follows:

	Balance, December 31, 2017	Additions	Retirements	Transfers	Balance, December 31, 2018
NONDEPRECIABLE CAPITAL ASSETS					
Land	\$ 14,631,178	\$ -	\$ -	\$ -	\$ 14,631,178
Construction in progress	255,056	-	-	(255,056)	-
Total nondepreciable capital assets	<u>14,886,234</u>	<u>-</u>	<u>-</u>	<u>(255,056)</u>	<u>14,631,178</u>
DEPRECIABLE CAPITAL ASSETS					
Land improvements	11,955,883	-	-	-	11,955,883
Buildings and improvements	31,774,156	-	-	255,056	32,029,212
Equipment	12,227,071	102,323	-	-	12,329,394
LESS ACCUMULATED DEPRECIATION					
Buildings and improvements	(7,390,111)	(2,443,894)	-	-	(9,834,005)
Equipment	(5,256,421)	(843,741)	-	-	(6,100,162)
Depreciable capital assets, net	<u>43,310,578</u>	<u>(3,185,312)</u>	<u>-</u>	<u>255,056</u>	<u>40,380,322</u>
Capital assets, net	<u>\$ 58,196,812</u>	<u>\$ (3,185,312)</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 55,011,500</u>
	Balance, December 31, 2016	Additions	Retirements	Transfers	Balance, December 31, 2017
NONDEPRECIABLE CAPITAL ASSETS					
Land	\$ 14,631,178	\$ -	\$ -	\$ -	\$ 14,631,178
Construction in progress	401,251	-	-	(146,195)	255,056
Total nondepreciable capital assets	<u>15,032,429</u>	<u>-</u>	<u>-</u>	<u>(146,195)</u>	<u>14,886,234</u>
DEPRECIABLE CAPITAL ASSETS					
Land improvements	11,952,082	3,801	-	-	11,955,883
Buildings and improvements	31,769,051	5,105	-	-	31,774,156
Equipment	12,079,639	1,237	-	146,195	12,227,071
LESS ACCUMULATED DEPRECIATION					
Buildings and improvements	(4,943,880)	(2,446,231)	-	-	(7,390,111)
Equipment	(4,366,037)	(890,384)	-	-	(5,256,421)
Depreciable capital assets, net	<u>46,490,855</u>	<u>(3,326,472)</u>	<u>-</u>	<u>146,195</u>	<u>43,310,578</u>
Capital assets, net	<u>\$ 61,523,284</u>	<u>\$ (3,326,472)</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 58,196,812</u>

Depreciation expense for the years ended December 31, 2018 and 2017, was \$3,287,635 and \$3,336,615, respectively.

Public Hospital District No. 4, King County, Washington

Notes to Financial Statements

Note 7 – Long-Term Debt and Other Noncurrent Liabilities

Interest rates and maturities of long-term debt at December 31, 2018 and 2017, for the District consisted of the following:

	2018	2017
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, beginning in 2023.	\$ 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 \$665,000 to \$2,880,000, net of unamortized discount of \$558,777 and \$586,716.	31,111,223	31,648,284
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 \$780,000 to \$3,455,000, net of unamortized discount of \$1,109,000 and \$1,150,074.	46,834,321	47,528,247
Less current portion	93,305,544 (1,445,000)	94,536,531 (1,300,000)
	\$ 91,860,544	\$ 93,236,531

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 was deferred and will be 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.

Public Hospital District No. 4, King County, Washington

Notes to Financial Statements

Note 7 – Long-Term Debt and Other Noncurrent Liabilities (continued)

Changes in the District's long-term liabilities during the years ended December 31, 2018 and 2017, are summarized below:

	Balance, December 31, 2017	Additions	Reductions	Balance, December 31, 2018	Amounts Due Within One Year
Bonds payable					
2015 Revenue bonds	\$ 47,528,247	\$ -	\$ (693,926)	\$ 46,834,321	\$ 780,000
2015 LTGO bonds	31,648,284	-	(537,061)	31,111,223	665,000
2011 LTGO bonds	15,360,000	-	-	15,360,000	-
	<u>\$ 94,536,531</u>	<u>\$ -</u>	<u>\$ (1,230,987)</u>	<u>\$ 93,305,544</u>	<u>\$ 1,445,000</u>
Total noncurrent liabilities					
	<u>\$ 94,536,531</u>	<u>\$ -</u>	<u>\$ (1,230,987)</u>	<u>\$ 93,305,544</u>	<u>\$ 1,445,000</u>

	Balance, December 31, 2016	Additions	Reductions	Balance, December 31, 2017	Amounts Due Within One Year
Bonds payable					
2015 Revenue bonds	\$ 48,179,143	\$ -	\$ (650,896)	\$ 47,528,247	\$ 735,000
2015 LTGO bonds	32,110,345	-	(462,061)	31,648,284	565,000
2011 LTGO bonds	15,360,000	-	-	15,360,000	-
	<u>\$ 95,649,488</u>	<u>\$ -</u>	<u>\$ (1,112,957)</u>	<u>\$ 94,536,531</u>	<u>\$ 1,300,000</u>
Total noncurrent liabilities					
	<u>\$ 95,649,488</u>	<u>\$ -</u>	<u>\$ (1,112,957)</u>	<u>\$ 94,536,531</u>	<u>\$ 1,300,000</u>

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

	2011 LTGO Bonds		2015 LTGO Bonds		2015 Revenue Bonds		Total	
	Principal	Interest	Principal	Interest	Principal	Interest	Principal	Interest
2019	\$ -	\$ 1,068,738	\$ 665,000	\$ 1,560,300	\$ 780,000	\$ 2,892,250	\$ 1,445,000	\$ 5,521,288
2020	-	1,068,738	765,000	1,530,375	830,000	28,743,500	1,595,000	31,342,613
2021	-	1,068,738	860,000	1,495,950	880,000	2,791,625	1,740,000	5,356,313
2022	-	1,068,738	885,000	1,452,950	930,000	2,741,375	1,815,000	5,263,063
2023	15,000	1,068,738	980,000	1,408,813	980,000	2,694,875	1,975,000	5,172,426
Amounts due 2024 - 2028	970,000	5,220,690	5,915,000	6,329,263	5,695,000	12,663,713	12,580,000	24,213,666
Amounts due 2029 - 2033	2,055,000	4,782,513	8,940,000	4,570,500	7,515,000	10,844,213	18,510,000	20,197,226
Amounts due 2034 - 2038	4,015,000	3,816,050	12,660,000	1,983,750	10,070,000	8,298,588	26,745,000	14,098,388
Amounts due 2039 - 2043	8,305,000	884,800	-	-	13,610,000	4,750,938	21,915,000	5,635,738
Amounts due 2044 - 2045	-	-	-	-	6,710,000	635,313	6,710,000	635,313
							95,030,000	<u>\$ 117,436,034</u>
Less amount representing unamortized discount							1,724,456	
							<u>\$ 93,305,544</u>	

Public Hospital District No. 4, King County, Washington Notes to Financial Statements

Note 8 – 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 \$149,317 and \$188,967 in 2018 and 2017, respectively.

Defined contribution plan – In 2006, the District also began sponsoring a defined contribution plan in accordance with IRC 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.

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 \$142,435 and \$142,236 in 2018 and 2017, respectively. Contributions made by employees to the benefit plan totaled approximately \$818,647 and \$846,707 in 2018 and 2017, respectively. For more information on the plans, contact the District's human resources office.

Note 9 – 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:

	2018	2017
Medicare	48%	44%
Medicaid	10%	6%
Other commercial	33%	30%
Patient and self-pay	9%	20%
	<u>100%</u>	<u>100%</u>

Public Hospital District No. 4, King County, Washington

Notes to Financial Statements

Note 10 – 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, 2018:

2019	\$ 1,096,904
2020	447,472
2021	146,886
2022	<u>5,369</u>
	<u><u>\$ 1,696,631</u></u>

Rent expense on operating leases for 2018 and 2017 was \$1,933,094 and \$1,988,411, 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.

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 Physicians Insurance. 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.

Report of Independent Auditors on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*

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

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of Public Hospital District No. 4, King County, Washington (the District), as of and for the year ended December 31, 2018, and the related notes to the financial statements, which collectively comprise the District's financial statements, and have issued our report thereon dated May 22, 2019.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the District's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the District's internal control. Accordingly, we do not express an opinion on the effectiveness of the District's internal control.

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

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the District's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Moss Adams LLP

Everett, Washington
May 22, 2019

