Office of the Washington State Auditor
Pat McCarthy

January 23, 2017

Board of Commissioners
King County Public Hospital District No. 2
Kirkland, Washington

Contracted CPA Firm's Audit Report on Financial Statements and Federal Single Audit.

We have reviewed the audit report issued by a certified public accounting (CPA) firm on King County Public Hospital District No. 2's financial statements and compliance with federal grant requirements for the fiscal year ended December 31, 2015. The District contracted with the CPA firm for this audit under an agreement with the State Auditor's Office.

Based on this review, we have accepted this report in lieu of the audit required by RCW 43.09.260. The State Auditor's Office did not audit the accompanying financial statements or the compliance with federal grant agreements and, accordingly, we do not express an opinion on those financial statements or on compliance.

This report is being published on the State Auditor's Office website as a matter of public record.

Sincerely,

Pat McCarthy

State Auditor

Olympia, WA

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KPMG

PUBLIC HOSPITAL DISTRICT NO. 2
OF KING COUNTY, WASHINGTON
(d/b/a EvergreenHealth)

Federal Uniform Guidance Reports

Year ended December 31, 2015

and

Basic Financial Statements

December 31, 2015

(With Independent Auditors’ Reports Thereon)

PUBLIC HOSPITAL DISTRICT NO. 2
OF KING COUNTY, WASHINGTON
(d/b/a EvergreenHealth)

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KPMG LLP
Suite 2900
1918 Eighth Avenue
Seattle, WA 98101

Independent Auditors' Report

The Board of Commissioners
Public Hospital District No. 2,
King County, Washington
dba EvergreenHealth:

Report on the Financial Statements

We have audited the accompanying financial statements of the business-type activities of Public Hospital District No. 2, King County, Washington, dba EvergreenHealth (the District), as of and for the year ended December 31, 2015, and the related notes to the financial statements, which collectively comprise the District's basic 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 U.S. generally accepted accounting principles; 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 opinions on these financial statements based on our audit. We conducted our audit 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 auditors' 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 opinions.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the business type activities of Public Hospital District No. 2, King County, Washington, dba EvergreenHealth, as of December 31, 2015, and the respective changes in financial position, and where applicable, cash flows thereof for the year then ended in accordance with U.S. generally accepted accounting principles.

Other Matters

Required Supplementary Information

U.S. generally accepted accounting principles require that the management's discussion and analysis on pages 3–19 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 who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated April 27, 2016 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 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 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.

KPMG LLP

April 27, 2016

This discussion and analysis of King County Public Hospital District No. 2, d/b/a EvergreenHealth (the District) provides an overview of the District's financial activities for the year ended December 31, 2015. Please read it in conjunction with the District's financial statements, which follow this analysis.

The District is a municipal corporation of the State of Washington formed under the provisions of Chapter 70.44 of the Revised Code of Washington. The District is considered a political subdivision of the State of Washington and is allowed by law to be its own Treasurer.

The District includes the incorporated cities of Kirkland, Redmond, Woodinville, Kenmore, and Duvall, portions of Bothell, Sammamish, and Carnation, as well as adjacent unincorporated areas.

The District's primary operations include Evergreen Hospital Medical Center (the Medical Center), an acute care hospital with 318 licensed beds, and a 15 bed freestanding inpatient hospice care center.

Type of beds	Number of beds	License category
Critical care	20	Acute
Family maternity	36	Acute
Acute rehabilitation	14	Acute rehab
Medical/surgical	205	Acute
NICU	43	Acute/newborn
Hospice	15	Hospice
Total beds	333	

The Medical Center is accredited by the Joint Commission, a nonprofit organization that accredits more than 21,000 healthcare organizations and programs in the United States. The Medical Center provides clinical excellence in many specialties, including heart and vascular care, oncology, surgical care, orthopedics, neurosciences, women's and children's services, pulmonary care and home care and hospice services.

The employed physician practices comprise 61 primary care providers and 198 specialty care providers in 2015. Since 1972, the District's patient and family centered care philosophy, combined with its commitment to advancing medical solutions, has enabled the District to focus on providing excellent patient care.

The District is governed by a board of five publicly elected commissioners, each elected by district residents to serve a six-year term in accordance with the laws of the State of Washington. The commissioners have delegated day-to-day operations of the District and the Medical Center to the chief executive officer/superintendent.

Utilization Statistics

Historical patient utilization data of the District's facilities is shown in the following table:

Utilization statistics	2015	2014
Licensed beds[1]	333	333
Acute care admissions	15,184	14,707
Acute care adjusted admissions	32,753	32,669
Acute care patient days	60,266	54,873
Acute care adjusted patient days	129,945	121,739
Acute care average length of stay	4.0	3.7
Occupancy	51.9%	47.3%
Outpatient surgeries	13,991	13,925
Home health episodes and admissions	10,137	10,020
Hospice program days (outpatient)	181,232	165,764
Emergency room visits	56,946	54,788

(1) Licensed beds at December 31

Sources of Patient Revenue

The District derives a substantial portion of its operating revenue from federal and state programs and insurance plans that pay for all or a portion of the healthcare services provided to its patients. As a consequence, the District's operating revenue depends to a great extent on the availability and level of reimbursement or payment under those programs and plans.

The following table sets forth the percentages of the District's gross patient revenue applicable to various programs and plans for the fiscal years ended December 31, 2015 and 2014.

	2015	2014
Medicare	39.1%	37.8%
Other third-party payors	15.9	16.7
Premera	15.9	16.6
Medicaid	12.1	9.6
Regence	11.9	13.3
First choice	3.9	4.6
Patient self-pay	1.2	1.4

Economic Factors Affecting the Future

Challenges and opportunities that face the District are similar to those that face the healthcare industry across the country. Among those issues are:

- Financial Health: The District continues to implement service enhancement and growth plans, discussed below, which result in significant capital outlays. The investment in new and expanded facilities may put financial constraints on the organization; however, management believes the District is positioned to better serve the needs of the community.

- Competition: The Puget Sound has experienced increased market consolidation and collaboration between healthcare providers over the past year. In addition, eastside and Seattle providers have opened healthcare facilities both within and around the District boundaries with the intention of drawing patients from the service area.

- Operating Costs: Several key volume indicators, including overall adjusted patient days, were higher than 2014. The District has continued working to manage its operating costs in line with volumes. Labor is the most significant operating cost for the District. During 2015, the District continued to practice various cost saving initiatives including supply chain standardization and managing to productivity labor targets.

- Regulatory Environment: Continued focus by regulatory agencies on the healthcare industry may impact the District.

- Labor Availability: Throughout 2015, the District experienced an increased reliance on RN agency personnel. To address this issue, the District developed an RN New-to-Specialty Program and increased the number of new graduate RN hires. Labor shortages continued for various nursing and therapist positions. Approximately 49% of the District's 4,254 employees are members of one of four labor unions. In October 2015, the District began negotiations with the Washington State Nurses Association, which represents approximately 1,040 employees. That contract was settled in January 2016. In January 2016, the District began negotiations with the Service Employees International Union for the organization's Social Worker/Case Manager bargaining unit, which represents approximately 70 employees. In March 2016, the District also began negotiations of its labor contract with the United Food and Commercial Workers Local 21 bargaining unit, which represents approximately 175 employees. Both of these negotiations are still currently in progress.

- Contracting/Risk-Sharing Arrangements: The District has six pay-for-performance contracts currently in effect with payors. In addition, EvergreenHealth Partners, a physician-led organization formed in 2013 of which the District is the sole LLC member, has its own six pay-for-performance contracts for the broader ACO that includes the District and is backed by the District. All of these contracts are "layered" on top of the existing fee for service arrangements between the District and those payors and provides for additional bonus dollars based upon efficiency and quality performance. The healthcare industry is seeing an increasing desire of payors to tie future rate increases to performance standards.

- Payor Reimbursement: Reimbursement for patient services from federal, state, and private insurance payors continues to be a concern as healthcare costs continue to rise. The District monitors reimbursement closely and works with payors in an effort to keep payment levels in line with operating cost increases.

- Alliances: During 2015, the District continued to develop its strategic alliances with Seattle Cancer Care Alliance (SCCA), Virginia Mason Medical Center and EvergreenHealth Monroe (EHM), formerly Valley General Hospital of Monroe.

  SCCA – The Halvorson Cancer Center connects patients to promising new treatments with on-site access to the innovative research programs and breakthrough clinical trials of SCCA.

  Virginia Mason – The District's strategic partnership with Virginia Mason continued to develop during 2015 to advance a virtual healthcare system that broadens the geographic network of both healthcare systems via clinical collaborations focused on exceptional clinical outcomes and value. Collaborations are focused on cardiology, neurosciences, home care services, and Telestroke technology.

  EvergreenHealth Monroe (EHM) – EvergreenHealth finalized the alliance agreement with Valley General Hospital on March 1, 2015. The hospital was renamed EHM. The District's affiliation with EHM continues to grow. EHM is governed by the Alliance Governance Board. Both organizations remain independently and separately governed, licensed, and accredited. The purpose of the affiliation is to provide EHM the ability to better serve its community through enhanced clinical services and to adopt the District's approaches to clinical outcomes, patient safety, and patient experience. EHM is reported within the District's financial statements as a discretely presented component unit in accordance with government accounting standards.

Other substantial changes are anticipated in the U.S. healthcare system including numerous provisions affecting the delivery of healthcare services, the financing of healthcare costs, the Affordable Care Act and uncertainty surrounding the act, reimbursement of healthcare providers, and the legal obligations of health insurers, providers, and employers. Management will continue evaluating how it will respond to various healthcare reform components as they develop.

The District recognizes that providing the community with high-quality healthcare goes beyond offering outstanding programs and services. As the community continues to grow and age, the District must keep pace with the need for more types of services. The 2015 population within the District's boundaries is estimated to be 300,769 people. Population is projected to grow 7.5% over the next five years and reach 323,385 in 2020 according to the Economic and Social Research Institute. The District's Master Campus Plan filed with the City of Kirkland in 2003 includes facility and service expansions based on projected needs. In 2013, the District filed its Master Campus Signage Plan, one of three plans that comprise the next Master Campus Plan to be filed with the City of Kirkland in August 2016.

In 2015, the District initiated or completed the following related projects:

- Clinic acquisitions and asset purchases, including EvergreenHealth General Surgery Care, EvergreenHealth Primary Care – Sultan, EvergreenHealth Urology Care, EvergreenHealth Infectious Disease Care, EvergreenHealth Orthopedics & Sports Care, Coral and EvergreenHealth Surgical & Vein Care, Monroe
- Transitioned Valley General Hospital to EHM
- Selected the WellCentive platform for Population Health Management for EvergreenHealth Partners

- Implemented eHomeHealth to virtually connect providers to patients in the home
- Opened new infant stabilization rooms in our Family Maternity Center
- Established a neurohospitalist program
- Established a geriatric consult program
- EvergreenHealth Partners/Puget Sound High Value Network secured Washington State Health Care Authority contract as an Accountable Care Program option for state employees
- Implemented ICD-10
- Finalized a long–term master facility plan ("Plan"). The Plan includes five phases and spans eleven years and was approved by the District's Board in July 2015. The Plan will consist of acquiring, constructing, remodeling and renovating improvements to the Hospital System including the following:
  - Expand space in the DeYoung Pavilion (Floors 4 and 5) to provide for the aggregation of musculoskeletal services including pain, physiatry, orthopedics and orthopedic spine;
  - Expand the progressive care unit in 5 and 4 Silver to provide 64 additional telemetry beds;
  - Update the current critical care unit in 3 Silver (26 beds);
  - Expand the Hospital's cardiac catheterization and interventional radiology suites to add a third laboratory and to accommodate electrophysiology and neuro-interventional services;
  - Update the Hospital System's infrastructure, including air handling units, generator, utility redundancy and other improvements;
  - Expand the Canyon Park Clinic;
  - Relocate and expand the Kenmore Clinic;
  - Establish a clinic in Mill Creek;
  - Add new clinic space and build out shelled space on the Hospital's campus to support the operation of the Hospital System; and
  - Complete additional capital improvements as part of Phase 1 of the District's Master Facility Plan for the Hospital System.

Overview of the Financial Statements

The District's financial statements consist of three components: statement of net position; statement of revenue, expenses, and changes in net position; and statement of cash flows. The activities of EvergreenHealth Foundation (the Foundation) are included with the District's financial statements as a blended component unit. These financial statements and related notes provide information about the activities of the District, including resources held by the District designated for specific purposes. The statement of net position includes all the District's assets and liabilities, using the accrual basis of accounting, as well as an indication about which assets can be utilized for general purposes and which are restricted for a specific purpose. The statement of revenue, expenses, and changes in net position report all of the revenue, expenses, and changes in net position during the time periods indicated.

The statement of cash flows report the cash provided by the District's operating activities, as well as other cash sources such as investment income and issuance of new debt, and use of cash such as cash payments for capital asset additions and improvements and repayment of debt.

On March 1, 2015, the District entered into a Strategic Alliance Agreement with EHM. GASB standards require that this entity be presented as a discrete component unit; therefore, its financial position at December 31, 2015 and the results of its operations for the year ended December 31, 2015 are included with the District in a separate column for financial statement presentation purposes (Note 1 to the Financial Statements).

The analysis presented below represents the District and its blended component unit (the Foundation), but excludes the financial position and results of operations of its discrete component unit (EHM), unless otherwise noted.

Contacting the District's Financial Management

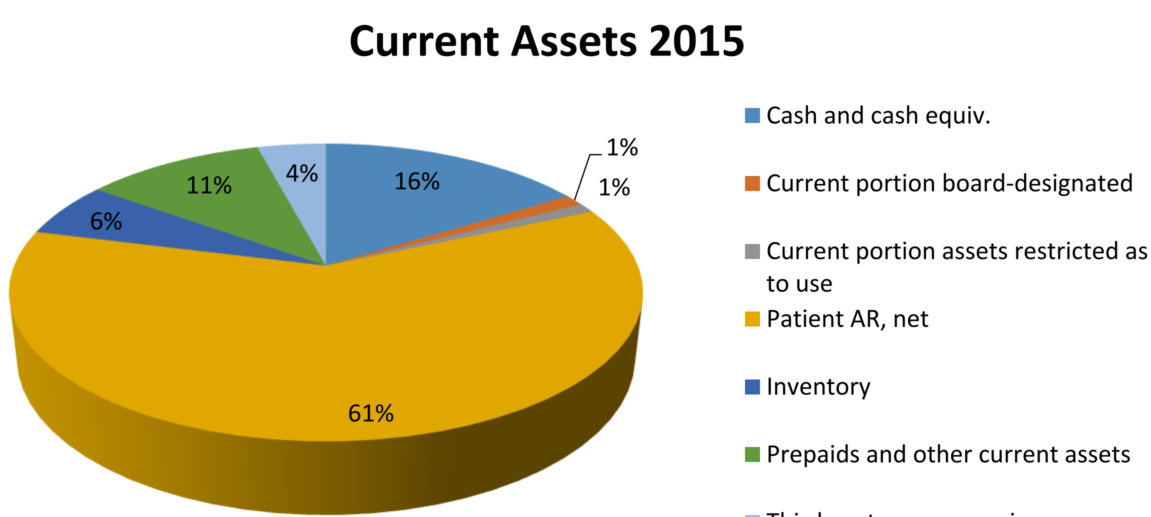
This financial report provides the reader with a general overview of the District's finances and operations. If you have questions about this report or need additional financial information, please contact the chief financial officer or director of finance at EvergreenHealth, 12040 NE 128th Street, Kirkland, Washington 98034.

Summary of Statements of Net Position
(Expressed in thousands)

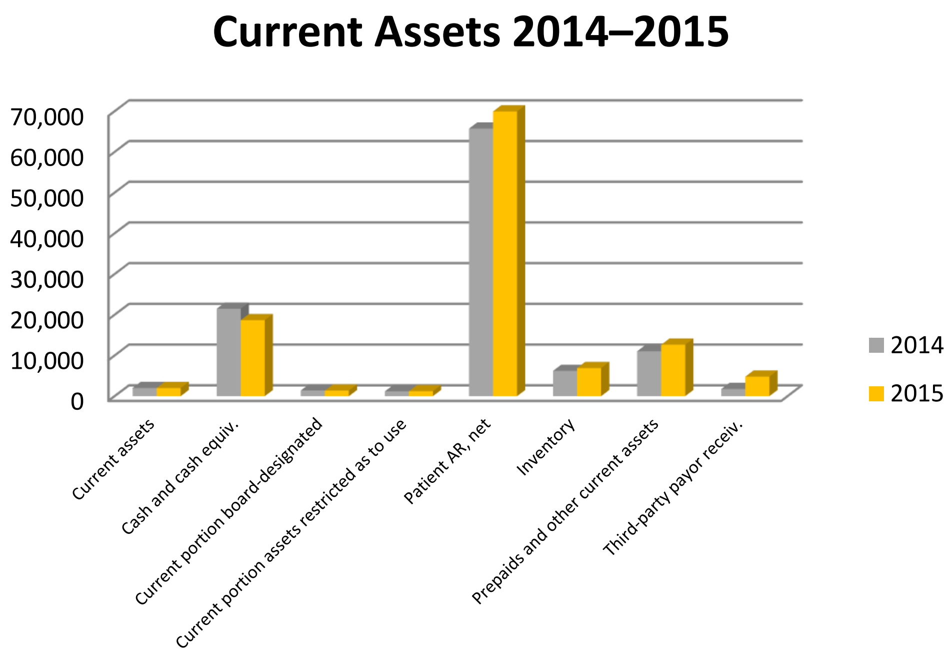
		2015	2014
Cash and cash equivalents	$	18,677	21,483
Patient accounts receivable, less allowance for uncollectible accounts		69,942	65,729
Other current assets		26,968	21,609
Total current assets		115,587	108,821
Restricted as to use and board-designated cash and investments		192,523	128,981
Capital assets, net		302,508	304,225
Other assets		28,276	18,762
Total assets		638,894	560,789
Deferred outflows of resource:			
Deferred loss on refunding		5,125	2,145
Total assets and deferred outflows of resources	$	644,019	562,934

Summary of Statements of Net Position
(Expressed in thousands)

		2015	2014
Current portion of long-term debt and capital lease obligations	$	11,868	11,652
Other current liabilities		74,259	63,469
Total current liabilities		86,127	75,121
Long-term liabilities		244,623	195,796
Total liabilities		330,750	270,917
Net position:			
Invested in capital assets, net of related debt		51,757	101,519
Restricted		8,018	7,978
Unrestricted		253,494	182,520
Total net position		313,269	292,017
Total liabilities and net position	$	644,019	562,934



Unaudited – see accompanying notes to financial statements

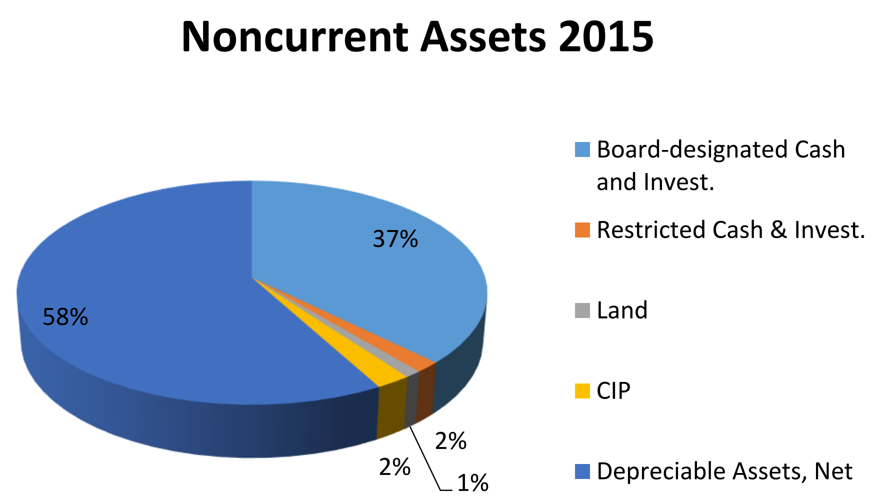


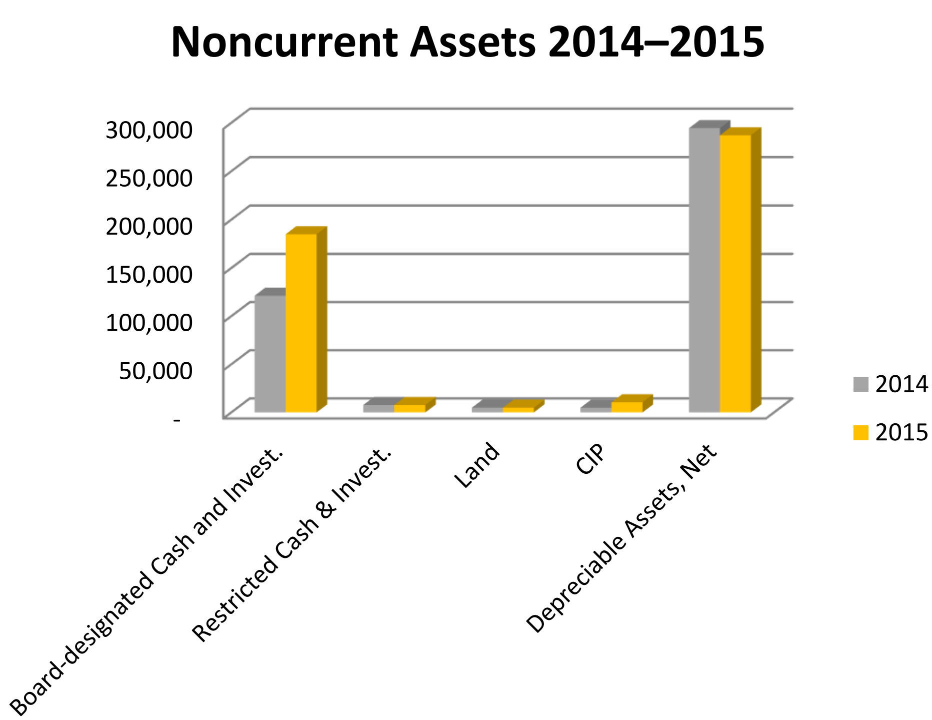
In 2015, current assets include accounts receivable (60.5% of total current assets), cash and cash equivalents (16.2%), prepaid expenses and other current assets (10.9%), and inventory and other assets. In 2015, current assets overall increased by $6.8 million primarily due to increases of $4.2 million in net patient accounts receivable related to price and volume increases, $3.0 million related to third-party payor receivables, $1.6 million in prepaid expenses and other current assets, offset by a decrease of $2.8 million in cash and cash equivalents.

KING COUNTY PUBLIC HOSPITAL DISTRICT NO. 2
(d/b/a EvergreenHealth)

Management's Discussion and Analysis

December 31, 2015

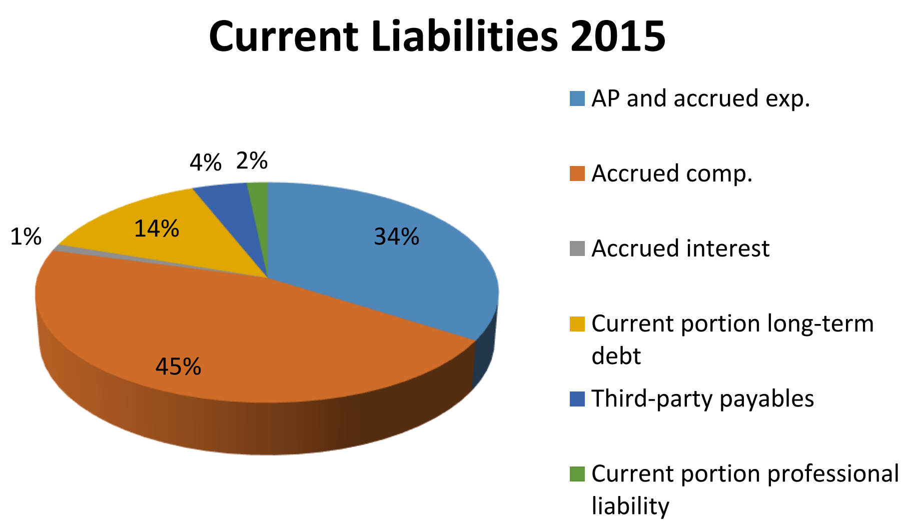


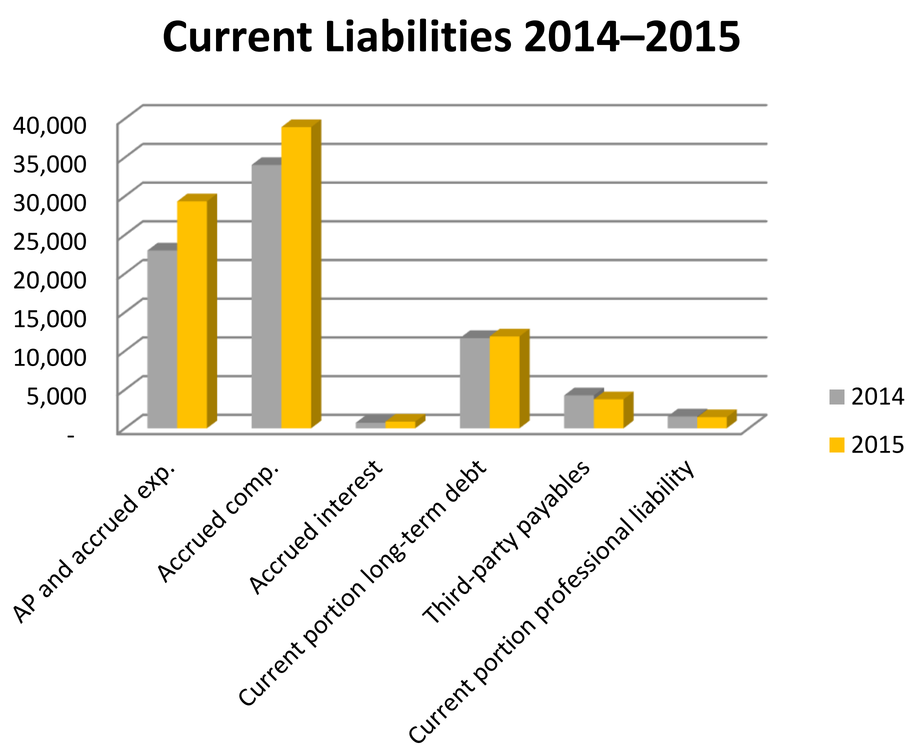


Unaudited – see accompanying notes to financial statements

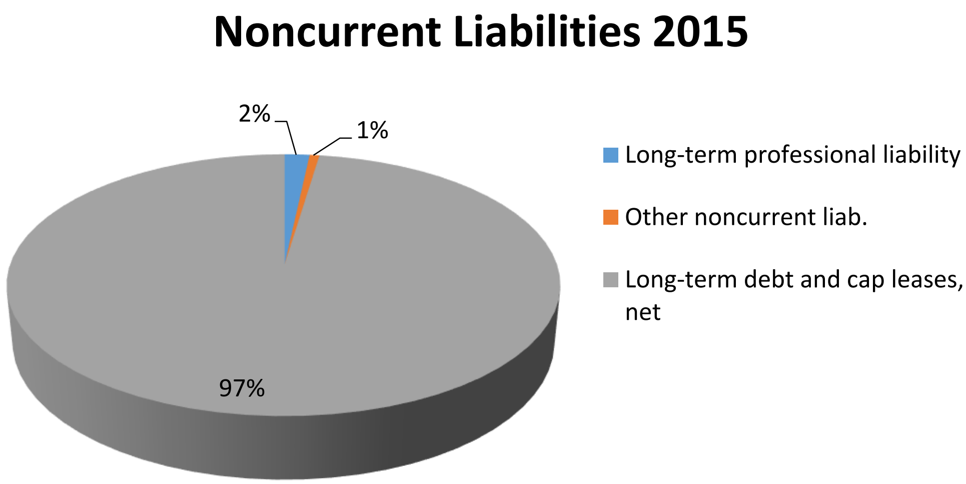
The District continues to devote resources for capital projects and improvements. During 2015, the District invested approximately $29.7 million in buildings, information technology, and equipment. This increase in capital assets was offset by $31.2 million of depreciation expense.

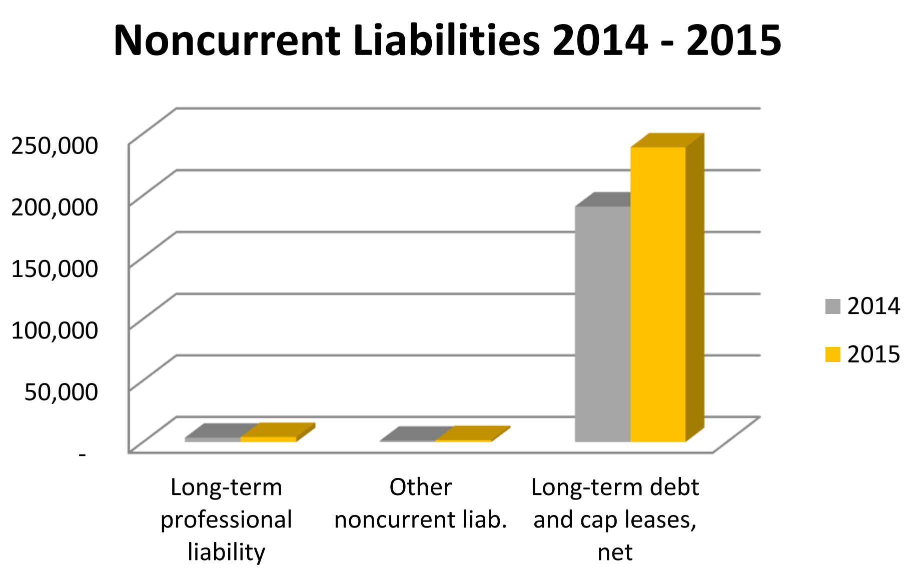
Restricted as to use and board-designated cash and investments increased in 2015 primarily due to issuance of the 2015 Limited Tax General Obligation Series B bonds, which resulted in approximately $57 million of bond proceeds included in board-designated assets.





In 2015, current liabilities include accrued compensation (45.2% of total current liabilities), accounts payable (34.0%), current portion of long-term debt and capital lease obligations (13.8%), current portion of professional liability, accrued interest, and estimated settlements related to third-party liabilities. Current liabilities increased approximately $11.0 million compared to prior year.





In 2015, long-term liabilities of $244.6 million include long-term debt and capital lease obligations of $238.9 million as well as a reserve for professional liability of $4.1 million. Long-term liabilities increased $48.8 million compared to prior year due to the issuance of $54.0 million in LTGO bonds in October 2015.

Net Position

Investment in Capital Assets, Net of Related Debt – This classification includes the District's property, plant, and equipment net of accumulated depreciation and outstanding debt obligations related to those capital assets.

Restricted Expendable Net Position – Restricted expendable net position represents resources that the District is legally or contractually obligated to spend in accordance with restrictions placed by donors and/or external parties that have placed time or purpose restrictions on the use of the assets.

Restricted Nonexpendable Net Position – Restricted nonexpendable net position represents resources that the District may not spend as the donor and/or external parties have placed a restriction on preservation of the assets.

Unrestricted Net Position – This category includes other funds available to the District that do not meet the definition of restricted or net investment in capital assets.

Summary of Revenue, Expenses, and Changes in Net Position

(Expressed in thousands)

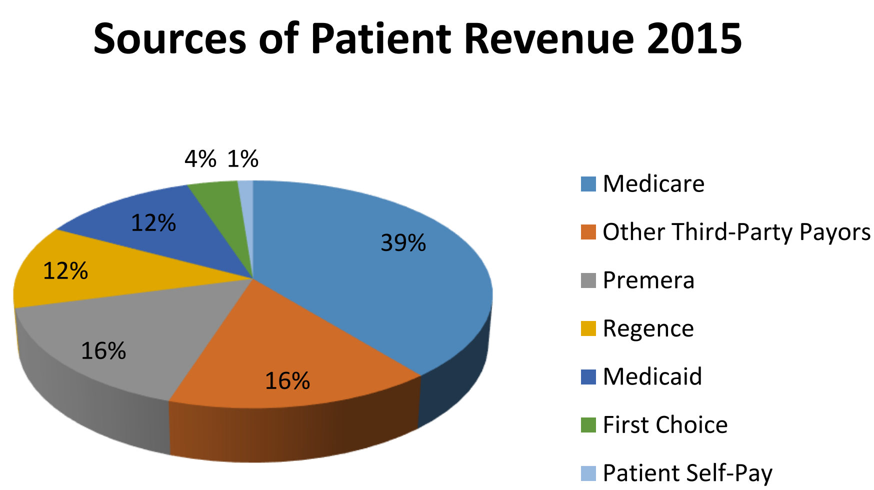
		2015	2014
Operating revenue:			
Net patient service revenue	$	565,832	511,862
Other operating revenue		37,074	34,701
Total operating revenue		602,906	546,563
Operating expenses:			
Salaries, wages, and employee benefits		379,131	342,071
Supplies, purchased services, and other		188,737	170,287
Depreciation and amortization		31,192	30,008
Total operating expenses		599,060	542,366
Excess of revenue over expenses from operations		3,846	4,197
Nonoperating income, net of expenses:			
Property taxes		24,825	24,871
Interest and amortization expense		(7,503)	(7,786)
Investment income		706	2,249
Other, net		(834)	249
Net nonoperating income		17,194	19,583
Excess of revenue over expenses		21,040	23,780
Capital grants and contributions		212	2,113
Total change in net position		21,252	25,893
Net position, beginning of year		292,017	266,124
Net position, end of year	$	313,269	292,017

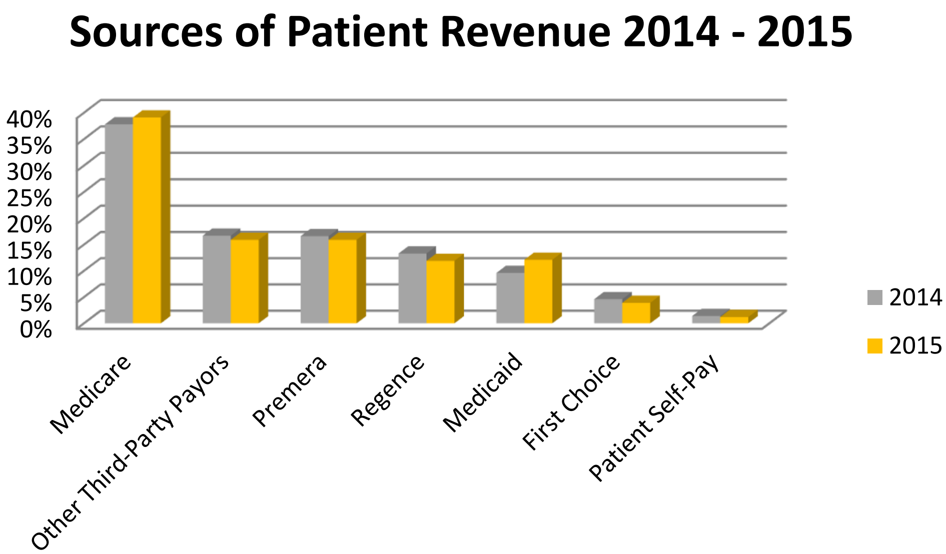
Financial Highlights

Revenue

In 2015, gross patient revenue increased by approximately $208.4 million or 16.0%. Gross patient revenue is the total fees charged to patients for services. The increase was due to a targeted rate increase of 7.0% overall implemented on January 1, 2015 and increased volumes. The overall gross revenue increase due to volumes was 9.0%. Average length of stay increased from 3.7 days to 4.0 days. Surgery cases increased 1.5% in 2015 compared to 2014. Outpatient hospice volume increased 9.3% and home health volume increased 1.2%.

In 2015, net patient service revenue increased by approximately $54.0 million or 10.5%. Net patient revenue consists of gross patient revenue less contractual adjustments, bad debt, and charity. This increase was due to volume increases, price increases, increases in reimbursement, and lower bad debt expense and charity care adjustments in 2015. Other operating revenue increased approximately $2.4 million, or 6.8%, $1.5 million of which is attributable to donations raised by the EvergreenHealth Foundation.





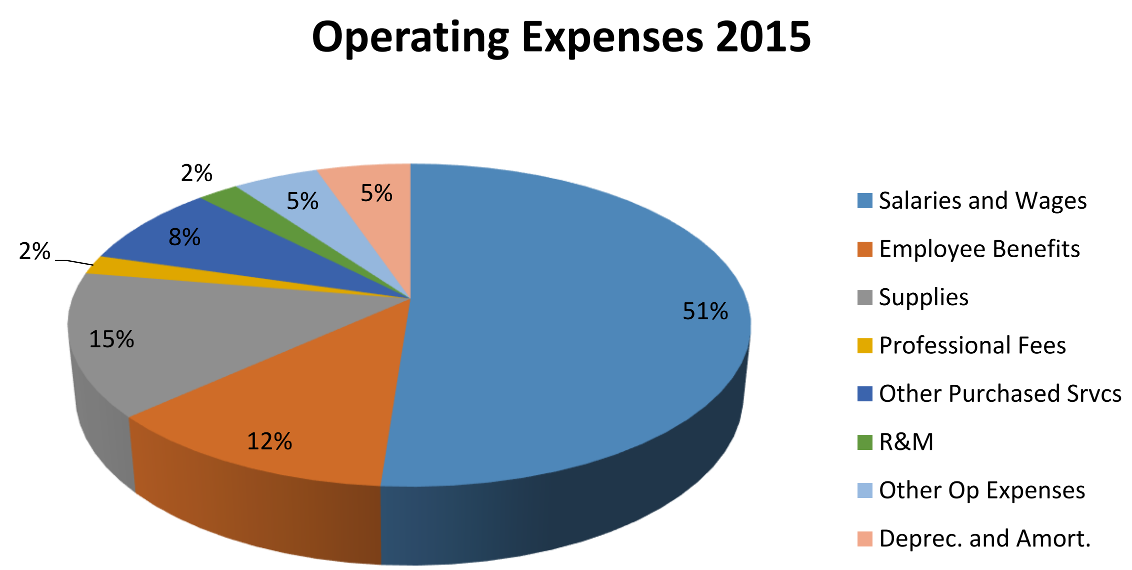
Operating Expenses

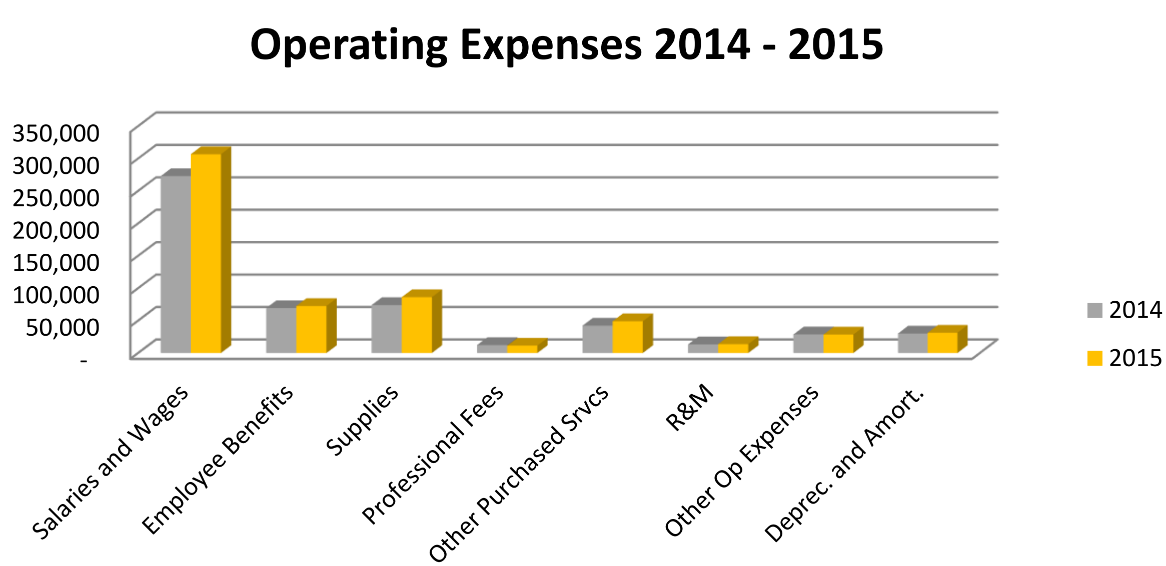
In 2015, salaries and wages increased approximately $33.8 million, or 12.4%, due to employee salary increases and an increase in the District's average employed full-time equivalents (FTEs). FTEs increased by 7.8% in 2015 at 3,382 compared to 3,137 FTEs in 2014.

Employee benefit expenses increased in 2015 by approximately $3.3 million, or 4.8%, over 2014. This was primarily due to increases in retirement plan and social security costs.

Supplies, purchased services, and other increased in 2015 by approximately $18.4 million, or 10.8%, due to overall hospital growth, including costs associated with the various clinic acquisitions and asset purchases throughout the year.

Total operating expenses of $599 million include expenses related to tax-supported community programs for which the offsetting revenue is included in nonoperating income.





Nonoperating Income, Net of Expenses

Nonoperating income, net of expenses decreased $2.4 million, or 12.2%, from $19.6 million in 2014 to $17.2 million in 2015. The decrease is largely driven by investment income of $706 thousand compared to investment income of $2.2 million in 2014.

KING COUNTY PUBLIC HOSPITAL DISTRICT NO. 2
(d/b/a EvergreenHealth)

Statement of Net Position

December 31, 2015

(In thousands)

Assets

		District	Component Unit EHM
Current assets:			
Cash and cash equivalents	$	18,677	1,162
Current portion board-designated assets		1,372	—
Current portion of assets restricted as to use		1,231	—
Patient accounts receivable, less allowance for uncollectible accounts of $15,215 and $1,417, respectively		69,942	4,669
Inventory		6,910	756
Prepaid expenses and other current assets		12,650	471
Third-party payor receivable		4,805	122
Total current assets		115,587	7,180
Assets limited as to use, less current portion of amounts required for current liabilities:			
Board-designated cash and investments		184,862	—
Restricted cash and investments		7,661	—
		192,523	—
Capital assets:			
Land		4,914	1,879
Construction in progress		10,547	80
Depreciable capital assets, net of accumulated depreciation		287,047	11,314
		302,508	13,273
Other assets		28,276	—
Total assets		638,894	20,453
Deferred outflows of resources:			
Deferred loss on refunding		5,125	117
Total assets and deferred outflows of resources	$	644,019	20,570

KING COUNTY PUBLIC HOSPITAL DISTRICT NO. 2
(d/b/a EvergreenHealth)

Statement of Net Position

December 31, 2015

(In thousands)

Liabilities and Net Position

		District	Component Unit EHM
Current liabilities:			
Accounts payable and accrued expenses	$	29,315	3,232
Accrued compensation and related liabilities		38,903	2,090
Accrued interest payable		870	81
Current portion of long-term debt and capital lease obligations		11,868	800
Third-party payor payable		3,740	—
Estimated current portion of professional liability		1,431	—
Other accrued liabilities		—	734
Total current liabilities		86,127	6,937
Long-term estimated professional liability		4,124	—
Unearned revenue and other noncurrent liabilities		1,616	309
Long-term debt and capital lease obligations, net of current portion		238,883	18,838
Total liabilities		330,750	26,084
Net position:			
Investment in capital assets, net of related debt		51,757	(6,365)
Restricted:			
Expendable for specific activities		5,621	—
Expendable for debt service		723	238
Nonexpendable permanent endowments		1,674	—
Unrestricted		253,494	613
Total net position		313,269	(5,514)
Total liabilities and net position	$	644,019	20,570

See accompanying notes to financial statements.

KING COUNTY PUBLIC HOSPITAL DISTRICT NO. 2
(d/b/a EvergreenHealth)

Statement of Revenue, Expenses, and Changes in Net Position

Year ended December 31, 2015

(In thousands)

		District	Component Unit EHM
Net patient service revenue (net of provision for bad debts of $21,189 and $4,423, respectively)	$	565,832	35,364
Other operating revenue		37,074	1,192
Total operating revenue		602,906	36,556
Expenses:			
Salaries and wages		306,611	15,554
Employee benefits		72,520	6,298
Supplies		86,095	4,324
Professional fees		11,413	—
Other purchased services		49,023	7,933
Repairs and maintenance		13,763	—
Other operating expenses		28,443	3,008
Depreciation and amortization		31,192	2,135
Total operating expenses		599,060	39,252
Excess (deficit) of revenue over expenses from operations		3,846	(2,696)
Nonoperating income, net of expenses:			
Property taxes		24,825	4,403
Interest and amortization expense		(7,503)	(1,136)
Investment income		706	—
Other, net		(834)	—
Net nonoperating income		17,194	3,267
Excess of revenue over expenses		21,040	571
Capital grants and contributions		212	—
Total change in net position		21,252	571
Net position, beginning of year		292,017	(6,085)
Net position, end of year	$	313,269	(5,514)

See accompanying notes to financial statements.

KING COUNTY PUBLIC HOSPITAL DISTRICT NO. 2
(d/b/a EvergreenHealth)

Statement of Cash Flows

Year ended December 31, 2015

(In thousands)

		District	Component Unit EHM
Cash flows from operating activities:			
Cash received from and on behalf of patients	$	587,653	34,148
Payments to suppliers and contractors		(190,410)	(14,576)
Payments to employees		(374,239)	(22,027)
Income distributions received from joint ventures		7,490	—
Other cash receipts		—	957
Net cash provided by (used in) operating activities		30,494	(1,498)
Cash flows from noncapital financing activity:			
Property taxes received for community programs		5,933	4,396
Net cash provided by noncapital financing activity		5,933	4,396
Cash flows from capital and related financing activities:			
Purchases of capital assets		(32,922)	(1,757)
Proceeds from sale of capital assets		3	—
Principal payments on long-term debt and capital lease obligations		(77,257)	(766)
Proceeds from issuance of long-term debt		124,854	—
Payment of issuance costs		(856)	—
Proceeds from property taxes related to debt service		18,892	—
Cash paid for interest on long-term debt, net of capitalized interest		(9,123)	(1,086)
Net cash provided by (used in) capital and related financing activities		23,591	(3,609)
Cash flows from investing activities:			
Purchases of board-designated assets and assets restricted as to use		(98,739)	—
Proceeds from sale of board-designated assets and assets restricted as to use		35,209	—
Investment income		706	—
Net cash used in investing activities		(62,824)	—
Net decrease in cash and cash equivalents		(2,806)	(711)
Cash and cash equivalents, beginning of year		21,483	1,873
Cash and cash equivalents, end of year	$	18,677	1,162

(Continued)

KING COUNTY PUBLIC HOSPITAL DISTRICT NO. 2
(d/b/a EvergreenHealth)

Statement of Cash Flows

Year ended December 31, 2015

(In thousands)

		District	Component Unit EHM
Reconciliation of excess of revenue over expenses from operations to net cash provided by operating activities:			
Excess of revenue over expenses from operations	$	3,846	(2,696)
Adjustments to reconcile excess of revenue over expenses from operations to net cash provided by operating activities:			
Depreciation and amortization		31,192	2,135
Provision for bad debts		21,189	4,423
Other		(788)	—
Changes in operating assets and liabilities:			
Patient accounts receivable, less provision for bad debt		(25,402)	(3,358)
Inventory		(704)	190
Prepaid expenses and other assets		(11,228)	177
Accounts payable and accrued expenses, net of amounts related to construction in progress		13,311	700
Accrued compensation and related liabilities		1,399	(377)
Third-party payor settlements, net		(3,549)	(2,457)
Professional liability and other noncurrent liabilities		1,228	(235)
Net cash provided by (used in) operating activities	$	30,494	(1,498)
Supplemental disclosures of noncash investing, capital, and financing activities:			
Change in capital asset additions included in accounts payable and accrued expenses	$	3,471	125
Capital lease additions		—	18

See accompanying notes to financial statements.

(1) Organization and Summary of Significant Accounting Policies

(a) Organization

King County Public Hospital District No. 2, King County, Washington, d/b/a EvergreenHealth (the District) is a municipal corporation established under Chapter 70.44 of the Revised Code of the State of Washington (RCW). The purpose of the District is to own and operate hospitals and other healthcare facilities and provide healthcare services to area residents. The District's primary operations include Evergreen Hospital Medical Center (the Medical Center), an acute care hospital; Evergreen Home Health Services, a home health agency; Evergreen Hospice Services, a program serving the terminally ill; EvergreenHealth Medical Group, a multispecialty practice group consisting of family practice physicians, physician assistants, and certified nurse practitioners; and EvergreenHealth Foundation (the Foundation). Affiliated organizations are evaluated for inclusion in the reporting entity as component units based on the significance of their relationship with the District.

Component units are legally separate organizations for which the District is financially accountable. These entities may be reported in the financial statements of the primary government in one of two ways: the component units' amounts may be blended with the amounts reported by the primary government, or they may be shown in a separate column, depending on the application of the criteria of Governmental Accounting Standards Board (GASB) Statement No. 61, *The Financial Reporting Entity: Omnibus*. The District has one component unit that meets the criteria for blending, the Foundation, and one component unit that does not meet the criteria for blending, EvergreenHealth Monroe (EHM). EHM is reported discretely as it is a legally separate organization for which the District is finally accountable.

Blended Component Unit

The Foundation is a separate nonprofit foundation. The purpose of the Foundation is to (a) receive grants, bequests, donations, and contributions on behalf of; (b) provide fund-raising and other support to; and (c) make contributions to the District. Consequently, the net financial position and the results of operations of the Foundation are included in the accompanying financial statements. For the year ended December 31, 2015, the Foundation raised approximately $2.0 million in contributions and its assets comprise 1.5% of total assets.

Discrete Component Unit

The District and EHM, a 72-bed semirural community hospital (together with a 40-bed residential treatment facility license), entered into a Strategic Alliance Agreement effective March 1, 2015. EHM is located in Monroe, Washington and is a separate legal entity governed by the Alliance Governance Board (AGB). The AGB comprises five directors, consisting of two commissioners of the District, two commissioners of EHM, and the District CEO. The audited financial statements of EHM are available by contacting EHM at 14701 179th Avenue SE, Monroe, Washington 98272 or online at the following address:

http://evergreenhealthmonroe.com/about_us/financial_responsibility.asp.

(b) Basis of Presentation

The financial statements have been prepared on the accrual basis of accounting. Under this method of accounting, revenue is recognized when earned and expenses are recorded when liabilities are incurred without regard to receipt or disbursement of cash.

The District reports its financial information in a form, which complies with the pronouncements of the GASB and the *Audit and Accounting Guide* for Healthcare Organizations of the American Institute of Certified Public Accountants.

(c) Financial Reporting Entity

As required by accounting principles generally accepted in the United States of America (GAAP), these financial statements present the District, the primary government, and its component units, the Foundation and EHM. The Foundation meets the criteria of a blended component unit and has been included in the financial statements. EHM does not meet the criteria of a blended component unit and has been reported as a discretely presented component unit in a separate column of the financial statements.

(d) Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates. Significant estimates in the District's financial statements include patient accounts receivable allowances, third-party payor settlements, professional liabilities, and the fair value of investments.

(e) Cash and Cash Equivalents

Cash and cash equivalents include investments in highly liquid financial instruments with original maturities of three months or less, excluding assets restricted as to use and board-designated assets. Deposits of up to $250 thousand are covered by the federal deposit insurance corporation and any deposits in excess of $250 thousand are covered by collateral held in a multifinancial institution collateral pool administered by the Washington Public Deposit Protection Commission.

(f) Patients Accounts Receivable

Receivables arising from revenue for services to patients are reduced by an allowance for estimated uncollectible accounts based on recent collection experience and other circumstances, which may affect the ability of patients to meet their obligations. There are various factors that can impact the collection trends and the estimation process, such as changes in the economy, the increased burden of copays, and deductibles to be made by patients and business practices related to collection efforts. Accounts deemed uncollectible are charged against this allowance.

(Continued)

(g) Assets Limited as to Use

Assets limited as to use include assets designated by the Board of Commissioners (the Board) for capital improvements and community service programs. The Board retains control of the assets and may, at its discretion, subsequently change the use for other purposes. Assets limited as to use include certain assets of the Foundation that are restricted by donor stipulations. Assets limited as to use also include unexpended proceeds and income generated from certain outstanding bond series restricted for the payment of principal, interest, and expenditures for construction and equipment costs. The assets of the Supplemental Executive Retirement Plan (SERP) are also recorded as assets limited as to use. The SERP is a postretirement plan covering the executive management team. Amounts required to meet related current liabilities have been classified as current assets in the accompanying statement of net position. These assets are carried at fair value with changes in fair value reported as investment income.

(h) Inventory

Inventory consists of pharmaceutical, medical-surgical, and other supplies used in the operation of the District. Inventory is stated at the lower of cost, determined on a first-in, first-out basis, or net realizable value.

(i) Capital Assets

Capital assets are recorded at cost. In accordance with governmental accounting standards, the District has established a capitalization threshold of $3 thousand and a life of three years or more above which asset acquisitions are added to the capital asset accounts. Donated items are recorded at fair value at the date of the contribution. Depreciation expense is computed using the straight-line method based on the following estimated useful lives of the assets:

Land improvements	10–20 years
Buildings	25–40 years
Equipment	3–20 years

Maintenance and repairs are expensed as incurred. Expenditures that materially increase values, change capacities, or extend useful lives of plant and equipment are capitalized.

Equipment under capital lease is amortized on the straight-line method over the shorter of the lease term or estimated useful life of the equipment. Such amortization is included in depreciation and amortization in the accompanying statement of revenue, expenses, and changes in net position.

(j) Compensated Absences

The District’s employees earn vacation days at varying rates depending on years of service. Accrued vacation is reported as a current liability as employees utilize their vacation days within the following year.

(k) Debt Issuance Costs

In accordance with GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities* (GASB No. 65), debt issuance costs are recognized as an expense in the period incurred. GASB No. 65 is effective for years beginning after December 15, 2012. Debt issuance costs recognized as an expense in 2015 associated with the issuance of the 2015 Limited Tax General Obligation Bonds (LTGO) bonds and the 2015 Series B LTGO bonds were $433 thousand and $423 thousand, respectively.

(l) Net Position

Net position of the District is classified in five components. Investment in capital assets, net of related debt consists of capital assets net of accumulated depreciation, reduced by the balances of any outstanding borrowings used to finance the purchase or construction of those assets. Restricted expendable net position includes expendable for specific activities and expendable for debt service and must be used for a particular purpose, as specified by grantors or contributors external to the District. Restricted nonexpendable net position equals the principal portion of permanent endowments. Unrestricted net position does not meet the definition of investment in capital, net of related debt or restricted. The District will first apply restricted resources when an expense is incurred for purposes for which both unrestricted and restricted net position is available.

(m) Operating Revenue and Expenses

The District's statement of revenue, expenses, and changes in net position distinguish between operating and nonoperating revenue and expenses. Operating revenue results from exchange transactions associated with providing healthcare services – the District's principal activity. Nonoperating income includes property taxes received or grants and contributions received for purposes other than capital asset acquisition. Operating expenses are all expenses incurred to provide healthcare services.

Other operating revenue includes tenant lease receipts, income from joint ventures, outreach laboratory service revenue, retail revenue such as gift shop and pharmacy, educational offerings, grant funds to support specific programs, restricted donations, and other services.

(n) 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. Payment arrangements include prospectively determined rates per discharge, reimbursed costs, discounted charges, and per diem payments. Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined.

(o) Charity Care

The District accepts all patients regardless of their ability to pay. A patient is classified as a charity patient by reference to an established policy of the District. The estimated cost of charity care is

(Continued)

determined by calculating the ratio of operating costs to charges, and then applying this ratio to total charity care charges. The estimated costs of charity care provided by the District were $1.9 million for 2015. Because the District does not pursue collection of amounts determined to qualify as charity care, associated charges are not included in net patient service revenue.

(p) Nonoperating Income, Net of Expenses

The District received property taxes of approximately $24.8 million in 2015. These property taxes represented regular levy proceeds and voter approved excess levies. These funds were used as follows:

		December 31, 2015 (000's)
Amount used for tax supported programs	$	5,933
Amounts used for debt service on general obligation bonds		18,892
	$	24,825

Of the amount used for debt service on general obligation bonds, $8.8 million as of December 31, 2015, is related to interest payments. The property taxes received are reflected in nonoperating income. Interest expense related to long-term debt is included in nonoperating expenses. All other expenses related to tax supported programs are included in operating expenses.

Investment income includes interest income and unrealized gains and losses on board-designated assets and earnings on cash deposits.

(q) Federal Income Taxes

No provision has been made for federal income taxes, as the District is a municipal corporation exempt from federal tax, under Section 115 of the Internal Revenue Code.

No provision has been made for federal income taxes related to EHM as it is a municipal corporation exempt from federal tax, under Section 115 of the Internal Revenue Code.

The Foundation is an organization exempt from taxation under Section 501(c)(3) of the Internal Revenue Code and is generally not subject to federal income taxes. However, the Foundation is subject to income taxes on any net income that is derived from a trade or business, regularly carried on, and not in furtherance of the purposes for which it was granted exemption. No income tax provision has been recorded as the net income, if any, from any unrelated trade or business, in the opinion of management, is not material to the financial statements taken as a whole.

(Continued)

(r) Prospective Accounting Standards

In January 2016, the GASB issued Statement No. 80, *Blending Requirements for Certain Component Units – an Amendment of GASB Statement No. 14* (GASB No. 80). The objective of this Statement is to improve financial reporting by clarifying the financial statement presentation requirements for certain component units. The requirements of this Statement are effective for reporting periods beginning after June 15, 2016. The District will assess financial reporting implications of GASB No. 80 for its financial statements for the period beginning January 1, 2017.

In December 2015, the GASB issued Statement No. 79, *Certain External Investment Pools and Pool Participants* (GASB No. 79), which addresses accounting and financial reporting for certain external investment pools and pool participants. This Statement establishes additional note disclosure requirements for qualifying external investment pools that measure all of their investments at amortized cost for financial reporting purposes and for governments that participate in those pools. The requirements of this Statement are effective for reporting periods beginning after June 15, 2015, except for certain provisions on portfolio quality, custodial credit risk, and shadow pricing. Those provisions are effective for reporting periods beginning after December 15, 2015. The District will assess financial reporting implications of GASB No. 79 for its financial statements for the period beginning January 1, 2016.

In August 2015, the GASB issued Statement No. 77, *Tax Abatement Disclosures* (GASB No. 77). This Statement requires disclosure of tax abatement information about (1) a reporting government’s own tax abatement agreements and (2) those that are entered into by other governments and that reduce the reporting government’s tax revenue. The requirements of this Statement are effective for financial statements for periods beginning after December 15, 2015. The District will assess financial reporting implications of GASB No. 77 for its financial statements for the period beginning January 1, 2016.

In June 2015, the GASB issued Statement No. 76, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments* (GASB No. 76). The objective of this Statement is to identify—in the context of the current governmental financial reporting environment—the hierarchy of GAAP. The “GAAP hierarchy” consists of the sources of accounting principles used to prepare financial statements of state and local governmental entities in conformity with GAAP and the framework for selecting those principles. This Statement reduces the GAAP hierarchy to two categories of authoritative GAAP and addresses the use of authoritative and nonauthoritative literature in the event that the accounting treatment for a transaction or other event is not specified within a source of authoritative GAAP. The requirements of this Statement are effective for financial statements for periods beginning after June 15, 2015, and should be applied retroactively. The District will assess financial reporting implications of GASB No. 76 for its financial statements for the period beginning January 1, 2016.

In February 2015, the GASB issued Statement No. 72, *Fair Value Measurement and Application* (GASB No. 72), which addresses accounting and financial reporting issues related to fair value measurements. GASB No. 72 provides guidance for determining a fair value measurement for financial reporting purposes. This Statement also provides guidance for applying fair value to certain investments and disclosures related to all fair value measurements. The requirements of this Statement are effective for financial statements for periods beginning after June 15, 2015. The District will assess financial reporting implications of GASB No. 72 for its financial statements for the period beginning January 1, 2016.

(2) Net Patient Service Revenue

The District has arrangements 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 is as follows:

(a) Medicare

Inpatient acute care services rendered to Medicare program beneficiaries are paid at predetermined, specific rates for each hospital discharge. Discharges are classified according to a list of diagnosis-related groups (DRGs). Each DRG has a payment weight assigned to it, based on the average resources used to treat Medicare patients in that DRG. Inpatient nonacute services and defined capital and medical education costs related to Medicare beneficiaries are paid based on a cost reimbursement methodology. The District is reimbursed for cost reimbursable items at a tentative rate with final settlement determined after submission of annual cost reports by the District and audits thereof by the Medicare fiscal intermediary. The District’s cost reports have been reviewed and/or audited by the Medicare fiscal intermediary through 2013. The District recognized interim and final cost report settlements resulting in increased net patient service revenue by $362 thousand in 2015. Most outpatient services to Medicare beneficiaries are paid prospectively based on ambulatory payment classifications (APCs). Centers for Medicare and Medicaid Service (CMS) assigns individual services (Healthcare Common Procedure Coding System codes) to APCs based on similar clinical characteristics and similar costs.

(b) Medicaid

In the spring of 2005, the Washington State Legislature and CMS approved a Medicaid Certified Public Expenditures (CPE) program for inpatient reimbursement. The CPE program uses public expenditures by certain public hospitals to earn federal matching funds. Certified public expenditures are qualifying expenditures made by the hospital to serve Medicaid eligible or uninsured patients. The program was designed to preserve a significant amount of federal match funding for the State of Washington (the State) and maintain the same level of reimbursement to the affected hospitals that they would have received prior to the implementation of the program.

The CPE program uses three payment mechanisms to reimburse hospitals for inpatient care: inpatient hospital claims payments, disproportionate share (DSH) payments, and state grants. Under the program, hospitals are paid an interim payment based on an estimate of the cost to provide services to Medicaid recipients. For each payment to a hospital in the program, only the federal matching portion of the payment is remitted to the hospital; the state portion is funded through DSH payments and state grants. The American Recovery and Reinvestment Act of 2011 temporarily increased the matching percentage from approximately 50% to approximately 62%.

The intent of the legislature is that hospitals in the program receive no less in combined federal and state payments than the hospital would have received under the methodology that was in place during fiscal year 2005. Any differences between the federal matching and state DSH components on the CPE program payments and this baseline amount are to be paid to the hospitals with state grant funds. To the extent that state grant funds allocated at the start of the year are insufficient to meet the hold harmless provision of the program, additional legislative appropriations may be required.

Interim state payments based on prospectively estimated experience are retrospectively reconciled to "hold harmless" after actual claims are repriced using the applicable methods. This process takes place at least six months after the end of the fiscal year and results in either a payable to, or receivable from, the state Medicaid Program. State inpatient claim and DSH payments are subject to retrospective determination of actual costs once the District's Medicare Cost Report is audited. CPE program payments are not considered final until retrospective cost reconciliation is complete. Final settlements of $3.1 million and $3.3 million have been recognized in 2015 related to state fiscal year 2006 and state fiscal year 2007, respectively. The District recognized interim settlements resulting in an adjustment to decrease net patient service revenue by $1.5 million in 2015.

Inpatient Medicaid charges represented approximately 12.25% of total inpatient charges for the District in fiscal year 2015.

The Medicaid CPE program continues through the State's fiscal year 2015. As of December 31, 2015, the District has recorded a payable of $1.1 million for estimated overpayments for state fiscal year 2015, which is included in third-party payor payable in the statement of net position.

Outpatient services are paid on a fee schedule or a percentage of allowed charges based on a ratio of the District's allowable operating expenses to total allowable revenue.

In the July 2009 legislative session, the Washington State legislature enacted the Hospital Safety Net Assessment to help mitigate an estimated $400 million reduction in hospital Medicaid payments. Under this law, nongovernmental Washington hospitals are assessed a fee on all non-Medicare patient days. The fees are used to obtain new federal Medicaid matching funds.

The safety net assessment was subject to approval by CMS before it took effect. In 2010, CMS approved the two amendments required to fully enact the safety net assessment program. The existing safety net program expired in June 2013 and the State passed a new safety net assessment program that was approved by CMS in April 2014. The new law is retroactive to July 1, 2013 and will sunset on June 30, 2017. The District is not subject to the assessment but is a recipient of grant dollars through the program. The District received safety net payments totaling $710 thousand for 2015.

(Continued)

(c) Other Third-Party Reimbursement

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

The following are the components of net patient service revenue for the year ended December 31, 2015:

		District (000's)	Component Unit (000's)
Gross patient service charges	$	1,512,772	96,629
Adjustments to patient service charges:			
Contractual adjustments		909,420	56,325
Provision for bad debts		21,189	4,423
Charity care		4,941	319
Administrative adjustments		11,390	198
		946,940	61,265
Net patient service revenue	$	565,832	35,364

Percentage of gross patient service charges for the District was as follows:

	2015
Medicare	39.1%
Other third-party payors	15.9
Premera	15.9
Medicaid	12.1
Regence	11.9
First choice	3.9
Patient self-pay	1.2

(Continued)

(3) Assets Limited as to Use

Board-designated assets represent unrestricted resources that have been designated by the Board for funded depreciation and community service programs. In addition, the Board has the authority to establish a regular property tax levy within statutory restrictions, with the proceeds being used for purposes designated by the Board. Board-designated assets are as follows:

Board-Designated Assets
December 31, 2015 (000's)

Investment type		Carrying amount		Investment maturities (in years): Less than 1		Investment maturities (in years): 1–5
U.S. Treasuries	$	92,996	$	—	$	92,996
U.S. government agencies		30,572		7,039		23,533
Mutual Fund – Bonds		859		859		—
U.S. government agency – mortgage backed		7,071		—		7,071
King County Investment Pool		858		858		—
Total investments		132,356	$	8,756		123,600
Cash and cash equivalents		52,006				
Total cash and investments		184,362				
Property tax, interest receivable, and other		1,872				
Total board-designated assets	$	186,234				

Maturities for mortgage-backed securities are based on the weighted average maturity date, or reset date for adjustable rate mortgages.

Assets restricted as to use are as follows:

Assets Restricted as to Use

Investment type		December 31, 2015 (000's) Carrying amount		Investment maturities (in years) Less than 1
King County Investment Pool	$	807		807
Mutual Fund – Bonds		996		996
Mutual Fund – Equity		1,571		1,571
Total investments		3,374	$	3,374
Cash and cash equivalents		109		
Total cash and investments		3,483		
Property tax, interest receivable, and other		5,409		
Total assets restricted as to use	$	8,892		

Interest Rate Risk – The District's investment policy limits investment maturities as a means of managing its exposure to fair value losses arising from changing interest rates. Shares of mutual funds with portfolios consisting of only U.S. government bonds or U.S. government bonds issued by federal agencies must have average maturities of less than four years. Unless matched to a specific cash flow, the District does not invest in securities maturing more than five years from the date of purchase. However, assets whose use is limited may be invested in securities exceeding 10 years if the maturity of such investments is timed to coincide with the expected use of funds.

Credit Risk – Statutes authorize the District to invest in obligations of the U.S. Treasury, agencies, and instrumentalities, public funds investment accounts, state, or local government bonds with one of the three highest credit ratings of a nationally recognized agency, money markets with investments in authorized securities, and mutual funds of only U.S. government bonds and agencies. The U.S. Treasury, agency, and agency mortgage backed are considered to be of high quality; and the U.S. Treasury carry the long-term sovereign rating of the United States of America. The District's policy requires that all certificates of deposit be collateralized.

The District utilizes an investment adviser as well as the King County Investment Pool (the Pool), an external investment pool. The Pool is not registered with the Securities and Exchange Commission as an investment company. Oversight of the Pool is provided by the King County Executive Finance Committee pursuant to RCW 36.29.020. Participation in this pool is voluntary. The intent of this policy is to balance reasonable security with reasonable investment return, seeking to maximize both while meeting the daily cash flow requirements of the District and conforming to all applicable laws and regulations governing the investment of public funds.

Concentration of Credit Risk – The District investment policy requires that no more than 20% of the District's total investment portfolio be invested in a single security type of a single financial institution with the exception of U.S. Treasury and agency securities, U.S. government funds, and authorized pools. The following table sets forth the percentages by investment type of the District's total investment portfolio as of December 31, 2015.

	2015
U.S. Treasuries	51%
Mutual fund/U.S. government securities	28
Federal National Mortgage Association	7
Federal Home Loan Bank	6
Federal Home Loan Mortgage Corporation	6
Federal Farm Credit Bank	1
King County Investment Pool	1

(4) Capital Assets (Tables in 000's)

The schedule of capital asset activity for the year ended December 31, 2015 is as follows:

	January 1, 2015	Additions and adjustments	Sales and retirements	Account transfers	December 31, 2015
Assets at cost:					
Nondepreciable capital assets:					
Land	$ 4,914	—	—	—	4,914
Construction in progress	4,856	28,516	—	(22,825)	10,547
Total nondepreciable capital assets	9,770	28,516	—	(22,825)	15,461
Depreciable capital assets:					
Land improvements	14,647	—	—	—	14,647
Buildings	318,861	205	39	3,540	322,645
Equipment	344,849	979	(3,620)	19,285	361,493
Equipment and property under capital lease	17,055	—	—	—	17,055
Total depreciable capital assets	695,412	1,184	(3,581)	22,825	715,840

		January 1, 2015	Additions and adjustments	Sales and retirements	Account transfers	December 31, 2015
Less accumulated depreciation:						
Land improvements	$	10,348	530	—	—	10,878
Buildings		131,137	11,603	37	—	142,777
Equipment		252,488	18,072	(3,597)	—	266,963
Equipment under capital lease		6,984	1,191	—	—	8,175
Total accumulated depreciation		400,957	31,396	(3,560)	—	428,793
Depreciable capital assets, net		294,455	(30,212)	(21)	22,825	287,047
Capital assets, net	$	304,225	(1,696)	(21)	—	302,508

The schedule of capital asset activity for EHM for the year ended December 31, 2015 is as follows:

		January 1, 2015	Additions and adjustments	Sales and retirements	Account transfers	December 31, 2015
Assets at cost:						
Nondepreciable capital assets:						
Land	$	1,879	—	—	—	1,879
Construction in progress		—	445	—	(365)	80
Total nondepreciable capital assets		1,879	445	—	(365)	1,959
Depreciable capital assets:						
Land improvements		1,146	—	—	—	1,146
Buildings		23,890	269	—	365	24,524
Equipment		14,879	1,134	—	—	16,013
Equipment and property under capital lease		2,395	56	—	—	2,451
Total depreciable capital assets		42,310	1,459	—	365	44,134

		January 1, 2015	Additions and adjustments	Sales and retirements	Account transfers	December 31, 2015
Less accumulated depreciation:						
Land improvements	$	600	56	—	—	656
Buildings		15,602	1,130	—	—	16,732
Equipment		12,500	855	—	—	13,355
Equipment under capital lease		1,984	93	—	—	2,077
Total accumulated depreciation		30,686	2,134	—	—	32,820
Depreciable capital assets, net		11,624	(675)	—	365	11,314
Capital assets, net	$	13,503	(230)	—	—	13,273

(5) Other Assets

Evergreen Radia, LLC

During 2003, the District formed a limited liability company with a local radiology group for the purpose of providing outpatient diagnostic imaging services to individuals within the community. The District has a 50% interest in this joint venture at December 31, 2015, which is accounted for using the equity method of accounting. During the year ended December 31, 2015, the District recognized a gain of $1.2 million for its share of the Evergreen Radia, LLC's net income, which is recorded as other operating revenue. The District's recorded investment in Evergreen Radia, LLC was $4.4 million as of December 31, 2015 and is included in other assets in the District's statement of net position.

PacLab, LLC

Effective January 1, 2004, the District became a member in PacLab, LLC to provide outreach laboratory and testing services in order to further its own congruent mission of providing accurate, timely, and integrated laboratory testing series for patients, physicians, and other healthcare professionals in the community. The District's ownership interest was approximately 11% as of December 31, 2015. This percentage interest is equivalent to the ratio of the gross billed revenue generated by the District from its outreach laboratory testing business to other members' volumes. For the year ended December 31, 2015, the District recognized a loss of $63 thousand for its share of the net loss realized by PacLab, LLC, which is recorded within other operating revenue. Due to the nature of the investment, the District recorded distributions of excess cash from PacLab, LLC in other operating revenue of $3.0 million for the year ended December 31, 2015. The District records its investment in PacLab, LLC using the equity method of accounting. The investment balance was $711 thousand as of December 31, 2015, and is included in other assets in the District's statement of net position.

(Continued)

The following represents the summary financial information of Evergreen Radia, LLC and PacLab, LLC as of December 31, 2015 (in 000's):

		Evergreen Radia, LLC (Unaudited)	PacLab, LLC (Unaudited)
Current assets	$	4,273	4,166
Noncurrent assets, net		1,556	3,309
	$	5,829	7,475
Current liabilities	$	1,532	430
Long-term liabilities		1,162	—
Equity		3,135	7,045
	$	5,829	7,475
Revenue	$	10,077	151
Expenses		8,750	1,076
Net income (loss)	$	1,327	(925)

(6) Long-Term Debt and Capital Lease Obligations of the District consist of the following:

		December 31, 2015 (000's)
LTGO Series 2010 (fixed rate), payable annually through 2028, interest at 2.00% to 5.25%	$	27,535
LTGO Series 2011 (fixed rate), payable annually through 2030, interest at 2.00% to 5.00%		24,010
LTGO Series 2015 (fixed rate), payable annually through 2031, interest at 3.63 to 5.00%		60,295
LTGO Series 2015 B (fixed rate), payable annually through 2037, interest at 4.00% to 5.00%		54,000
Unlimited Tax General Obligation Refunding Bonds (UTGO), Series 2013 (fixed rate), payable semiannually through 2023, interest at 3.00% to 5.00%		53,950
Capital lease obligations, $9,856 (fixed rate), payable monthly including interest at 0.18% to 10.0%, collateralized by equipment		10,719
		230,509

(Continued)

		December 31, 2015
Plus bond discounts and premiums	$	20,242
		250,751
Less current portion		(11,868)
	$	238,883

Long-term debt and capital lease obligations 2015 activity summary for the District is as follows (in 000's):

		January 1, 2015	Additions	Reductions	December 31, 2015	Amounts due within one year
Limited general obligation bonds:						
2006 series	$	65,730	—	65,730	—	—
2010 series		29,020	—	1,485	27,535	1,555
2011 series		25,175	—	1,165	24,010	1,210
2015 series		—	62,740	2,445	60,295	2,555
2015 series B		—	54,000	—	54,000	—
Unlimited general obligation bonds:						
2013 series		59,460	—	5,510	53,950	5,685
Total long-term debt		179,385	116,740	76,335	219,790	11,005
Capital lease obligations		11,641	—	922	10,719	863
Total long-term debt and capital lease obligations		191,026	116,740	77,257	230,509	11,868
Bond discounts and premiums		11,680	12,682	4,120	20,242	—
Total long-term debt and capital lease obligations	$	202,706	129,422	81,377	250,751	11,868

A summary of the District future maturities on long-term debt for the next five years and thereafter as of December 31, 2015 for both principal and interest is presented below (in 000's):

		Principal		Interest
2016	$	11,005		13,513
2017		11,505		12,864
2018		12,090		12,176
2019		12,695		11,424
2020		13,280		10,675
Amounts due 2021–2025		59,425		41,171
Amounts due 2026–2030		40,500		24,137
Amounts due 2031–2035		39,305		10,412
Amounts due 2036–2040		19,985		1,211
		219,790	$	137,583
Plus amount representing net unamortized bond discounts and premiums		20,242		
	$	240,032		

UTGO bonds are secured by the irrevocable pledge of the District to levy taxes annually, without limitation as to rate or amount based on a vote of the electors, on all taxable property within the District. LTGO are secured by the irrevocable pledge of the District to levy taxes annually, within the constitutional and statutory limitations provided by law without a vote of the electors, upon property in the District, as well as the net revenue of the District for amounts that exceed that available through the levy.

In January 2015, the District refinanced $62.7 million of the 2006 LTGO bonds from an original bond amount of more than $76.9 million. The new bonds, to which Moody's Investor Service gave an Aa3 rating, will mature in December 2031. The bond closing was January 7, 2015. The difference between the reacquisition price of the new debt and the net carrying amount of the old debt resulted in a loss on refunding of approximately $3.7 million, which is accounted for as a deferred outflow of resources.

In October 2015, the District issued $54.0 million in LTGO bonds to be used to provide funds necessary to carry out capital improvements in accordance with the District's Board approved long-term master facility plan. The new bonds, to which Moody's Investor Service gave an Aa3 rating, will mature in December 2037. The bond closing was October 15, 2015.

(Continued)

Component Unit – EHM

Long-Term Debt and Capital Lease Obligations of EHM consist of the following (in 000's):

	December 31, 2015
LTGO Improvement and Refunding Bonds, 2009, payable annually through 2034, interest at 5.00% to 5.38%	$ 17,510
LTGO Bonds, 2004, payable annually through 2018, interest at 4.10% to 4.50%	1,475
Capital lease obligations, payable monthly including interest at 6.70% to 10.51%, collateralized by equipment	885
	19,870
Plus bond discounts and premiums	(232)
	19,638
Less current portion	(800)
	$ 18,838

Long-term debt and capital lease obligations 2015 activity summary of EHM are as follows (in 000's):

	January 1, 2015	Additions	Reductions	December 31, 2015	Amounts due within one year
Limited general obligation bonds:					
2009 series	$ 17,510	—	—	17,510	—
2004 series	1,885	—	410	1,475	450
Total long-term debt	19,395	—	410	18,985	450
Capital lease obligations	1,224	18	357	885	350
Total long-term debt and capital lease obligations	20,619	18	767	19,870	800
Bond discounts and premiums	(246)	—	(14)	(232)	—
Total long-term debt and capital lease obligations	$ 20,373	18	753	19,638	800

A summary of EHM's future maturities on long-term debt for the next five years and thereafter as of December 31, 2015 for both principal and interest is presented below (in 000's):

		Principal		Interest
2016	$	450		972
2017		490		952
2018		535		930
2019		585		906
2020		635		876
Amounts due 2021–2025		4,050		3,849
Amounts due 2026–2030		4,510		2,661
Amounts due 2031–2035		7,730		886
		18,985	$	12,032
Plus amount representing net unamortized bond discounts		(232)		
	$	18,753		

Capital Leases

The District acquired certain equipment under capital lease obligations. The leases are collateralized by the related equipment. Future minimum lease payments are as follows (in 000's):

		Amount
Year(s) ending December 31:		
2016	$	1,325
2017		1,359
2018		1,394
2019		1,382
2020		1,216
2021–2025		6,548
2026–2030		117
Total minimum lease payments		13,341
Less amount representing interest		(2,622)
Total capital lease payments	$	10,719

EHM acquired certain equipment under capital lease obligations. The leases are collateralized by the related equipment. Future minimum lease payments are as follows (in 000's):

		Amount
Year(s) ending December 31:		
2016	$	350
2017		366
2018		212
2019		26
Total minimum lease payments		954
Less amount representing interest		(69)
Total capital lease payments	$	885

(7) Tenant and Equipment Capital Lease Receipts

The District owns and operates the Evergreen Professional Center (EPC), the Evergreen Surgical and Physicians Center (ES&PC), and the DeYoung Pavilion, which contain approximately 97,340 total square feet of space for physician offices available for lease. As of December 31, 2015, the District had space under operating lease terms from 5 to 15 years.

Future minimum rent receipts on noncancelable operating leases are as follows:

		Amount (000's)
Year ending December 31:		
2016	$	5,422
2017		4,585
2018		4,006
2019		3,167
2020		2,278
Thereafter		6,118
	$	25,576

Rental income related to the EPC, ES&PC, and the DeYoung Pavilion leases was approximately $2.0 million in 2015, and is included in other operating revenue.

(8) Commitment and Contingencies

(a) Leases

The District leases various equipment and facilities under operating leases. Total rental expense in 2015 for all operating leases and various rental agreements was approximately $10.8 million.

The future minimum lease payments and sublease receipts under noncancelable operating leases that have initial lease terms in excess of one year are as follows:

		Payments (000's)	Receipts (000's)
Year ending December 31:			
2016	$	7,415	3,612
2017		6,722	2,802
2018		6,319	2,399
2019		5,819	1,625
2020		5,789	1,326
Thereafter		36,825	2,915
	$	68,889	14,679

(b) Insurance Coverage

The District holds professional liability insurance coverage through an independent insurance company. The insurance coverage is based on a claims-made policy. The District is self-insured for professional liability tail and expected claims payout on this coverage. The policy's self-insured retention limit is $1.0 million per claim and $3.5 million per aggregate.

The District records its actuarial estimate for professional claims liability at its best estimate of the ultimate losses and costs associated with settling claims. The professional liability expense was $2.4 million for the year ended December 31, 2015. At December 31, 2015, the estimated professional claims liability was $5.6 million.

The District is self-insured for various programs, including employee medical benefits and workers' compensation. The estimated ultimate costs of claims under these programs are accrued when the incidents occur that give rise to the claims. Accrued amounts for these programs of approximately $6.7 million at December 31, 2015 are reported as part of accrued compensation and related liabilities in the accompanying statement of net position. The accrued amounts include known liabilities of the programs and estimated incurred but not reported claims.

(c) Litigation

The District is involved in litigation arising in the ordinary 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.

(d) Compliance with Laws and Regulations

The healthcare industry is subject to numerous laws and regulations of federal, state, and local governments. These laws and regulations include, but are not limited to, matters such as licensure, accreditation, governmental healthcare program participation requirements, reimbursement for patient services, and Medicare and Medicaid fraud and abuse. Government agencies are actively conducting investigations concerning possible violations of fraud and abuse statutes and regulations by healthcare providers. Violations of these laws and regulations could result in expulsion by healthcare providers, 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 known or unasserted at this time.

(e) 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 illnesses; and natural disasters. The District maintains commercial insurance coverage designed to provide for claims arising from such matters.

(9) Retirement Plans

The District has a defined-contribution retirement plan covering substantially all eligible employees. The District makes a matching contribution of up to a maximum of 8% of the employee's eligible compensation. All contributions vest over a five-year schedule.

In addition to the retirement plan, the District maintains a voluntary employee deferred compensation program under the provision of Section 457 of the Internal Revenue Service Code. Under this program, the District employees can defer a portion of their income until withdrawn in future years. All assets are required to be held in trust for the exclusive benefit of participants and their beneficiaries. The District also contributes up to 4% of compensation as base pension depending on years of service.

Retirement plan expense incurred and reflected in employee benefits was approximately $15.2 million in 2015. Contributions made by employees to the benefit plans totaled approximately $22.4 million in 2015. Both plans are administered by the District under record-keeping and trust agreements with third parties.

The District has a postemployment benefit plan covering the executive management team. The District makes annual contributions to the SERP. The SERP is recorded under assets limited as to use and under noncurrent liabilities on the statement of net position. At December 31, 2015, the SERP balance was $1.6 million.

(10) Concentration of Credit Risk

The District grants credit without collateral to its patients, most of who are local residents and are insured under third-party payor agreements. The mix of Hospital receivables at December 31 was as follows:

	Receivables 2015
Medicare	28.4%
Other third-party payors	17.7
Medicaid	15.8
Patients self-pay	12.8
Premera	11.2
Regence	9.3
First choice	4.8
	100.0%

(11) Disclosures about Fair Value of Financial Instruments

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

Cash and Cash Equivalents – The carrying value approximates fair value because of the short maturity of those instruments.

Assets Limited as to Use – The carrying value approximates fair value of investments. The fair values are estimated based on quoted market prices for those or similar investments.

Long-Term Debt – The fair value and carrying value of its long-term debt are $246.5 million and $240.0 million as of December 31, 2015.

(12) Property Taxes

The King 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 King County assessor at 100% of 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 by the county treasurer.

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 84.55.100, limit the rate. The District may also levy taxes at a lower rate. Additional amounts of tax need to be authorized by a vote of the residents of the District.

(Continued)

For 2015, the District's regular levy request was $0.27 per $1,000 on a total assessed valuation of the property within the District of $62.0 billion for a total regular levy of $16.6 million. Excess levies totaled $8.2 million in 2015 related to debt service, mainly due to the hospital-based emergency department and patient facility, which opened in 2007.

Property taxes are recorded as receivables when levied. Since state law allows for sale of property for failure to pay taxes, no estimate of uncollectible taxes is made.

(13) Blended Component Unit

Condensed combining statements for the District and its blended component unit, the Foundation, are shown below:

Statement of Net Position – December 31, 2015 (000's)

	Combined entities	Eliminations/ reclassifications	District	Foundation
Assets:				
Current assets:				
Total current assets	$ 115,587	(1,143)	110,146	6,584
Noncurrent assets:				
Total other assets	225,924	296	222,448	3,180
Capital assets, net	302,508	—	302,508	—
Total assets	$ 644,019	(847)	635,102	9,764
Liabilities:				
Total current liabilities	$ 86,127	(847)	86,127	847
Total noncurrent liabilities	244,623	—	244,623	—
Total liabilities	330,750	(847)	330,750	847
Net position:				
Invested in capital assets, net of related debt	51,757	—	51,757	—
Restricted:				
Expendable	6,344	—	824	5,520
Nonexpendable	1,674	—	—	1,674
Unrestricted	253,494	—	251,771	1,723
Total net position	313,269	—	304,352	8,917
Total liabilities and net position	$ 644,019	(847)	635,102	9,764

	Statement of revenue, expenses, and changes in net position – year ended December 31, 2015 (000's)		
	Combined entities	**District**	**Foundation**
Revenue:			
Operating revenue:			
Net patient service revenue	$ 565,832	565,832	—
Other operating revenue	37,074	35,170	1,904
Total operating revenue	602,906	601,002	1,904
Expenses:			
Operating expenses:			
Other operating expenses	567,868	566,210	1,658
Depreciation and amortization	31,192	31,192	—
Total operating expenses	599,060	597,402	1,658
Operating income	3,846	3,600	246
Nonoperating income, net of expenses:			
Property taxes	24,825	24,825	—
Interest and amortization expense	(7,503)	(7,503)	—
Other nonoperating revenue	(128)	(176)	48
Net nonoperating income	17,194	17,146	48
Excess of revenue over expenses	21,040	20,746	294
Capital grants and contributions	212	(866)	1,078
Total change in net position	21,252	19,880	1,372
Net position, beginning of year	292,017	283,394	8,623
Net position, end of year	$ 313,269	303,274	9,995

(Continued)

KING COUNTY PUBLIC HOSPITAL DISTRICT NO. 2
(d/b/a EvergreenHealth)

Notes to Financial Statements

December 31, 2015

		Statement of cash flows – year ended December 31, 2015 (000's)		
		Combined entities	**District**	**Foundation**
Net cash provided by (used in):				
Operating activities	$	30,494	29,232	1,262
Noncapital financing activities		5,933	5,770	163
Capital and related financing activities		23,591	23,591	—
Investing activities		(62,824)	(62,831)	7
Net (decrease) increase in cash and cash equivalents		(2,806)	(4,238)	1,432
Cash and cash equivalents, beginning of year		21,483	17,186	4,297
Cash and cash equivalents, end of year	$	18,677	12,948	5,729

KPMG LLP
Suite 2900
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Seattle, WA 98101

Independent Auditors' Report 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

The Board of Commissioners
Public Hospital District No. 2,
King County, Washington
dba EvergreenHealth:

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. 2, King County, Washington, dba EvergreenHealth (the District), which comprise the statement of financial position as of December 31, 2015, and the related statements of revenue, expenses, and changes in net position and cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated April 27, 2016.

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 opinion 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 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 District'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 District's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

KPMG LLP

April 27, 2016

KPMG LLP
Suite 2900
1918 Eighth Avenue
Seattle, WA 98101

Independent Auditors' Report on Compliance for Each Major Federal Program; Report on Internal Control Over Compliance; and Report on Schedule of Expenditures of Federal Awards Required by the Uniform Guidance

The Board of Commissioners
Public Hospital District No. 2,
King County, Washington
d/b/a EvergreenHealth:

Report on Compliance for Each Major Federal Program

We have audited Public Hospital District No. 2, King County, Washington, d/b/a EvergreenHealth's (the District) compliance with the types of compliance requirements described in the *OMB Compliance Supplement* that could have a direct and material effect on each of the District's major federal programs for the year ended December 31, 2015. The District's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs.

Management's Responsibility

Management is responsible for compliance with federal statutes, regulations, and the terms and conditions of its federal awards applicable to its federal programs.

Auditors' Responsibility

Our responsibility is to express an opinion on compliance for each of the District's major federal programs based on our audit of the types of compliance requirements referred to above. We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and the audit requirements of Title 2 U.S. Code of Federal Regulations Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance). Those standards and the Uniform Guidance require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the District's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances.

We believe that our audit provides a reasonable basis for our opinion on compliance for each major federal program. However, our audit does not provide a legal determination of the District's compliance.

Opinion on Each Major Federal Program

In our opinion, Public Hospital District No. 2, King County, Washington, d/b/a EvergreenHealth complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended December 31, 2015.

Other Matters

The results of our auditing procedures disclosed an instance of noncompliance, which is required to be reported in accordance with the Uniform Guidance and which is described in the accompanying schedule of findings and questioned costs as item 2015-001. Our opinion on each major federal program is not modified with respect to this matter.

The District's response to the noncompliance finding identified in our audit is described in the accompanying schedule of findings and questioned costs. The District's response was not subjected to the auditing procedures applied in the audit of compliance and, accordingly, we express no opinion on the response.

Report on Internal Control Over Compliance

Management of the District is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered the District's internal control over compliance with the types of requirements that could have a direct and material effect on each major federal program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for each major federal program and to test and report on internal control over compliance in accordance with the Uniform Guidance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the District's internal control over compliance.

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

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses. However, we identified certain deficiencies in internal control over compliance, as described in the accompanying schedule of findings and questioned costs as items 2015-001 and 2015-002 that we consider to be significant deficiencies.

The District's responses to the findings identified in our audit are described in the accompanying schedule of findings and questioned costs. The District's responses were not subjected to the auditing procedures applied in the audit of compliance and, accordingly, we express no opinion on the responses.

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of the Uniform Guidance. Accordingly, this report is not suitable for any other purpose.

Report on Schedule of Expenditures of Federal Awards Required by the Uniform Guidance

We have audited the financial statements of the business-type activities of the District as of and for the year ended December 31, 2015, and the related notes to the financial statements, which collectively comprise the District's basic financial statements. We issued our report thereon dated April 27, 2016, which contained an unmodified opinion on those financial statements. Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise the basic financial statements. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by the Uniform Guidance and is not a required part of the basic financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements. The information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the schedule of expenditures of federal awards is fairly stated in all material respects in relation to the basic financial statements as a whole.

KPMG LLP

Seattle, Washington
September 30, 2016

PUBLIC HOSPITAL DISTRICT NO. 2
OF KING COUNTY, WASHINGTON
(d/b/a EvergreenHealth)

Federal Uniform Guidance Report

Schedule of Expenditures of Federal Awards

Year ended December 31, 2015

Federal CFDA, grant, or contract number	**Federal grantor/pass-through grantor/program title**	**2015 Federal expenditures**
	Aging Cluster	
	U.S. Department of Health and Human Services	
	Pass through from City of Seattle, Human Services Department:	
93.044	Special Programs for the Aging Title III, Part B Grants for Supportive Services and Senior Centers	$ 25,726
	Total Aging Cluster	25,726
	Medicaid Cluster	
	U.S. Department of Health and Human Services	
	Pass through from City of Seattle, Human Services Department:	
93.778	Medical Assistance Program	924,489
	Total Medicaid Cluster	924,489
	Other Federal Awards	
	U.S. Department of Health and Human Services	
	Pass through from City of Seattle, Human Services Department:	
93.052	National Family Caregiver Support, Title III, Part E	85,247
	Pass through from King County:	
93.958	Block Grants for Community Mental Health Services	633,291
	Total Other Federal Awards	718,538
	Total Expenditures of Federal Awards	$ 1,668,753

See accompanying notes to schedule of expenditures of federal awards.

PUBLIC HOSPITAL DISTRICT NO. 2
OF KING COUNTY, WASHINGTON
(d/b/a EvergreenHealth)

Federal Uniform Guidance Report

Notes to Schedule of Expenditures of Federal Awards

Year ended December 31, 2015

(1) Basis of Presentation

The accompanying schedule of expenditures of federal awards (the Schedule) includes the federal grant activity of Public Hospital District No. 2 under programs of the federal government for the year ended December 31, 2015. The information in this Schedule is presented in accordance with the requirements of the Title 2 U.S. Code of Federal Regulations (CFR) Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit requirements for Federal Awards* (Uniform Guidance). Because the Schedule presents only a selected portion of the operations of Public Hospital District No. 2, it is not intended to and does not present the net position, changes in net position or cash flows of Public Hospital District No. 2.

(2) Summary of Significant Accounting Policies

Expenditures reported on the Schedule are reported on the accrual basis of accounting. Such expenditures are recognized as applicable, following either the cost principles contained in OMB Circular A-122, *Cost Principles for Nonprofit Organizations,* or the Uniform Guidance, wherein certain types of expenditures are not allowable or are limited as to reimbursement. Public Hospital District No. 2 has elected not to use the 10-percent de minimis indirect cost rate allowed under the Uniform Guidance.

PUBLIC HOSPITAL DISTRICT NO. 2
OF KING COUNTY, WASHINGTON
(d/b/a EvergreenHealth)

Federal Uniform Guidance Report

Schedule of Findings and Questioned Costs

Year ended December 31, 2015

(1) Summary of Auditors' Results

Financial Statements

Type of report issued on whether the financial statements were prepared in accordance with generally accepted accounting principles: **Unmodified**

(b) Internal control deficiencies over financial reporting disclosed by the audit of the financial statements:

- Material weaknesses: **None reported**
- Significant deficiencies: **None reported**

(c) Noncompliance material to the financial statements: **No**

Federal Awards

(d) Internal control deficiencies over major programs disclosed by the audit:

- Material weaknesses: **None identified**
- Significant deficiencies: **Yes**

(e) Type of report issued on compliance for major programs: **Unmodified**

(f) Audit findings that are required to be reported in accordance with 2 CFR 200.516(a): **Yes**

(g) Major Programs:

- Department of Health and Human Services – Medicaid Cluster
- Department of Health and Human Services, Block Grants for Community Mental Health – Services – 93.958

(h) Dollar threshold used to distinguish between Type A and Type B Programs $750,000

(i) Auditee qualified as a low risk auditee: **Yes**

(2) Findings Relating to the Financial Statements Reported in Accordance with *Governmental Auditing Standards*

None

(3) Federal Award Findings and Questioned Costs

Finding: 15-001

Federal Programs

Medicaid Cluster; CFDA Number 93.778

Federal Agency

Department of Health and Human Services

Award Year

January 1, 2015 to December 31, 2015

Criteria

Per the grant agreement, awardees are required to meet ratios on the monthly case management case handling staff list of 1:77 and the monthly nursing capacity/supervisor list of 1:705 for nurses and 1:8 for supervisors.

Statement of Condition

During our testing over the Medicaid Cluster, the required staffing ratios on the monthly case management case handling staff list and the monthly nursing capacity/supervisor list were not met for all of the months tested.

Questioned Costs

None

Possible Asserted Cause and Effect

The District did not have enough funding during the year to adequately staff the grant as prescribed in the grant agreement. As a result, the District did not meet the monthly case management case handling staff list and the monthly nursing capacity/supervisor list staffing ratios.

Whether the Sampling was a Statistically Valid Sample

The sample was not intended to be, and was not, a statistically valid sample.

Repeat of a Finding in the Immediately Prior Audit

A similar finding was reported in the prior year's audit as finding number 2014-001.

Recommendation

We recommend that management strengthen the District's processes and controls to help to ensure that staffing ratios as outlined in the grant agreement are being met.

Views of Responsible Officials

ECN (93.778): The ECN contract terminated as of April 30, 2016. As such, no updates were made to subsequent contracts to include adjusted staffing ratios and/or additional funding to enable expected staffing ratios to be met.

Responsible contacts:
Shahzina Karim – ECN (93.778)

Anticipated Implementation Date:
ECN (93.778) – N/A due to contract termination

Finding: 15-002

Federal Programs

Block Grants for Community Mental Health Services; CFDA Number 93.958

Federal Agency

Department of Health and Human Services

Award Year

January 1, 2015 to December 31, 2015

Criteria

Per 45 CFR part 75, recipients' amounts charged to organized research for personal services, regardless of whether treated as direct costs or allocated as indirect costs, will be based on hospital payrolls that have been approved and documented in accordance with generally accepted hospital practices.

Statement of Condition

During our testing of allowable costs, specifically payroll, we selected a sample of 80 individual payroll transactions for employees across multiple pay periods. In our testing, we found one instance of an employee's time being entered incorrectly, and two instances of an employee getting paid more hours than what they had recorded on their daily itineraries. A significant deficiency was identified and is therefore reported for this finding, however, known and likely questioned costs were less than $2,000.

Questioned Costs

Known: $87.75 (representing overpayment)

Likely: $1,386 (representing extrapolation of the error)

Possible Asserted Cause and Effect

The District does not have adequately designed controls in place to ensure the accuracy and review of amounts paid to employees based on reporting of daily itineraries. If the District does not ensure the accuracy of payroll paid with funds acquired under the federal award, the District is in violation of the applicable grant agreement.

Whether the Sampling was a Statistically Valid Sample

The sample was not intended to be, and was not, a statistically valid sample.

Repeat of a Finding in the Immediately Prior Audit

A similar finding was reported in the prior year's audit as finding number 2014-002.

Recommendation

We recommend that management strengthen the District's processes and controls to help to ensure the accuracy of payment for payroll based on daily itineraries for funds acquired under the federal award in compliance with the guidelines. As a result of findings noted in the prior year, the District has implemented new processes as of 9/30/15. The new process was implemented after the date of these findings.

Views of Responsible Officials

GRAT (93.958): Similar finding was reported in the prior year and corrective action was implemented as of September 30, 2015. The corrective action plan included implementation of several new processes and controls to enable more accurate reporting of time in the system as well as reconciliations between the EMR system and the District's payroll system. The current year findings noted above occurred prior to the corrective action implementation.

Responsible contacts:
Leah Jones – GRAT (93.958)
Anticipated Implementation Date: September 30, 2016

EvergreenHealth

EvergreenHealth 2015 A-133 Status of Prior Year Findings

Finding Number	Description of Finding	Corrective Action Plan	Responsible Contact	Anticipated Implementation Date	Fully Corrected?	If yes, when?	If no, status?
14-001	During our testing of the reporting process, we were unable to determine review was performed over the sample (4 months each) of the client data file reports (Evergreen Care Network (ECN) 93.778). This finding was noted in the prior year audit findings and our selections were from the period before the corrective action plan for the prior year audit findings was implemented. In the case of the Geriatric Regional Assessment Team (GRAT) monthly summary reports (93.958), through our testwork it was determined that the reports were submitted with incorrect data that did not agree to the supporting documentation. This GRAT finding was noted in the prior year audit findings and our selections were from the period before the corrective action plan for the prior year audit findings was implemented. Further, the required staffing ratios for ECN (93.778) were not met for three of the months tested. In addition, the ECN/Aging and Disability Services (ADS) Consult (93.778) monthly reports were not all submitted by the deadline outlined in the grant agreement.	**ECN/ADS Consult (93.778):** Since the implementation of a new EMR system in July 2014, management has provided training to clinical and support staff on how to collect client data and other information for reporting purposes. Management has developed improved processes for reviewing contract requirements and managing communication with contracting entities to ensure timely and accurate submission of monthly reports. **ECN (93.778):** Management is currently working with ADS on updating future ECN contracts to include a more accurate reflection of actual staffing ratios and/or additional funding to enable expected staffing ratios to be met.	Responsible contacts: Leah Jones – **ECN/ADS Consult (93.778)** Shahzina Karim – **ECN (93.778)**	Anticipated Implementation Date: **ECN/ADS Consult (93.778)** – 9/30/2015 **ECN (93.778)** – 10/31/2015	**GRAT/ADS** - Yes. Related current year finding occurred before the implemenation date.	**GRAT/ADS - 9/30/15**	**ECN** - The ECN contract terminated as of 4/30/16. As such, there were no updates to the contract to include adjusted staffing ratios and/or additional funding.
14-002	During our testing of allowable costs, specifically payroll, we selected a sample of 90 individual payroll transactions for employees across multiple pay periods. In our testing, we found 1 instances of an individual incorrectly reimbursed for mileage; the amount paid to the individual was less than the mileage supporting documentation they submitted, 1 instance of an employee's time being entered incorrectly, and 1 instance of an employee that was paid more hours than what they had recorded on their daily itineraries. A significant deficiency was identified and is therefore reported for this finding, however, known and likely questioned costs were less than $10,000.	**GRAT (93.958)** and ECN/ADS Consult (93.778): Since the implementation of a new EMR system in July 2014, management has implemented several new processes and controls to enable more accurate reporting of time in this system as well as reconciliation between the EMR system and the District's payroll system. **ECN (93.778)**: ECN Supervisor performs audits at the end of every pay period comparing information submitted on daily activity logs to the District's payroll system. Management will work to strengthen this control and implement a secondary control, if deemed necessary, to avoid errors and ensure updates/corrections are submitted in both systems in a timely manner.	Responsible contacts: Leah Jones – **GRAT (93.958)** Shahzina Karim – **ECN (93.778)**	Anticipated Implementation Date: **ECN/ADS Consult (93.778)** – 9/30/2015 **ECN (93.778)** – 9/30/2015	**GRAT/ADS** - Yes. Related current year finding occurred before the implemenation date.	**GRAT/ADS - 9/30/15**	**ECN** - The ECN contract was terminated as of 4/30/16.

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FY 2015 Corrective Action Plan

Finding: 15-001

Views of Responsible Officials

ECN (93.778): The ECN contract terminated as of April 30, 2016. As such, no updates were made to subsequent contracts to include adjusted staffing ratios and/or additional funding to enable expected staffing ratios to be met.

Responsible contacts:
Shahzina Karim – ECN (93.778)

Anticipated Implementation Date:
ECN (93.778) – N/A due to contract termination

Finding: 15-002

Views of Responsible Officials

GRAT (93.958): Similar finding was reported in the prior year and corrective action was implemented as of September 30, 2015. The corrective action plan included implementation of several new processes and controls to enable more accurate reporting of time in the system as well as reconciliations between the EMR system and the District's payroll system. The current year findings noted above occurred prior to the corrective action implementation.

Responsible contacts:
Leah Jones – GRAT (93.958)

Anticipated Implementation Date: September 30, 2016