Washington State Auditor's Office

Troy Kelley

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Financial Statements and Federal Single Audit Report

King County Public Hospital District No. 1

(Valley Medical Center)

For the period July 1, 2013 through June 30, 2014

Published March 30, 2015

Report No. 1013856

Washington State Auditor
Troy Kelley

March 30, 2015

Board of Commissioners and Board of Trustees
Valley Medical Center
Renton, Washington

Report on Financial Statements and Federal Single Audit

Please find attached our report on the Valley Medical Center's financial statements and compliance with federal laws and regulations.

We are issuing this report in order to provide information on the District's financial condition.

Sincerely,

Troy X. Kelley

TROY KELLEY
STATE AUDITOR
OLYMPIA, WA

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FEDERAL SUMMARY

Valley Medical Center
King County
July 1, 2013 through June 30, 2014

The results of our audit of the Valley Medical Center are summarized below in accordance with U.S. Office of Management and Budget Circular A-133.

Financial Statements

An unmodified opinion was issued on the financial statements of the business-type activities and the aggregate discretely presented component units.

Internal Control Over Financial Reporting:

- *Significant Deficiencies:* We reported no deficiencies in the design or operation of internal control over financial reporting that we consider to be significant deficiencies.
- *Material Weaknesses:* We identified no deficiencies that we consider to be material weaknesses.

We noted no instances of noncompliance that were material to the financial statements of the District.

Federal Awards

Internal Control Over Major Programs:

- *Significant Deficiencies:* We reported no deficiencies in the design or operation of internal control over major federal programs that we consider to be significant deficiencies.
- *Material Weaknesses:* We identified no deficiencies that we consider to be material weaknesses.

We issued an unmodified opinion on the District's compliance with requirements applicable to its major federal program.

We reported no findings that are required to be disclosed under section 510(a) of OMB Circular A-133.

Identification of Major Programs:

The following was a major program during the period under audit:

CFDA No.	Program Title
93.268	Immunization Cooperative Agreements

The dollar threshold used to distinguish between Type A and Type B programs, as prescribed by OMB Circular A-133, was $300,000.

The District did not qualify as a low-risk auditee under OMB Circular A-133.

STATUS OF PRIOR FEDERAL AUDIT FINDINGS

This schedule presents the status of federal findings reported in prior audit periods. The status listed below is the representation of the Valley Medical Center. The State Auditor's Office has reviewed the status as presented by the District.

Audit Period: July 1, 2012 through June 30, 2013	**Report Ref. No.:** 1011542	**Finding Ref. No.:** 1	**CFDA Number(s):** 93.268
Federal Program Name and Granting Agency: U.S. Department of Health and Human Services		**Pass-Through Agency Name:** Washington State Department of Health	

Finding Caption:
The District lacked adequate internal controls to demonstrate it verified patients were eligible to receive vaccines under the Vaccine for Children program.

Background:
The District received vaccines under the Immunization Cooperative Agreements program that totaled $766,535 in fiscal year 2013. The District is required to perform Vaccines for Children status screening to determine whether the patient qualifies under the program. Screening results must be documented at each immunization visit even if there is no change in eligibility status.

We found the District incorrectly identified whether patients were eligible under the Vaccines for Children program for 11 of the 51 patients reviewed or 22 percent. In all instances, the District identified the patients were eligible under the program; however, the patients were not Medicaid-eligible, uninsured, underinsured, American Indian or Alaskan Native.

Status of Corrective Action: (check one)

X Fully Corrected	☐ Partially Corrected	☐ No Corrective Action Taken	☐ Finding is considered no longer valid

Corrective Action Taken:
The issue related to the order of the questions within EPIC, and where the toggle answers (yes/no) were located. The order of questions within EPIC were fixed, and employees who enter such data (typically, the Medical Assistants) attended an education session via Healthstream and quiz.

INDEPENDENT AUDITOR'S 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*

Valley Medical Center
King County
July 1, 2013 through June 30, 2014

Board of Commissioners and Board of Trustees
Valley Medical Center
Renton, Washington

We have audited, 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, the financial statements of the business-type activities and the aggregate discretely presented component units of the Valley Medical Center, King County, Washington, as of and for the years ended June 30, 2014 and 2013, and the related notes to the financial statements, which collectively comprise the District's basic financial statements, and have issued our report thereon dated March 26, 2015.

INTERNAL CONTROL OVER FINANCIAL REPORTING

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

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the District'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 the District's 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. However, this report is a matter of public record and its distribution is not limited. It also serves to disseminate information to the public as a reporting tool to help citizens assess government operations.

TROY KELLEY
STATE AUDITOR
OLYMPIA, WA

March 26, 2015

INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE FOR EACH MAJOR FEDERAL PROGRAM AND ON INTERNAL CONTROL OVER COMPLIANCE IN ACCORDANCE WITH OMB CIRCULAR A-133

Valley Medical Center
King County
July 1, 2013 through June 30, 2014

Board of Commissioners and Board of Trustees
Valley Medical Center
Renton, Washington

REPORT ON COMPLIANCE FOR EACH MAJOR FEDERAL PROGRAM

We have audited the compliance of the Valley Medical Center, King County, Washington, with the types of compliance requirements described in the U.S. *Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that could have a direct and material effect on each of its major federal programs for the year ended June 30, 2014. The District's major federal programs are identified in the accompanying Federal Summary.

Management's Responsibility

Management is responsible for compliance with the requirements of laws, regulations, contracts and grants applicable to its federal programs.

Auditor's 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 OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 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. Our audit does not provide a legal determination on the District's compliance.

Opinion on Each Major Federal Program

In our opinion, the District 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 June 30, 2014.

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 in order 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 OMB Circular A-133, 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 that might be material weaknesses or significant deficiencies. We did not identify any

deficiencies in internal control over compliance that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

PURPOSE OF THIS REPORT

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 OMB Circular A-133. Accordingly, this report is not suitable for any other purpose. However, this report is a matter of public record and its distribution is not limited. It also serves to disseminate information to the public as a reporting tool to help citizens assess government operations.

TROY KELLEY
STATE AUDITOR
OLYMPIA, WA

March 26, 2015

INDEPENDENT AUDITOR'S REPORT ON FINANCIAL STATEMENTS

Valley Medical Center
King County
July 1, 2013 through June 30, 2014

Board of Commissioners and Board of Trustees
Valley Medical Center
Renton, Washington

REPORT ON THE FINANCIAL STATEMENTS

We have audited the accompanying financial statements of the business-type activities and the aggregate discretely presented component units of the Valley Medical Center, King County, Washington, as of and for the years ended June 30, 2014 and 2013, and the related notes to the financial statements, which collectively comprise the District's basic financial statements as listed on page 15.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express opinions on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial

statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the District'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 District'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 financial position of the business-type activities and the aggregate discretely presented component units of the Valley Medical Center, as of June 30, 2014 and 2013, and the changes in financial position and cash flows thereof for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 16 through 34 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.

Supplementary and Other Information

Our audits were conducted for the purpose of forming opinions on the financial statements that collectively comprise the District's basic financial statements. The accompanying Schedule of Expenditures of Federal Awards is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. This schedule 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 information is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

OTHER REPORTING REQUIRED BY GOVERNMENT AUDITING STANDARDS

In accordance with *Government Auditing Standards*, we have also issued our report dated March 26, 2015 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.

TROY KELLEY
STATE AUDITOR
OLYMPIA, WA

March 26, 2015

FINANCIAL SECTION

Valley Medical Center
King County
July 1, 2013 through June 30, 2014

REQUIRED SUPPLEMENTARY INFORMATION

BASIC FINANCIAL STATEMENTS

SUPPLEMENTARY AND OTHER INFORMATION

PUBLIC HOSPITAL DISTRICT NO. 1 OF KING COUNTY, WASHINGTON, DBA VALLEY MEDICAL CENTER
(A Component Unit of the University of Washington)

Management's Discussion and Analysis

June 30, 2014 and 2013

The following discussion and analysis provides an overview of the financial position and activities of Public Hospital District No. 1 of King County, Washington, dba Valley Medical Center (VMC), for the years ended June 30, 2014, 2013 and 2012. This discussion has been prepared by management and is designed to focus on current activities, resulting changes, and current known facts and should be read in conjunction with the financial statements and accompanying notes that follow this section.

VMC is a discretely presented component unit of the University of Washington and part of UW Medicine which includes: UW Medical Center, Harborview Medical Center (Harborview), Northwest Hospital & Medical Center (Northwest Hospital), UW Physicians Network dba UW Neighborhood Clinics (UMNC), UW Physicians (UWP), the UW School of Medicine (the School) and Airlift Northwest (Airlift).

Financial Highlights for Fiscal Year 2014

VMC recorded just under $5.0 million in net income from operations for fiscal year 2014; this is an improvement of $22.8 million from the negative net income from operations of $17.8 million in 2013. VMC improved its net position by $6.0 million to $211.9 million from $205.9 million. The improved net operating income primarily relates to Medicaid expansion; strong growth in outpatient volumes, including outpatient surgeries, ambulatory outpatient hospital visits, and primary, urgent, and specialty care visits; increased other operating revenue from outpatient and contracted pharmacies, and continued success in implementing process improvement initiatives in the areas of revenue cycle, supply chain, and resource utilization. These areas were offset by lower admissions and lower growth in inpatient surgical volumes.

(in thousands)		2014	2013	2012
Total operating revenues	$	470,732	443,609	428,574
Total operating expenses		465,741	461,435	437,252
Operating income (loss)		4,991	(17,826)	(8,678)
Revenue from taxation		16,342	16,253	17,818
Interest income		3,165	4,009	3,900
Interest and amortization expense		(18,053)	(17,905)	(17,782)
Investment loss		(137)	(1,059)	905
Other, net		(273)	(421)	(1,370)
Nonoperating income (expense)		1,044	877	3,471
Increase (decrease) in net position		6,035	(16,949)	(5,207)
Net position, beginning of year		205,858	222,807	228,014
Net position, end of year	$	211,893	205,858	222,807

- During fiscal year 2014, the Washington state Medicaid program was expanded which significantly increase the number of Medicaid enrollees receiving benefits. With the increase of eligible Medicaid enrollees, VMC has seen a decline in the number of charity care applicants as these applicants now are eligible for Medicaid.
- VMC experienced significant growth in outpatient volumes, particularly in the primary, urgent, and specialty care clinics, and the Covington medical building was opened in September 2013.
- VMC is continuing to invest in information technology
- VMC management implemented cost saving initiatives through the process improvement program focusing on the purchasing standardization of high dollar medical supplies and equipment.
- New retirement and health benefit plans were implemented for certain employee groups during FY14, resulting in reductions in overall benefit expense between fiscal 2014 and 2013.

Factor Affecting the Future

UW Medicine Strategic Planning

Strategic Collaborations

In September 2013, UW Medicine signed a strategic collaboration with PeaceHealth for UW Medicine to serve as PeaceHealth's complex tertiary and quaternary health system for specialty care not available in the community. The agreement will also allow both organizations to work together to continue to improving the quality, safety and cost-effectiveness of care. The two organizations will remain legally independent and there is no change in the governance or mission of either organization.

In March 2014, UW Medicine and Capital Medical Center (Olympia, WA) signed an agreement selecting UW Medicine as the healthcare system of choice for complex tertiary and quaternary care for Capital Medical Center patients. This strategic collaboration, effective April 1, will provide Capital Medical Center patients prompt access to the highest level of care for advanced services while allowing the organizations to work together to continue improving the quality, safety and cost-effectiveness of care in the South Sound.

UW Medicine Accountable Care Network

In 2014, UW Medicine formed an accountable care network (ACN) with certain other health care organizations and healthcare professionals in Western Washington to work together to assume responsibility for the healthcare of particular populations of patients to achieve the Triple Aim: improved healthcare experience for the individual, improved health of the population, and more affordable care. The UW Medicine Accountable Care Network will focus on keeping people healthy and out of the hospital by employing evidence-based preventive measures to identify and treat underlying health problems early before they become chronic conditions. The UW and its Network members entered into agreements to provide health care services to employees of The Boeing Company beginning in January 2015. The arrangement provides an opportunity for shared savings between the ACN and Boeing based on achieving quality and financial benchmarks. If certain financial benchmarks are not

attained, UW Medicine, along with contractually agreed upon risk sharing payments from its Network members, will pay Boeing based on the agreement.

UW Medicine Patients Are First

UW Medicine is committed to its mission of improving the health of the public. Patients Are First was launched across UW Medicine as the organizational framework for delivering consistent quality and service excellence to every patient, every time. Through Patients Are First, UW Medicine creates better leaders, refines metrics to support systems of accountability, and provides employees and physicians with the tools, tactics, and reports to achieve its strategic outcomes. UW Medicine relies on the following four "pillars" as the foundation for building its Patients Are First culture:

- Focus on Serving the Patient & Family: serve all patients and family members with compassion, respect, and excellence
- Provide the Highest Quality Care: provide the highest quality, safest and most effective care to every patient, every time
- Become the Employer of Choice: recruit and retain a competent, professional workforce focused on serving our patients and their families
- Practice Fiscal Responsibility: ensure effective financial planning and the economic performance necessary to invest in strategies that improve the health of our patients

Each pillar has several measurable core goals that, when cascaded throughout the entire health system and teamed with other evidence-based leadership tactics, hardwire commitment to Patients Are First.

UW Medicine engaged a national expert consultant group, Studer Group, LLC, in 2010 to implement its evidence-based leadership program that improves service, satisfaction, quality, and safety while reducing costs. The current contract with Studer Group runs through fiscal year 2016.

Using the Financial Statements

VMC's financial statements consist of three statements: statements of net position; statements of revenues, expenses, and changes in net position; and statements of cash flows. These financial statements and related notes provide information about the activities of VMC, including resources held by VMC but restricted for specific purposes by contributors, grantors, or enabling legislation.

The statements of net position includes all of VMC's assets and liabilities, using the accrual basis of accounting, as well as an indication about which assets can be used for general purposes and which are designated for a specific purpose. The statements of net position also include deferred inflows and outflows of resources as required by the adoption of GASB Statement No. 65 as well as information to help compute the rate of return on investments, evaluate the capital structure of VMC, and assess the liquidity and financial flexibility of VMC.

The statements of revenues, expenses, and changes in net position reports all of the revenues and expenses during the time period indicated. Net position, the difference between the sum of assets and the sum of liabilities and deferred inflows and outflows — net position is one way to measure the financial health of VMC and whether the organization has been able to recover all its costs through net patient service revenues and other revenue sources.

The statements of cash flows reports the cash provided by VMC's operating activities, as well as other cash sources such as investment income and cash payments for capital additions and improvements. These statements provide meaningful information on where VMC's cash was generated and what it was used for.

As defined by generally accepted accounting principles (GAAP), VMC presents financial statements for its primary government as well as for its discretely presented component unit, Imaging Partners at Valley (IPV), which is a legally separate organization for which VMC is financially accountable. The analysis presented below excludes the financial position and results of operations of IPV, unless otherwise noted.

Financial Health

Statement of Net Position

The table below is a presentation of certain condensed financial information derived from VMC's statement of net position for the fiscal years ended June 30, 2014, 2013 and 2012. As part of the affiliation with the University of Washington Medicine (UWM), VMC changed its fiscal year to June 30, effective as of June 30, 2012.

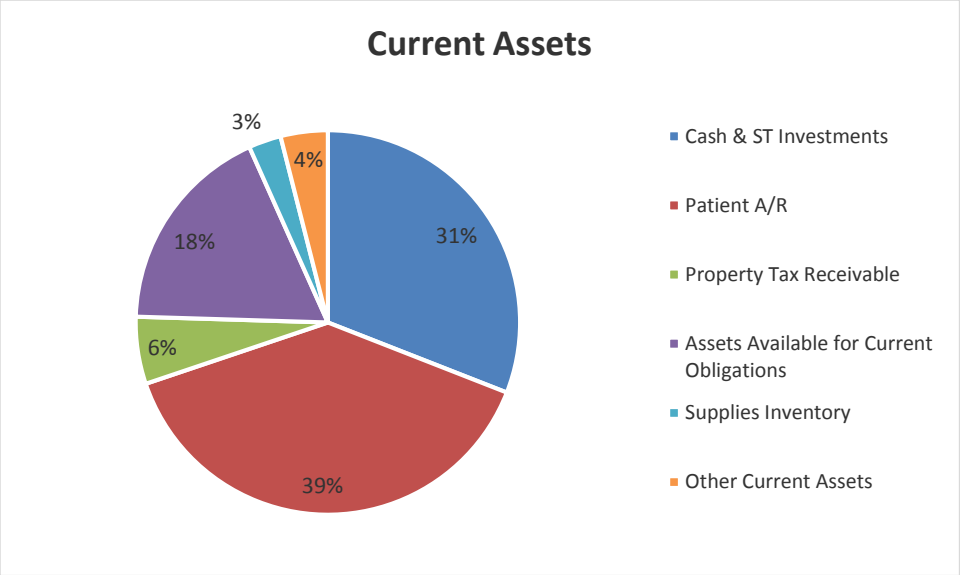
		2014	2013	2012
			(in thousands)	
Current assets	$	149,360	143,293	160,830
Noncurrent assets:				
Capital assets, net		366,830	386,179	385,610
Noncurrent assets		75,072	46,501	62,795
Long-term investments		18,393	31,264	24,178
Other		4,626	4,415	5,229
Total assets		614,281	611,652	638,642
Current liabilities		74,443	70,964	72,998
Noncurrent liabilities		319,360	326,807	334,444
Total liabilities		393,803	397,771	407,442
Total deferred inflows		8,585	8,023	8,393
Net position	$	211,893	205,858	222,807

Total assets were $614.3 million at June 30, 2014 compared to $611.7 million at June 30, 2013, an increase of $2.9 million. Significant events within total assets during fiscal year 2014 included the completion and opening

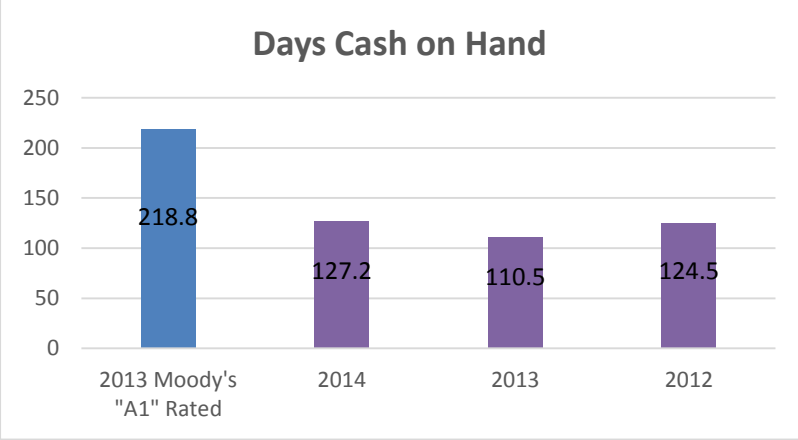
of the Covington Medical Building and completion of the build-out of the 6th and 7th floors of the Emergency Services Tower. Total assets decreased $30.4 million in fiscal year 2013 from fiscal year 2012 primarily due to the disposal of assets related to the South Tower renovation and the replacement of several computer systems with the new electronic medical health system.

Current Assets

Current Assets consist of cash and cash equivalents, and other current assets that are expected to be converted to cash within a year. Current assets also include net patient accounts receivable valued at the estimated net realizable amount due from patients and insurers. Total current assets were $149.4 million at fiscal year-end 2014, compared to $143.3 million at year-end 2013. Fiscal year 2014 composition of current assets is illustrated in the pie chart below.



Cash and short-term investments represent cash and short-term investments held by VMC. The short-term investments consist of cash and cash equivalents. Cash and short-term investments increased $3.3 million in 2014 from $43.3 million at June 30, 2013 to $46.6 million at June 30, 2014. The increase in 2014 was attributed to less capital spending and improved operating performance. Cash and short-term investments were essentially comparable at $43.3 million and $43.4 million at June 30, 2013 and 2012, respectively. Days cash on hand is utilized to evaluate an organization's continuing ability to meet its short-term operating needs. Days cash on hand, including short and long-term investments and board designated assets for general capital improvements and operations, as of June 30 for fiscal years 2014, 2013 and 2012 are illustrated in the graph below.

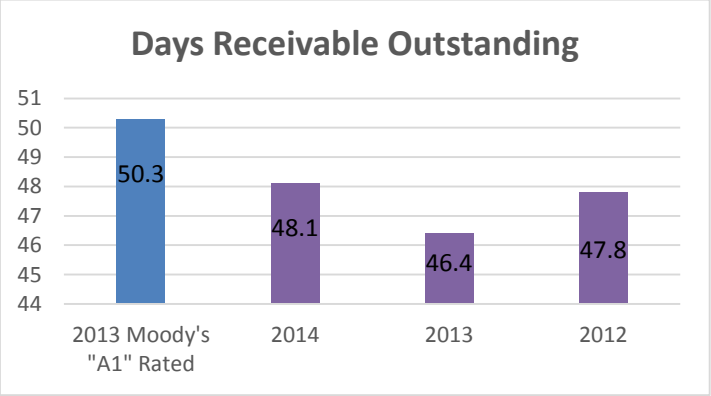


VMC's total days cash on hand, including short and long-term investments and board designated assets for general capital improvements and operations, increased 26 days from 111 days at June 30, 2013 to 127 days at June 30, 2014 and decreased 14 days from 125 days at June 30, 2012 to 111 days at June 30, 2013. The increase in 2014 was primarily due to less capital spending and overall performance improvements that reduced operating expenses. The decrease in days cash on hand at June 30, 2013 was primarily due to planned funding of major capital projects including an electronic health record system and the 6th and 7th floors Emergency Services Tower expansion, as well as declining operating performance in fiscal year 2014.

Net patient accounts receivable was $58.1 million as of June 30, 2014, compared to $52.9 million at June 30, 2013. The increase of $5.2 million was driven by growth in revenue and industry trends regarding payer strategy for cost containment and contract management.

Net patient accounts receivable was comparable at June 30, 2013 and 2012 with amounts of $52.9 million and $53.1 million, respectively.

Days receivable outstanding illustrates an organization's ability to convert service revenue to cash. Days receivable outstanding as of June 30 for fiscal years 2014, 2013 and 2012 are illustrated in the graph below.



VMC's total net days receivable outstanding increased 1.7 days from 46.4 days at June 30, 2013 to 48.1 days at June 30, 2014, and decreased 1.4 days from 47.8 days at June 30, 2012 to 46.4 days at June 30, 2013. The slight increase between 2013 and 2014 was attributed to changes in payer mix related to the implementation of healthcare reform. The slight decrease between 2012 and 2013 was attributed primarily to the implementation of the new electronic health record system.

As of June 30, 2014 and 2013, 46% and 45% of the net patient accounts receivable balance is due from commercial payers, 48% and 39% is due from governmental payers Medicare and Medicaid, and 6% and 16% from self-pay patients. On January 1, 2014, the Washington state Medicaid program was expanded which significantly increased the number of eligible Medicaid enrollees receiving benefits. Due to expansion of the Medicaid program, VMC has seen an increase in Medicaid gross patient accounts receivable and a decrease in self-pay gross accounts receivable at June 30, 2014, when compared to the previous fiscal year.

Property tax receivable increased $0.4 million from $8.0 million at June 30, 2013 to $8.4 million at June 30, 2014 and is reflective of a less pro-rationed property tax levy for calendar year 2014. In 2013, property tax receivable decreased $0.5 million as a result of a lower property tax levy calendar for 2013.

Restricted unspent bond proceeds represent proceeds from bond issuances that have not been expended. Bond issuances are restricted to a specific purpose as outlined in the associated public offering statement. Until expenditures have been incurred related to the defined purpose funds are required to be held by a trustee in limited risk investments. All bond proceeds were completely expended on the completion of the 6th and 7th floors of the Emergency Services tower, the electronic health record system, and other infrastructure projects in 2013.

Noncurrent assets available for current obligations represents board designated and externally restricted funds expected to be used within one year for debt and interest obligations. Assets available for current obligations increased $0.1 million from $26.5 million at June 30, 2013 to $26.6 million at June 30, 2014. The increase in 2014 is a result of debt payments per the amortization schedule. Assets available for current obligations decreased $6.5 million in 2013 due to debt payments per the amortization schedule.

Supplies inventory was comparable between years, as the balance was $4.1 million at June 30, 2014, compared to $4.2 million at June 30, 2013 and $4.2 million at June 30, 2012.

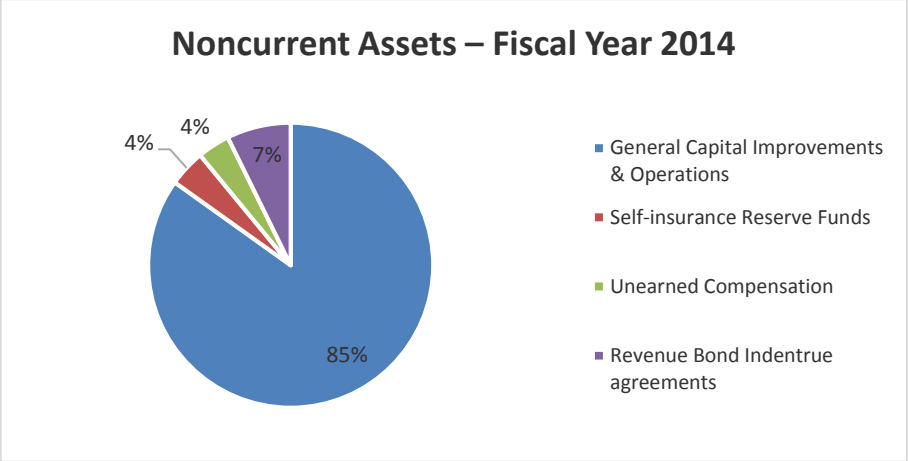
Prepaid expenses and other assets consist of amounts primarily related to prepaid dues, licenses, insurance, and maintenance contracts. Prepaid expenses and other assets decreased $1.3 from $7.0 million at June 30, 2013 to $5.7 million at June 30, 2014. The decrease is attributable to the timing of maintenance and other prepaid renewal dates, as well as fewer maintenance agreements. During fiscal year 2013, prepaid expenses and other assets decreased $2.3 million primarily due to the reduction in information technology maintenance agreements as a single medical electronic health record was implemented.

Noncurrent Assets

Capital assets decreased $19.4 million during fiscal year 2014 from $386.2 million at June 30, 2013 to $366.8 million at June 30, 2014 and $0.6 million during fiscal year 2013 from $385.6 million at June 30, 2012 to $386.2 million at June 30, 2013. In fiscal year 2014, the increase was a direct result of the opening and capitalization of the Covington medical building. In fiscal year 2013, the information system electronic health record was placed into service resulting in a shift from construction in progress to depreciable capital assets. The table below illustrates capital spend and commitment activity by major project category for the fiscal year-ended June 30, 2014.

Additional discussion regarding capital asset activity during the fiscal years can be found in the notes to the financial statements.

Noncurrent assets consist of board-designated and externally restricted assets held by VMC for general capital improvements and other operations, self-insurance reserves, and unearned compensation arrangements, and various revenue obligation bond agreements.



Total noncurrent assets increased $28.6 million from $46.5 million at June 30, 2013 to $75.1 million at June 30, 2014. The increase in 2014 is related to increased unrestricted assets and investments to be utilized for general capital improvements and operations.

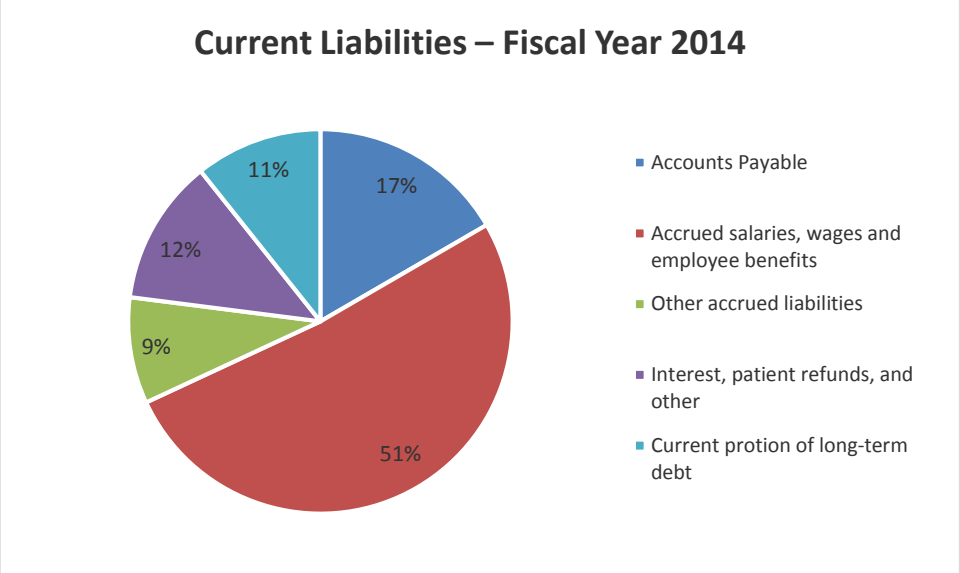
Total noncurrent assets decreased $16.3 million during fiscal years 2013. The majority of the decrease is related to the $15.2 million decrease in unrestricted assets for general capital improvements, as well as $8.0 million in restricted bond proceeds, both of which illustrated the continued spend specific construction and Information Technology (IT) projects (including the completion of the electronic health record) the 6th and 7th floors, and the ongoing construction of the Covington Ambulatory/Urgent Care building.

Long-term investments represent unrestricted and undesignated investments with greater than one year to maturity. Long-term investments decreased $12.9 million from $31.3 million at June 30, 2013 to $18.4 million at June 30, 2014 and $7.1 million from $24.2 million at June 30, 2012 to $31.3 million at June 30, 2013. The decrease between 2013 and 2014 is primarily a classification shift from long-term investments to short-term investments. The increase between 2012 and 2013 was a classification shift from short-term to long-term.

Other noncurrent assets consist primarily of VMC's goodwill and intangible assets related to the acquisition of two physician practices and VMC's membership interest in First Choice Health Network. Other noncurrent assets decreased $3.3 million from $7.9 million at June 30, 2013 to $4.6 million at June 30, 2014 due primarily to the adoption of GASB 65, whereby the net position was restated at July 1, 2013, as a result of a retrospective write-off of debt issuance costs that were previously recorded as an asset for approximately $3.4 million. In fiscal year 2013, other noncurrent assets decreased $0.8 million due to amortization.

Current Liabilities

Current liabilities consist of accounts payable and other accrued liabilities that are expected to be paid within a year. Total current liabilities were $74.4 million at June 30, 2014, compared to $71.0 million at June 30, 2013. Fiscal year 2014 composition of current liabilities is illustrated in the pie chart below.



Accounts payable were consistent between June 30, 2013 and June 30, 2014 at $12.4 million each year and decreased $6.9 million from $19.3 million at June 30, 2012 to $12.4 million at June 30, 2013. Changes in accounts payable are primarily driven by timing of payments to vendors. Accounts payable include amounts accrued for capital related expenditures. Included in accounts payable as of June 30, 2014 and 2013 were amounts accrued for capital related expenditures of $0.2 million and $0.9 million, respectively. The decrease in fiscal year 2013 was due to the amounts accrued for capital related expenditures of $9.0 million at June 30, 2012.

Accrued salaries, wages and employee benefits increased $3.0 million from $35.3 million at June 30, 2013 to $38.3 million at June 30, 2014 and $2.2 million from $33.1 million at June 30, 2012 to $35.3 million at June 30, 2013. Changes in accrued salaries, wages and employee benefits are primarily by timing of payments to employees.

Other accrued liabilities, including estimated third-party payer settlements increased $3.3 million from $3.4 million at June 30, 2013 to $6.7 million at June 30, 2014 primarily due to an estimated final CPE cost settlement for fiscal years 2010-2014. The increase in other accrued liabilities, including estimated third-party payer settlements was $0.2 million in fiscal year 2013.

The current portion of long-term debt was $8.0 million as of June 30, 2014 and represents upcoming debt payments on various bond issues within the next year. The current portion of long-term debt as of June 30, 2013 and 2012 was $8.2 million and $8.0 million, respectively.

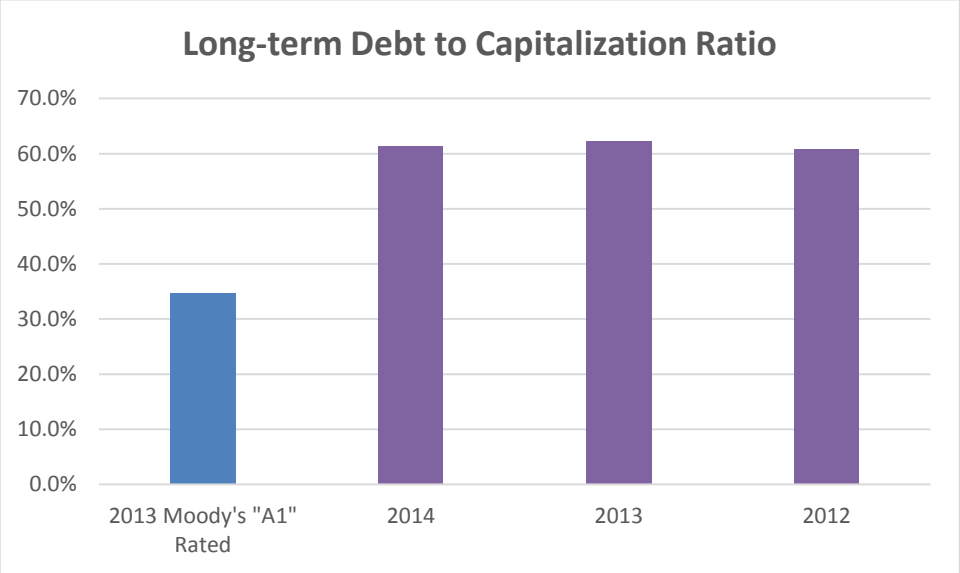
Other current liabilities consist of accrued interest relating to long-term debt, accrued taxes and retainage and accrued professional liability expense.

Noncurrent Liabilities

Noncurrent liabilities consist of long-term debt and other noncurrent liabilities. In total noncurrent liabilities were $319.4 million at June 30, 2014, compared to $326.8 million at June 30, 2013.

Long-term debt decreased $7.7 million from $323.3 million at June 30, 2013 to $315.6 million at June 30, 2014 and decreased $7.9 million from $331.2 million at June 30, 2012 to $323.3 million at June 30, 2013. Decreases in both years were a result of payments made in accordance with debt repayment schedules.

Long-term debt to capitalization is a ratio used to evaluate the capital structure of healthcare organizations. The graph above shows the long-term debt to capitalization ratio as of June 30 for 2014, 2013 and 2012 and comparison to the stand-alone hospital for Moody's A1 rated hospitals has been included in the bar chart below.



VMC's long-term debt to capitalization ratio is higher than the stand-alone hospital median due to planned debt issues to fund several significant construction and information technology initiatives, including the 6th and 7th floor Emergency Services Tower expansion, the Covington Ambulatory Clinic, and the information technology electronic medical record. Additional discussion regarding long-term debt activity during the fiscal years can be found in the notes to the financial statements.

Other noncurrent liabilities include unearned compensation arrangements with employees.

Deferred Inflow of Resources for Property Taxes

Deferred inflow of resources for property taxes increased $0.6 million at June 30, 2014 to $8.6 million compared to $8.0 million at June 30, 2013. Deferred inflow of resources for property taxes decreased $0.4 million at June 30, 2013 to $8.0 million compared to $8.4 million at June 30, 2012. The increase between June 30, 2013 and June 30, 2014 was due to a lower statutory pro-rationing impact on the District's actual tax levy for calendar year 2014 than in 2013.

Net Position

VMC reports its net position in three categories (VMC does not have assets meeting the criteria of the fourth category, donor-restricted nonexpendable net position):

Net investment in capital assets – Total investment in VMC property, plant, and equipment net of accumulated depreciation and outstanding debt obligations related to those capital assets

Restricted for debt service and expendable – Resources VMC 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 asset

Unrestricted – All other funds available to VMC for the general obligations to meet current expenses for any purpose

As of June 30, 2014, total net position was $211.9 million compared to $205.9 million at June 30, 2013.

Statements of Revenues, Expenses, and Changes in Net Position

VMC reported an operating income of $5.0 million and an increase in net position of $6.0 million and for the year ended June 30, 2014. VMC reported operating losses of $17.8 million and $8.7 million and a decrease in net position of $16.9 million and $5.2 million for the years ended June 30, 2013 and 2012, respectively.

	2014	2013	2012
		(in thousands)	
Total operating revenues	$ 470,732	443,609	428,574
Total operating expenses	465,741	461,435	437,252
Operating income (loss)	4,991	(17,826)	(8,678)
Revenue from taxation	16,342	16,253	17,818
Interest income	3,165	4,009	3,900
Interest and amortization expense	(18,053)	(17,905)	(17,782)
Investment loss	(137)	(1,059)	905
Other, net	(273)	(421)	(1,370)
Nonoperating income (expense)	1,044	877	3,471
Increase (decrease) in net position	6,035	(16,949)	(5,207)
Net position, beginning of year	205,858	222,807	228,014
Net position, end of year	$ 211,893	205,858	222,807

Contributing factors for the improved performance in fiscal year 2014 included the following

- Increase in outpatient surgeries
- Increases in primary, urgent, and specialty care volumes.
- Decreased average length of stay despite increases in case acuity.

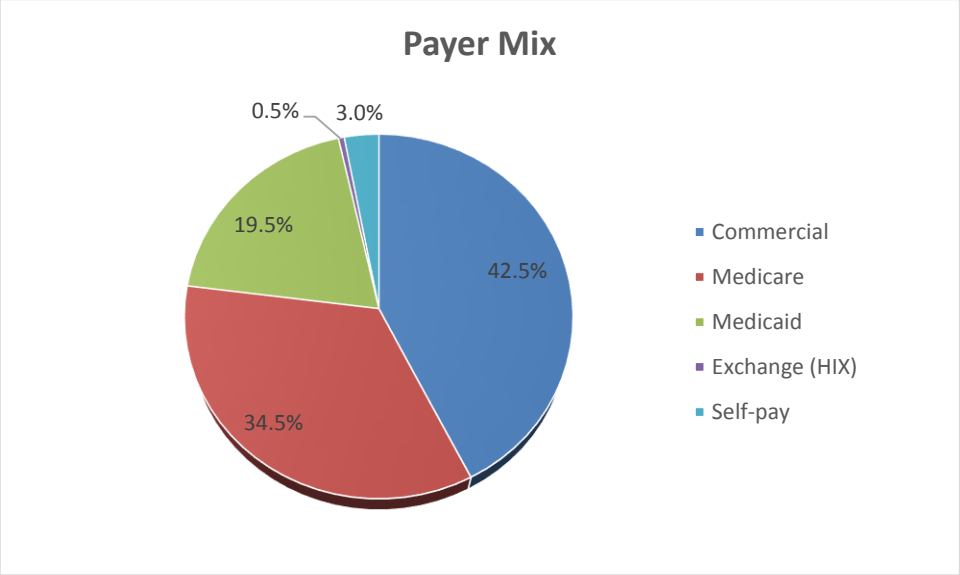
- Lower operating expenses as management focused on cost reduction, such as modifications to the health and retirement plans for certain employee groups. Also in 2013, expenses were higher due to the implementation of electronic health record information technology.

	2014	2013	2012
Available beds	270	270	270
Discharges	16,693	17,477	16,842
Patient days	61,395	65,769	63,001
Average length of stay	3.70	3.80	3.70
Occupancy	62%	67%	66%
Case mix index (CMI)	1.40	1.33	1.30
Surgery cases	11,270	11,171	11,444
Emergency room visits	73,763	74,202	75,586
Primary care clinic visits	154,546	152,594	154,350
Specialty/Urgent care clinic visits	248,623	209,680	190,597
Full time equivalents (FTEs)	2,421	2,456	2,445
Births	3,935	4,356	3,964

Total Operating Revenues

Total operating revenues consists primarily of net patient service revenue and other operating revenues. Net patient service revenues are recorded based on standard billing rates less contractual adjustments, charity, and an allowance for uncollectible accounts. VMC has agreements with federal and state agencies, and commercial insurers that provide for payments at amounts different from gross charges. The differences between gross charges and contracted payments are identified as contractual adjustments. VMC, as well as its component unit, provide care at no charge or reduced charges to patients who qualify under VMC's charity policy. VMC also estimates the amount of patient responsibility accounts receivable that will become uncollectible which is reported as a reduction of operating revenues. The difference between gross charges and the estimated net realizable amounts from payers and patients is recorded as an adjustment to charges. The resulting net patient service revenue is shown in the statements of revenues, expenses, and changes in net position.

Net patient revenue comprises inpatient and outpatient revenue. Outpatient revenue consists of both hospital-based and clinic network revenue. Other operating revenue comprises hospital-related revenues such as the pharmacies and the cafeteria.



VMC's payer mix is a key factor in the overall financial operating results. The chart above illustrates payer mix for 2014. For the year ended June 30, 2014 and 2013, Medicaid revenue represented 20% and 18%, respectively. This increase in Medicaid revenue is a direct result of the expansion of the Medicaid program in Washington State as part of the Affordable Care Act. Due to Medicaid expansion, patients who were previously self-pay now qualify for Medicaid coverage, thus there is a decrease in the number of applicants for charity care and a decrease in the cost of charity care provided.

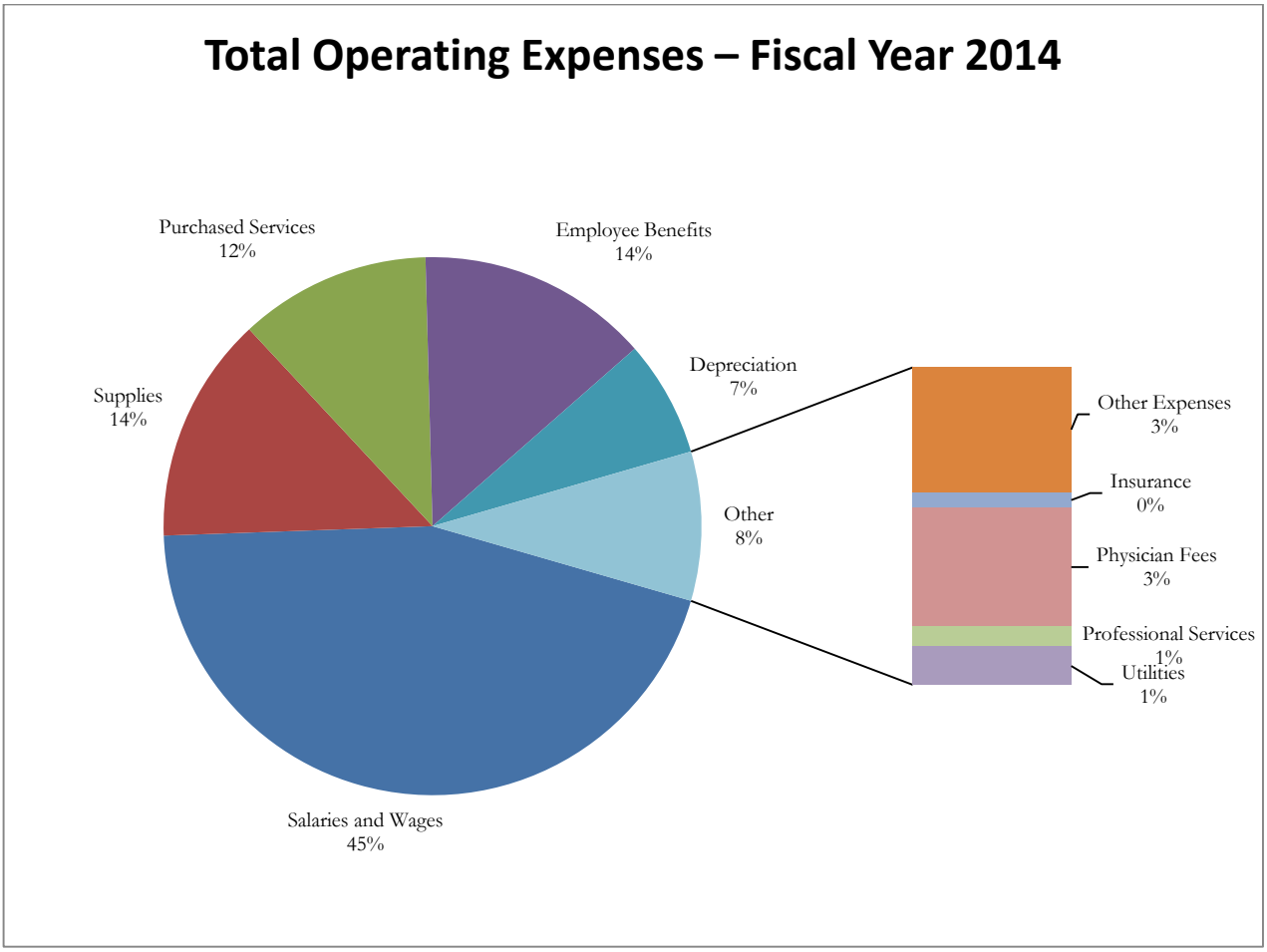
Reimbursement from governmental payers is generally below commercial rates and reimbursement rules are complex and subject to both interpretation and settlements. With the expansion of Medicaid, VMC will have higher government revenues which are subject to settlements. For the years ended June 30, 2014, 2013, and 2012, VMC's total operating revenues were $470.7 million, $443.6 million, and $428.6 million composed of $440.7 million, $416.3 million, and $405.6 million in net patient service revenues and $30.0 million, $27.3 million, and $23.0 million in other operating revenue, respectively.

In 2014, the increase in operating revenue is due primarily to growth in outpatient volumes across the clinic network (primary, specialty, and urgent care), as well as outpatient surgical procedures. The increase in other operating revenue is attributed to increases in the radiology imaging service line, and in outpatient and contract pharmaceutical volumes.

In 2013, the increase in operating revenues is due to increases in inpatient volumes and the increases within other operating revenue are primarily related to the opening of several new pharmacy locations, as well as a Medicaid electronic health record incentive payment.

Total Operating Expenses

Total operating expenses were just over $465.7 million for the year ended June 30, 2014 compared to $461.4 million for the year ended June 30, 2013. The composition of fiscal year 2014 operating expenses is illustrated in the pie chart below.



Salaries and wages increased $5.8 million from $203.6 million in fiscal year 2013 to $209.4 million in fiscal year 2014. The increase were primarily related to contractually agreed upon wage increases; the clinic network's expansion of services in primary, urgent and specialty care, and growth in certain hospital outpatient departments.

Salaries and wages increased $9.3 million from $194.3 million in fiscal year 2012 to $203.6 million in fiscal year 2013. The increase were primarily related to contract labor in information technology due to the EPIC electronic health record implementation; the clinic network's expansion of services in urgent care, oncology, women's healthcare/obstetrics and gynecology; the opening of several outpatient pharmacies, and in general medical/surgical units due to volume increases.

Employee benefits decreased $3.0 million from $68.0 million in fiscal year 2013 to $65.0 million in fiscal year 2014 and increased $7.4 million from $60.6 million in fiscal year 2012 to $68.0 million in fiscal year 2013. Employee benefit costs are a function of employment. In fiscal year 2014, the decrease was related to both a restructure of healthcare benefits for certain employee groups, as well as the restructure of retirement benefits through the termination of the pension plan and modification to the 403B retirement plan. In fiscal year 2013, much of the increase in employee benefits was related to healthcare benefit expense. Other increases in expense between fiscal years 2014, 2013 and 2012 were consistent with increased salaries and wages expense.

Purchased services expense, which consists of professional and consulting fees, decreased $4.6 million from $76.5 million in fiscal year 2013 to $71.9 million in fiscal year 2014 and increased $11.4 million from $65.1 million in fiscal year 2012 to $76.5 million in fiscal year 2013. The decrease in purchased service expense between fiscal year 2014 and 2013 is primarily attributable to consulting fees incurred in the first part of fiscal year 2013 related to the completion of the electronic health record implementation. The increase in fiscal year 2012 and 2013 is related to consulting and IT fees incurred as part of the electronic health record implementation, which was occurring throughout most of 2013.

Supplies and other expense include medical and surgical supplies, pharmaceutical supplies, insurance, taxes, and other expenses. In total, these expenses increased $6.0 million from $80.9 million in fiscal year 2013 to $86.9 million in fiscal year 2014. The increase is primarily related to noncapitalizable expenses incurred as part of the Covington medical building project. In 2013, supplies and other expense increased $4.4 million from $76.5 million to $80.9 million as medical supplies expense increased as a result of price inflation and the opening of several new outpatient pharmacies, Pharmaceutical expense also increased.

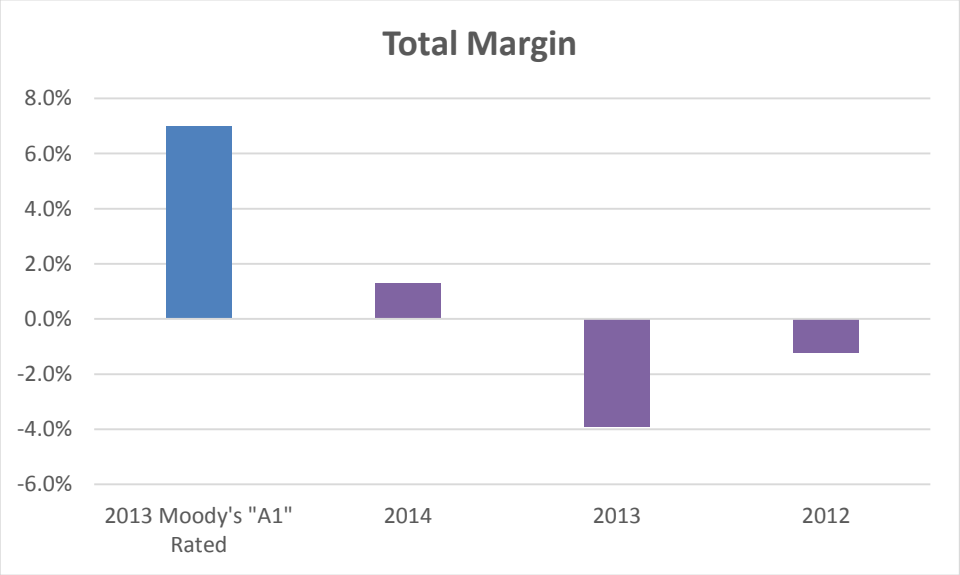
Depreciation expense increased $0.1 million from $32.4 million in fiscal year 2013 to $32.5 million in fiscal year 2014 and decreased $0.1 million from $32.5 million in fiscal year 2012 to $32.4 million in fiscal year 2013.

Nonoperating Revenue (Expense)

Net nonoperating income consists of revenue from property taxes and interest and investment income offset by interest and amortization expense and other activities not directly related to patient care. Net nonoperating revenue increased $0.1 million between fiscal years 2014 and 2013, due primarily to a small increase in revenue from taxation (as the pro-rationed amount of the tax levy was less than in fiscal year 2013). Net nonoperating revenue decreased $2.6 million between fiscal years 2013 and 2012, which was primarily driven by a statutorily require $1.5 million reduction in property tax revenue and a decrease in investment income which includes unrealized losses in the fair market value of investments.

Total Margin

Total margin or excess margin is a ratio that defines the percentage of total revenue that has been realized in the form of net income and is a common measure of total hospital profitability. Total margin for the fiscal years 2014, 2013 and 2012 compared to the industry median for Moody's A1 rated stand-alone hospitals is illustrated in the bar chart below.



Regulatory, Legislative, and Accounting Changes

The following regulatory and legislative activity will impact all entities in UW Medicine during fiscal year 2014 and beyond:

- ***International Classification of Diseases v10 (ICD-10)*** – Code of Federal Regulations (45 CFR Part 162) requires healthcare providers to implement ICD-10 no later than October 1, 2015. The implementation date has been delayed from October 1, 2014. ICD-10 represents a significant change in the standard healthcare coding system and will impact every system, process and transaction that contains or uses a diagnosis code or inpatient procedure code.

  UW Medicine has been undertaking activities related to the implementation of ICD-10 since the beginning of fiscal year 2012.

- ***Medicare Sequestration*** – On April 1, 2013, a provision of the Budget Control Act of 2011 requiring mandatory across-the-board reductions in Federal spending commenced (commonly referred to as sequestration). The provision included a 2% reduction to Medicare payments made to healthcare providers, including payments made under the meaningful use incentive program. The payment reduction is effective until 2023.

- ***WA Medicaid IP & OP Payment System Rebasing*** – The Washington Healthcare Authority (HCA) uses the Outpatient Prospective Payment System (OPPS) and All Patient Diagnosis Related Group (AP-DRG) methodologies for reimbursing outpatient and inpatient Medicaid claims, respectively. In 2013, HCA began a project to implement new payment systems for outpatient and inpatient claims which was implemented on July 1, 2014. Under the project, outpatient reimbursement will transition to Enhanced Ambulatory Payment Groups (EAPG) methodology and inpatient reimbursement will transition to All Patient Refined Diagnosis Related Group (APR-DRG) methodology. The EAPG method is a visit-based patient classification system that directs payment to the main significant procedure or treatment provided during a visit, instead of "a la carte" volume-based purchasing and uses packaging and bundling of payment for related services to create incentives to provide services in the most efficient way. The APR-DRG will ensure the state is compliant with ICD-10 requirements, is more granular than AP-DRG and will increase the number of acuity-driven groupings for payment purposes.

- ***Medicaid Expansion***– On January 1, 2014, the Washington state Medicaid program was expanded which significantly increase the number of Medicaid enrollees receiving benefits. Due to the increased access to Medicaid coverage, VMC is experiencing a reduction in uninsured and underinsured patients and an increase in patients that qualify for Medicaid. The reduction of uninsured and underinsured patients is expected to have an impact on Medicare and Medicaid Disproportionate Share (DSH) reimbursement methodologies in the future. VMC has experienced a change to their payer mix, which is expected to continue in 2015.

- ***Pay for Performance*** – The Affordable Care Act mandated programs that affect reimbursement through evaluation of the quality of care and cost of care provided to patients at the federal level, however, there are an increasing number of programs arising from state and private interests. These programs provide incentives (and/or penalties) for reporting performance data and those that provide incentives (and/or penalties) based on benchmarking performance data against other providers regionally and nationally. The pay for performance programs will continue into the future and UW Medicine is examining performance to attain incentive dollars.

PUBLIC HOSPITAL DISTRICT NO. 1 OF KING COUNTY, WASHINGTON, DBA VALLEY MEDICAL CENTER
(A Component Unit of the University of Washington)

Statements of Net Position

June 30, 2014 and 2013

Assets	VMC 2014	VMC 2013	Component unit – IPV 2014	Component unit – IPV 2013
Current assets:				
Cash and cash equivalents	$ 36,110,782	22,557,276	1,139,702	1,108,028
Short-term investments	10,103,735	20,724,208	—	—
Accounts receivable, less allowance for uncollectible accounts	58,085,753	52,914,600	120,902	302,219
Property tax receivable	8,438,871	8,028,709	—	—
Due from:				
Primary government	—	—	541,942	1,836,989
Component Unit	204,046	1,420,241	—	—
Noncurrent assets, required for current obligations	26,617,953	26,476,410	—	—
Supplies inventory	4,082,983	4,224,793	—	—
Prepaid expenses and other assets	5,716,209	6,946,482	43,067	55,647
Total current assets	149,360,332	143,292,719	1,845,613	3,302,883
Long-term investments	18,392,495	31,264,465	—	—
Other noncurrent assets:				
Unrestricted for general capital improvements and operations	86,310,653	55,298,974	—	—
Restricted for self-insurance reserve funds	4,230,744	6,686,547	—	—
Restricted under unearned compensation arrangements	3,748,959	3,613,518	—	—
Restricted under revenue bond indenture agreements	7,399,654	7,378,745	—	—
	101,690,010	72,977,784	—	—
Less amounts required for current obligations	(26,617,953)	(26,476,410)	—	—
Total other noncurrent assets	75,072,057	46,501,374	—	—
Capital assets:				
Land	13,299,497	13,299,497	—	—
Construction in progress	11,289,947	33,062,351	—	—
Depreciable capital assets, net of accumulated depreciation	342,240,606	339,817,116	2,284,253	1,524,892
Total capital assets	366,830,050	386,178,964	2,284,253	1,524,892
Goodwill, intangible assets and other	4,625,737	4,414,454	—	—
Total assets	$ 614,280,671	611,651,976	4,129,866	4,827,775

PUBLIC HOSPITAL DISTRICT NO. 1 OF KING COUNTY,
WASHINGTON, DBA VALLEY MEDICAL CENTER
(A Component Unit of the University of Washington)

Statements of Net Position

June 30, 2014 and 2013

Liabilities and Net Position	VMC 2014	VMC 2013	Component unit – IPV 2014	Component unit – IPV 2013
Current liabilities:				
Accounts payable	$ 11,839,864	10,570,098	59,652	512,790
Accrued salaries, wages and benefits	38,294,347	35,275,544	21,622	22,802
Due to:				
Primary government	—	—	204,046	1,420,241
Component Unit	541,942	1,836,989	—	—
Other accrued liabilities, including estimated third-party payor settlements	6,659,545	3,448,968	—	—
Interest, patient refunds and other	9,138,680	11,606,792	—	9,285
Current portion of long-term debt and capital lease obligations	7,968,374	8,225,472	470,966	211,806
Total current liabilities	74,442,752	70,963,863	756,286	2,176,924
Unearned compensation	3,748,959	3,525,258	—	—
Long-term debt and capital lease obligations, net of current portion	315,610,590	323,281,483	873,318	264,233
Total liabilities	393,802,301	397,770,604	1,629,604	2,441,157
Deferred inflow of resources for property taxes	8,585,293	8,023,310	—	—
Net position:				
Invested in capital assets net of related debt	43,155,954	53,946,246	939,969	1,048,853
Restricted:				
For debt service	7,399,654	7,378,745	—	—
Expendable for specific operating activities	413,843	348,374	—	—
Unrestricted	160,923,626	144,184,697	1,560,293	1,337,765
Total net position	211,893,077	205,858,062	2,500,262	2,386,618
Total liabilities and net position	$ 614,280,671	611,651,976	4,129,866	4,827,775

See accompanying notes to financial statements.

PUBLIC HOSPITAL DISTRICT NO. 1 OF KING COUNTY, WASHINGTON, DBA VALLEY MEDICAL CENTER
(A Component Unit of the University of Washington)

Statements of Revenue, Expenses, and Changes in Net Position

Years ended June 30, 2014 and 2013

	VMC		Component unit – IPV	
	2014	2013	2014	2013
Operating revenues:				
Net patient service revenue (net of provision for uncollectible accounts of $22,365,806 in 2014 and $35,924,268 in 2013)	$ 440,712,924	416,324,353	2,533,250	9,564,159
Other operating revenue	30,019,010	27,284,521	7,187,713	1,846,042
Total operating revenues	470,731,934	443,608,874	9,720,963	11,410,201
Operating expenses:				
Salaries and wages	209,411,491	203,576,730	190,184	1,940,753
Employee benefits	64,999,851	68,019,926	93,760	830,361
Purchased services	71,878,340	76,464,813	1,419,563	2,779,122
Supplies and other expenses	86,911,191	80,934,417	592,996	1,064,489
Depreciation	32,540,147	32,439,867	621,953	469,621
Total operating expenses	465,741,020	461,435,753	2,918,456	7,084,346
Operating income (loss)	4,990,914	(17,826,879)	6,802,507	4,325,855
Nonoperating income (expense):				
Property tax revenue	16,342,394	16,253,562	—	—
Interest income	3,165,356	4,009,173	—	—
Interest and amortization expense	(18,053,237)	(17,904,892)	(46,506)	(36,242)
Investment loss	(137,233)	(1,059,459)	—	—
Other, net	(273,179)	(420,944)	—	—
Members' cash distributions	—	—	(6,642,357)	(3,725,109)
Net nonoperating income (expense)	1,044,101	877,440	(6,688,863)	(3,761,351)
Increase (decrease) in net position	6,035,015	(16,949,439)	113,644	564,504
Net position, beginning of year	205,858,062	222,807,501	2,386,618	1,822,114
Net position, end of year	$ 211,893,077	205,858,062	2,500,262	2,386,618

See accompanying notes to financial statements.

PUBLIC HOSPITAL DISTRICT NO. 1 OF KING COUNTY,
WASHINGTON, DBA VALLEY MEDICAL CENTER
(A Component Unit of the University of Washington)

Statements of Cash Flows

Years ended June 30, 2014 and 2013

	VMC		Component unit – IPV	
	2014	2013	2014	2013
Cash flows from operating activities:				
Receipts from and on behalf of patients	$ 438,752,348	416,354,203	4,009,614	10,559,828
Payments to suppliers and contractors	(159,947,364)	(150,752,108)	(2,142,450)	(3,909,577)
Payments to employees	(271,168,838)	(269,124,118)	(285,124)	(2,964,224)
Other cash receipts	24,705,126	24,303,892	7,187,713	162,654
Net cash provided by operating activities	32,341,272	20,781,869	8,769,753	3,848,681
Cash flows from noncapital financing activities:				
Cash received from tax levy	16,494,215	16,336,811	—	—
Other	65,469	(10,151)	—	—
Net cash provided by noncapital financing activities	16,559,684	16,326,660	—	—
Cash flows from capital and related financing activities:				
Principal payments on long-term debt and capital lease obligations	(7,745,372)	(7,525,478)	(382,571)	(199,112)
Interest paid, net of amounts capitalized	(17,212,650)	(16,792,410)	(46,506)	(36,242)
Purchases of capital assets	(13,345,667)	(41,376,137)	(130,498)	(612,741)
Purchase of VM Oncology	(480,100)	(480,100)	—	—
Purchase of Southlake Cardiology Clinic	(960,000)	—	—	—
Other	57,922	33,624	—	—
Net cash used in capital and related financing activities	(39,685,867)	(66,140,501)	(559,575)	(848,095)
Cash flows from investing activities:				
Distributions from joint venture	6,530,079	2,284,187	—	—
Distribution to Valley Medical Center	—	—	(6,530,079)	(2,848,287)
Distribution to noncontrolling member of Imaging Partners at Valley, LLC	—	—	(1,648,425)	(407,817)
Sale of investments and noncurrent assets	46,384,117	71,706,832	—	—
Purchases of investments and noncurrent assets	(51,741,135)	(50,995,156)	—	—
Investment and interest income, net of amounts capitalized	3,165,356	4,009,173	—	—
Net cash provided by (used in) investing activities	4,338,417	27,005,036	(8,178,504)	(3,256,104)
Net increase (decrease) in cash and cash equivalents	13,553,506	(2,026,936)	31,674	(255,518)
Cash and cash equivalents, beginning of year	22,557,276	24,584,212	1,108,028	1,363,546
Cash and cash equivalents, end of year	$ 36,110,782	22,557,276	1,139,702	1,108,028

PUBLIC HOSPITAL DISTRICT NO. 1 OF KING COUNTY,
WASHINGTON, DBA VALLEY MEDICAL CENTER
(A Component Unit of the University of Washington)

Statements of Cash Flows

Years ended June 30, 2014 and 2013

	VMC		Component unit – IPV	
	2014	2013	2014	2013
Reconciliation of operating income to net cash from operating activities:				
Operating income (loss)	$ 4,990,914	(17,826,879)	6,802,507	4,325,855
Adjustments to reconcile operating income to net cash from operating activities				
Depreciation	32,540,147	32,439,867	621,953	469,622
Provision for uncollectible accounts	22,365,806	35,924,268	7,133	181,410
Income recognized from joint venture	(5,313,884)	(2,980,629)	—	—
Amount expensed from purchase of Southlake Cardiology Clinic	185,000	—	—	—
Changes in assets and liabilities				
Accounts receivable	(27,536,959)	(35,705,826)	174,184	814,259
Due from:				
Primary government	—	—	1,295,047	(1,683,388)
Component unit	—	(132,342)	—	—
Supplies inventory	141,810	21,918	—	38,582
Prepaid expenses and other assets	1,230,273	3,082,225	12,580	12,223
Accounts payable	1,027,631	(659,447)	(133,186)	(158,487)
Accrued salaries, wages, and benefits	3,018,803	2,202,979	(1,180)	(283,737)
Due to:				
Primary government	—	—	—	132,342
Component unit	(1,295,047)	1,683,388	—	—
Other accrued liabilities and estimated third-party payor settlements	3,210,577	(188,592)	—	—
Other liabilities	(2,447,500)	2,651,380	(9,285)	—
Unearned compensation	223,701	269,559	—	—
Net cash provided by operating activities	$ 32,341,272	20,781,869	8,769,753	3,848,681
Supplemental disclosure of noncash investing, capital, and financing activities:				
Increase (decrease) in capital assets included in accounts payable	$ 242,135	(7,923,268)	—	—

See accompanying notes to financial statements.

(1) Organization

Public Hospital District No. 1 of King County, Washington (the District), is a Washington municipal corporation established under Chapter 70.44 Revised Code of the State of Washington (RCW). The District includes the majority of the cities of Kent, Renton, and Covington, and portions of Bellevue, Newcastle, Maple Valley, Black Diamond, Auburn, SeaTac, Tukwila, and Federal Way. The District is considered a political subdivision of the state of Washington and is allowed, by law, to be its own treasurer.

On July 1, 2011, Public Hospital District No. 1 of King County, dba Valley Medical Center (VMC), and the University of Washington (the University) entered into a Strategic Alliance Agreement, whereby the governance of VMC was modified. VMC is managed as a discretely presented component unit of the University, subject to the oversight of a Board of Trustees.

The Board of Trustees oversees the healthcare operations of the District, while a publicly elected Board of Commissioners oversees the District's tax levies and certain nonhealthcare-related functions.

The Board of Commissioners comprises five individuals, each elected by district residents to serve a six-year term. The District itself is divided into three subdistricts, each represented by one commissioner. The remaining two commissioners serve as at-large members of the Board of Commissioners. Terms of the subdistrict commissioners are staggered.

The Board of Trustees is designed to include all of the then-current Public Hospital District Commissioners, as well as five trustees who reside within the District Service Area, at least three of whom also reside within the boundaries of the District. In addition, two current or former trustees of the UW Medicine board or a Board of another component unit within UW Medicine and the CEO of UW Medicine and dean of the School of Medicine, University of Washington or his designee also serve on the Board of Trustees. The Board of Trustees members, which included the five elected Board of Commissioners, during fiscal year 2014 were:

Lisa Jensen, Chair
Peter Evans, Vice Chair
Bernie Dochnahl
Paul Joos, M.D. (President of Board of Commissioners)
Julia Patterson
Johnese Spisso, R.N., M.P.A.
Aaron Heide, M.D. (Commissioner – resigned from Board of Trustees)
Gary Kohlwes, Ed. D.
Barbara Drennen (Commissioner – January 2014)
Anthony Hemstad (Commissioner – resigned November 2013 – resigned from Board of Trustees)
Donna Russell
Mike Miller
Carolyn Parnell (Commissioner)
Tamara Sleeter, M.D. (Commissioner – January 2014)

VMC is under the direction of the Executive Director, who is accountable to the District Board of Trustees and UW Medicine's Executive Vice-President for Medical Affairs and Dean of the University of Washington School of Medicine for the management of VMC.

The District owns and operates a district health system, VMC, which comprises a 321 licensed bed hospital and a network of primary care, specialty care and behavioral health clinics. The district health system mission statement states that it "is committed to providing access to safe, quality healthcare for the public. The District healthcare system is integrated with UW Medicine and collaborates to ensure comprehensive, high quality, safe, compassionate, and cost-effective healthcare is provided."

VMC is a discretely presented component unit of the University of Washington and part of UW Medicine which includes: UW Medical Center, Harborview Medical Center (Harborview), Northwest Hospital & Medical Center (Northwest Hospital), UW Physicians Network dba UW Neighborhood Clinics (the Clinics), UW Physicians (UWP), the UW School of Medicine (the School) and Airlift Northwest (Airlift).

Financial Reporting Entity

As defined by generally accepted accounting principles (GAAP), the financial reporting entity consists of VMC as the primary government, and its component unit, which is a legally separate organization for which the primary government is financially accountable. Financial accountability is defined as an appointment of the voting majority of the component unit's board, and either (a) the ability to impose will by the primary government, or (b) the possibility that the component unit will provide a financial benefit to or impose a financial burden on the primary government, or (c) the component unit is financially dependent on the primary government.

Component units are reported as part of the reporting entity under the blended or discrete method of presentation. Blending involves merging the component unit data with the primary government. There are two situations when blending is allowed: (1) when the board of the component unit is substantially the same as that of the primary government, and (2) when the component unit serves the primary government exclusively, or almost exclusively. VMC has no blended component units.

The discrete method presents the financial statements of the component unit outside of the basis of the financial statement totals of the primary government. The following is a description of the discrete component unit of VMC.

The Imaging Partners at Valley (IPV) is a limited liability company formed in 1999 under the laws of Washington State. IPV has two members: the District and Mustang Technology Group, LLC. IPV provides inpatient and outpatient magnetic resonance, positron emission tomography, and computed tomography imaging services to patients. IPV is considered a component unit of the District because the IPV's operating budget is subject to the overall approval of the District, even though the District does not have a voting majority on the IPV's governing board.

The primary government and the discretely presented component unit report their financial information in a form that complies with the "Healthcare Organizations Audit and Accounting Guide" of the American Institute of Certified Public Accountants. The accounting systems of the primary government and the discretely presented component unit have been adapted to also provide the financial information necessary to meet the governmental reporting requirements of the District.

Additionally, VMC is a discretely presented component unit of the University under the Strategic Alliance Agreement between the University of Washington and the District, whereby VMC is managed as a component unit of the UW Medicine, subject to the oversight of the Board of Trustees.

(2) Summary of Significant Accounting Policies

(a) Accounting Standards

The accompanying financial statements are prepared in accordance with accounting principles generally accepted in the United States of America using the accrual basis of accounting. VMC's financial statements and note disclosures are based on all applicable Government Accounting Standards Board (GASB) pronouncements and interpretations. VMC uses proprietary fund accounting.

VMC prepares and presents its financial information in accordance with GASB Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments* (GASB 34), known as the "Reporting Model" statement. GASB 34 requires that financial statements be accompanied by a narrative introduction and analytical overview of the reporting entity in the form of "management's discussion and analysis" (MD&A). This reporting model also requires the use of a direct method cash flow statement.

(b) Basis of Accounting

VMC's financial statements have been prepared using the accrual basis of accounting with the economic resources measurement focus. Under this method of accounting, revenues are recognized when earned and expenses are recorded when liabilities are incurred without regard to receipt or disbursement of cash.

(c) Use of Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles, 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 revenues and expenses during the reporting period. Actual results could differ from those estimates. Significant estimates in VMC's financial statements include patient accounts receivable allowances, third-party payer settlements, liabilities related to self-insurance programs and the fair value of investments.

(d) General Accounts

VMC is required to maintain its financial records on an accounting basis that segregates assets, liabilities, revenues, and expenses in conformity with state of Washington municipal corporation laws prescribed by the State Auditor under the authority of Chapter 43.09 RCW and the Department of Health in *Accounting and Reporting Manual for Hospitals*, as well as the Board of Commissioners' resolutions. Certain accounts maintained separately on the books of VMC have been combined for financial statements presentation.

Operating Account

The operating account is used to track current operating assets, liabilities, revenues, and expenses.

Plant and Construction Accounts

These account for land, buildings, and equipment; and the proceeds of the 2001, 2004, 2008, and 2011 limited tax general obligation bonds. The District transfers sufficient taxation revenues to the bond redemption fund to make principal payments on the Series 2004, 2008, and 2011 bonds. Interest payments are also made from the bond redemption fund.

Bond Account

Principal and interest payments on the Series 2004, 2008, and 2011 bonds are made from this account.

Revenue Bond Account

This account was established pursuant to Bond Resolution 943 and is used to pay the Series 2010A and 2010B principal and interest payments.

2010 Refundable Credits Account

Created pursuant to Bond Resolution 943, this account receives all refundable credits (the subsidy), if any, from the U.S. Department of the Treasury in respect to the Series 2010B Build America Bonds. The District has irrevocably pledged the 2010 Refundable Credits to the payment of principal and interest on the Series 2010B Bonds only, and such funds will not be used for any other purpose until all of the Series 2010 Bonds have been paid in full.

Restricted Accounts

These accounts are maintained to account for restricted donations, gifts, and bequests received from outside sources for specific purposes.

(e) Cash and Cash Equivalents

Cash and cash equivalents include investments in highly liquid debt instruments with an original maturity of three months or less at the date of purchase, excluding amounts whose use is limited by board designation or by other arrangements under trust agreements. Cash and cash equivalents for the primary government were $36.1 million and $22.6 million at June 30, 2014 and 2013, respectively.

Custodial credit risk for deposits is the risk that in the event of a financial institution failure, the deposits may not be returned to the depositor. The Federal Deposit Insurance Corporation (FDIC) provides insurance to depositors to guard against custodial credit risk. Under FDIC insurance coverage is provided for account balances up to $250,000 per depositor, per insured bank. As of June 30, 2014 and 2013, VMC had bank balances of approximately $370,148 and $768,000, respectively that were subject to custodial credit risk as they were neither insured nor collateralized.

(f) Investments

VMC holds investments, as allowed by State law, in the form of bankers' acceptances, repurchase agreements, obligations secured by the U.S. Treasury, other obligations of the United States or its agencies, and certificates of deposit or money market funds with financial institutions in accordance with state guidelines. Investments are for the funding of future capital improvements, self-insurance reserves, and operational cash. In addition, certain funds are restricted by bond indentures to be used solely for debt service.

VMC accounts for its marketable investments in accordance with GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*, which requires that most investments be reported at fair value. Fair value is determined based on quoted market prices. Investment income, including interest income and realized and unrealized gains or losses, is reported as nonoperating revenue or expense.

(g) Inventories

Inventories consist primarily of surgical, medical, and pharmaceutical supplies in organized stores at various locations across VMC. Inventories are recorded at the lower of cost (first-in, first-out (FIFO) or market. Obsolete and uninsurable items are written off.

(h) Capital Assets

Capital assets, defined as purchases with a per item cost of $2,500 or greater and a useful life of at least three years, are stated at cost at acquisition or if acquired by gift, at fair market value at the date of the gift. Additions, replacements, major repairs, and renovations are capitalized. Maintenance and repairs are expensed. The cost of the capital assets sold or retired and the related accumulated depreciation are removed from the accounts, and any resulting gain or loss is recorded.

The provision for depreciation is determined by the straight-line method, which allocates the cost of tangible property ratably over its estimated useful life. VMC's depreciation and useful life policies utilize several methodologies in assigning depreciable lives to assets. Construction projects under $5 million and equipment and information technology systems' useful lives are typically established by using American Hospital Association guidelines. Projects in excess of $5 million are assigned useful lives using a composite weighted life provided by external consultants or by facility life analyses performed by external consultants, and reviewed by VMC management. The estimated useful lives used by VMC are as follows:

Land improvements	10 to 20 years
Buildings, renovations and furnishings	5 to 72 years
Fixed equipment	5 to 25 years
Movable equipment	3 to 20 years
Leasehold improvements	The shorter of the lease term or useful life

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

Interest is capitalized on construction projects as a cost of the related project beginning with commencement of construction and ceases when the construction period ends and the related asset is placed in service. Interest capitalized during 2014 and 2013 was $451,332 and $1,014,319, respectively.

(i) Goodwill, Intangible Assets, and Other

Intangible assets include items related to the purchase of physician practices. Physician noncompetition agreements are amortized over the terms of the agreements. Goodwill, which represents the excess of the cost of an acquired physician practice over the net amounts assigned to acquired assets and assumed liabilities, is currently amortized over the estimated life of the asset. Goodwill is also reviewed annually for impairment.

VMC also has a membership interest, considered an other asset, in First Choice Health Network, a group purchasing cooperative.

(j) Compensated Absences

VMC employees earn annual leave at rates based on the employee's level of employment, applicable labor agreements, and length of service and sick leave based on hours worked during a biweekly pay period. Annual leave balances, which are limited to two times the annual accrual rate, can be converted to monetary compensation upon employment termination. Sick leave balances, which are unlimited, may be converted to monetary compensation upon employment termination at a percentage of the employees' normal compensation rate based on continuous years of service depending upon the employee's level of employment and the applicable labor agreement. VMC recognizes annual and sick leave liabilities when earned. Forfeited balances are recognized at time of forfeiture.

Annual leave accrued at June 30, 2014 and 2013 was $11.9 million and $11.4 million, respectively. Sick leave accrued as of June 30, 2014 and 2013 was $4.0 million and $3.9 million, respectively.

(k) Payable to Contractual Agencies, Net

VMC is reimbursed for Medicare inpatient, outpatient, and rehabilitation services, and for capital and medical education costs during the year either prospectively or at an interim rate. The difference between the interim payments and the reimbursement computed based on the Medicare filed cost report results in an estimated receivable from or payable to Medicare at the end of each year.

The Medicare program's administrative procedures preclude final determination of amounts receivable from or payable to VMC until after the cost reports have been audited or otherwise reviewed and settled by Medicare. The estimated amounts for unsettled Medicare cost reports are

included in payable to contractual agencies, net in the accompanying primary government statements of net position.

(l) Classification of Revenues and Expenses

VMC's statement of revenues, expenses, and changes in net position distinguishes between operating and nonoperating revenues and expenses. Operating revenues, such as patient service revenue, result from exchange transactions associated with providing healthcare services – VMC's primary business. Exchange transactions are those in which each party to the transaction receives and gives up essentially equal values.

Operating expenses are all expenses, other than financing costs, incurred by the primary government and component units to provide healthcare services to patients.

Nonoperating revenues and expenses are recorded for certain exchange and nonexchange transactions. This activity includes tax levy income and debt service related to bonds and other peripheral or coincidental transactions.

(m) Net Patient Service Revenue

VMC has agreements with third-party payers that provide for payments to VMC 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 revenues are reported at the estimated net realizable amounts from patients, third-party payers, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payers.

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. A summary of the payment arrangements with major third-party payers is as follows:

Medicare

Acute inpatient services rendered to Medicare program beneficiaries are paid at prospectively determined rates per discharge based on Medicare severity diagnosis-related groupings (MS-DRGs), as well as reimbursements related to capital costs. These rates vary according to a patient classification system that is based on clinical, diagnostic, and other factors. Payments for Medicare outpatient services are provided based upon a prospective payment system known as ambulatory payment classifications (APCs). APC payments are prospectively established and may be greater than or less than the primary government's actual charges for its services. The Medicare program utilizes the prospective payment system known as case mix group (CMGs) for rehabilitation services reimbursement. As with MS-DRGs, CMG payments are prospectively established and may be greater than or less than VMC's actual charges for its services. Third-party settlements are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined.

Medicaid

Inpatient services rendered to Medicaid program beneficiaries are provided at prospectively determined rates per discharge. Outpatient services rendered are provided based upon the APC prospective payment system.

Commercial

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

(n) Charity Care

VMC provides care at no charge or reduced charges to indigent patients who meet certain criteria under VMC's approved charity care policies. VMC maintains records to identify and monitor the level of charity care it provides. These records include charges foregone for services and supplies furnished under its charity care policy to the uninsured and the underinsured. Because VMC does not pursue collection of amounts determined to qualify as charity care, they are not reported as net patient service revenue. The charges associated with charity care provided by VMC were approximately $22,740,801 and $24,639,644, respectively, for the years ended June 30, 2014 and 2013.

VMC estimates the cost of charity care using its cost to charge ratio of 30.1% and 29.9% for the fiscal years ended June 30, 2014 and 2013, respectively. Applying VMC's cost to charge ratio of 30.1% to total charity of $22,740,801 results in a cost of charity care of $6,844,981 for the fiscal year ended June 30, 2014. Applying VMC's cost to charge ratio of 29.9% to total charity of $24,639,644 results in a cost of charity care of $7,367,253 for the fiscal year ended June 30, 2013.

(o) Federal Income Taxes

The District, as a political subdivision of the state of Washington, is not subject to federal income taxes under Section 115 of the Internal Revenue Code unless unrelated business income is generated during the year.

Since 1983, the District has been deemed a 501(c)(3) entity by the IRS. During fiscal year 2013, because of what the District believed to be a clerical error, the District's 501(c)(3) was administratively revoked. The District received confirmation from the IRS in September 2014 that the District's 501(c)(3) status had been retroactively reinstated, and had been previously revoked in error.

VMC's discretely presented component unit is a limited liability company and, therefore, is not a tax-paying entity for federal income tax purposes. Accordingly, no current or deferred income tax expense has been recorded in the component unit's financial statements. Income of the component

unit is taxed to the members on their individual tax returns, if applicable. The discretely presented component unit had no uncertain tax positions at June 30, 2014 and 2013.

(p) New Accounting Pronouncements

On July 1, 2013, VMC adopted GASB Statement No. 65 (GASB 65), "Items Previously Reported as Assets and Liabilities". This Statement establishes accounting and financial reporting standards that reclassify, as deferred outflows of resources or deferred inflows of resources, certain items that were previously reported as assets and liabilities and recognizes, as expenses or revenues, certain items that were previously reported as assets and liabilities. With the adoption of GASB 65, net position was restated at July 1, 2012, which resulted in a retrospective write-off of debt issuance costs that were previously recorded as an asset. The impact to the July 1, 2012 net position is reflected below (in thousands):

Net position at July 1, 2012, as previously reported	$	209,301,557
Adoption of GASB 65		(3,443,495)
Net position at July 1, 2012, as restated	$	205,858,062

VMC has an account that prior to the adoption of GASB No. 65 was presented as a liability that met the definition of a deferred inflow of resources. VMC's property taxes are levied on a calendar year, but VMC has a fiscal year-end of June 30. Therefore, six months of property tax revenue is considered a deferred inflow of resources for property taxes.

On July 1, 2013 VMC adopted GASB Statement No. 70, "*Accounting and Financial Reporting for Nonexchange Financial Guarantees*". This Statement requires a government that extends a nonexchange financial guarantee to recognize a liability when qualitative factors and historical data, if any, indicate that it is more likely than not that the government will be required to make a payment on the guarantee. This Statement specifies the information required to be disclosed by governments that extend nonexchange financial guarantees. In addition, this Statement requires new information to be disclosed by governments that receive nonexchange financial guarantees. VMC has not extended or received any nonexchange financial guarantees for the years then ended June 30, 2014 and 2013, therefore there is no impact to the VMC financial statements.

In January 2013, GASB issued Statement No. 69, "*Government Combinations and Disposals of Government Operations*". This Statement requires disclosures to be made about government combinations and disposals of government operations in order to enable financial statement users to evaluate the nature and financial effects of those transactions. The requirements of this Statement are effective for financial reporting periods beginning in fiscal year 2015, and will be applied on a prospective basis when applicable. VMC is currently analyzing the impact of this Statement.

(3) Net Patient Service Revenue

Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payers, and others for services rendered, including estimated retroactive adjustments under reimbursement

agreements with third-party payers. 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. In 2014 and 2013, net patient service revenue includes approximately $1,313,544 and $1,921,293, respectively, relating to prior years' net Medicare and Medicaid cost report settlements and revised estimates, including disproportionate share reimbursement.

The following are the components of net patient service revenue for the years ended June 30, 2013 and 2014:

	VMC	
	2014	**2013**
Patient service revenue	$ 1,402,386,880	1,255,937,306
Less adjustments to patient service revenue:		
Charity	(22,740,801)	(24,639,644)
Contractual discounts	(916,567,349)	(779,049,041)
Provision for uncollectible accounts	(22,365,806)	(35,924,268)
Total adjustments to patient service revenue	(961,673,956)	(839,612,953)
Net patient service revenue	$ 440,712,924	416,324,353

	Component Unit	
	2014	**2013**
Patient service revenue	$ 5,966,259	21,237,399
Less adjustments to patient service revenue:		
Charity	(19,566)	—
Contractual discounts	(3,406,310)	(11,491,830)
Provision for uncollectible accounts	(7,133)	(181,410)
Total adjustments to patient service revenue	(3,433,009)	(11,673,240)
Net patient service revenue	$ 2,533,250	9,564,159

VMC grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payer agreements. The mix of gross patient charges from significant third-party payers at June 30, 2014 and 2013 was as follows:

	2014	
	VMC	
	Patient service charges	Accounts receivable
Medicare	34%	28%
Medicaid	20	20
Commercial and other	42	45
Self pay	3	6
Exchange (HIX)	1	1
Total	100%	100%

	2013	
	VMC	
	Patient service charges	Accounts receivable
Medicare	34%	25%
Medicaid	17	14
Commercial and other	44	45
Self pay	5	16
Total	100%	100%

(a) Medicaid Certified Public Expenditure Reimbursement

Public hospitals located in the State of Washington that are not certified as critical access hospitals, are reimbursed at the "full cost" of Medicaid covered services under the public hospital certified public expenditure (CPE) payment method.

"Full cost" payments are determined using the respective hospital's Medicaid ratio of cost to charges to determine the cost for covered medically necessary services. The costs will be certified as actual expenditures by the hospital and the State claim will be allowed federal match on the amount of the related certified public expenditures. The payment method pays only the federal match portion of the allowable claims. VMC received $9,055,922 and $8,434,554 in claims payments under this program for the years ended June 30, 2014 and 2013, respectively.

In addition, VMC receives the federal match portion of Disproportionate Share Payments (DSH), which are the lesser of qualifying uncompensated care cost or the hospital's specific limit. VMC received $14,410,287 and $13,338,493 in DSH funding under this program for the years ended June 30, 2014 and 2013, respectively.

Since the inception of the program, the Washington State Legislature (the State) has provided through an annual budget proviso, a "hold harmless" provision for hospitals participating in the CPE program. Through this proviso, hospitals participating in the CPE program will receive no less in combined state and federal payments than they would have received under the previous payment methodology. In addition, the hold harmless provision ensures that participating hospitals receive DSH payments as specified in the legislation.

In the event of a shortfall between CPE program payments and the amount determined under the hold harmless provision, the difference is paid to the hospitals as a grant from state-only funds. VMC did not receive any state grants for the years ended June 30, 2014 or 2013. Claims payments, DSH payments, and state grant funds are included in net patient service revenues in the statements of revenues, expenses, and changes in net position.

CPE payments are subject to retrospective determination of actual costs once VMC's Medicare Cost Report is audited. CPE program payments are not considered final until retrospective cost reconciliation is complete, after VMC receives its Medicare Notice of Program Reimbursements (NPR) for the corresponding cost reporting year. To date, beginning with the 2006 CPE year, no CPE program year has had a final settlement.

Interim state grant payments are retrospectively reconciled to "hold harmless" after actual claims are repriced using the applicable DRG payment methodology. Interim cost settlement is also performed after the Medicare and Medicaid cost report are filed. This process takes place approximately 12 months after the end of the fiscal year and results in either a payable to, or receivable from, the state Medicaid Program. VMC has estimated the expected final cost settlement amounts based on the difference between CPE DSH payments received and the estimated uncompensated care cost amount.

As of June 30, 2014 and 2013, for fiscal years 2006 through 2014 VMC had an estimated payable of $6.2 million and $3.8 million, respectively, which is included as a liability in other accrued liabilities, including estimated third-party payer settlements in the accompanying statements of net position.

(b) Professional Services Supplemental Payment (PSSP) Program

The professional services supplemental payment (PSSP) program is a program managed by the Washington State Health Care Authority (WSHCA) benefiting certain public hospitals. Under the program, VMC receives supplemental Medicaid payments for the physician and other professional services for which they bill. These supplemental payments equal the difference between the standard Medicaid reimbursement and the upper payment limit allowable by federal law. VMC provides the nonfederal share of the supplemental payments that will be used to obtain the matching federal funds.

VMC recorded $265,785 and $561,933 for the years ended June 30, 2014 and 2013, respectively, in supplemental payments, via Intergovernmental Transfers (IGTs) to WSHCA related to professional

claims paid in those fiscal years, which is included in net patient service revenue in the statements of revenues, expenses, and changes in net position.

WSHCA used the federal match funds to make professional services payments to VMC. VMC received $593,425 and $1,078,431 in supplemental payments for the years ended June 30, 2014 and 2013, respectively. These payments are included in net patient service revenues in the statements of revenue, expenses, and changes in net position.

In July 2013, WSHCA submitted a state plan amendment (SPA) to the Center for Medicare and Medicaid Services (CMS) to create a Provide Access Payment (PAP) program. PAP will create supplemental professional payments similar to PSSP for services provided to Medicaid managed care enrollees. WSHCA could not make PAP payments until CMS approved the SPA. CMS approved the SPA in August 2014 for services on and after July 1, 2014.

(c) Hospital Safety Net Program

The Hospital Safety Net Assessment Act (HSNA) uses local funds obtained through an assessment levied on Prospective Payment System (PPS) hospitals and federal matching funds to increase Medicaid payments to hospitals. Under this program, PPS program hospitals are assessed a fee on all non-Medicare patient days. Under the original HSNA program, HSNA funds were used to prevent the significant budget cuts proposed during the 2009 session of the state legislature. The original legislation expired on June 30, 2013.

In its 2013 session, the Washington State legislature passed a new assessment program that was similar to the original program as they will use federal matching funds to increase Medicaid hospital payments. Under the new HSNA program, PPS hospitals receive supplemental Medicaid payments, Critical Access Hospitals receive disproportionate share payments and CPE hospitals receive state grants. The safety net assessment was subject to approval by the Center for Medicare and Medicaid Services before it took effect. CMS approved this program in 2014. The program has an expiration date of June 30, 2017.

VMC is exempt from the assessment as the hospital is operated by an agency of the state government and also participates in the CPE program.

VMC received grant funding of $1.6 million for the year ended June 30, 2014, and is recorded in other operating revenue in the statements of revenues, expenses, and changes in net position. Under the original program, VMC received increased reimbursement of $1.5 million under this program for the years ended June 30, 2013, which is included in net patient service revenues in the statements of revenues, expenses and changes in net position.

(d) Meaningful Use Incentives

The American Recovery and Reinvestment Act of 2009 (ARRA) established incentive payments to eligible professionals and hospitals participating in Medicare and Medicaid programs that adopt certified electronic health records (EHRs) but only if the technology is being used in a “meaningful”

way that supports the ultimate goals of improving quality, safety, and efficiency of care. "Meaningful use" is defined with specific quality performance metrics for eligible healthcare professionals and hospitals and certain thresholds must be met and maintained to receive payment. Revenue recognition occurs when certain clinical measurements have been attested to.

VMC recorded meaningful use incentives of $1,130,797 and $5,210,579 for the years ended June 30, 2014 and 2013, respectively, which is included in other operating revenue in the statements of revenues, expenses, and changes in net position. These amounts may be subject to future audits.

(4) Property Tax Revenues

The King County Treasurer acts as an agent to collect property taxes in the county for all taxing authorities. Taxes are levied annually on January 1 on property values as of the prior May 31. Assessed values are established by the 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. Funds are distributed monthly to the District by the County Treasurer as collected.

The District is permitted by law to levy up to $0.75 per $1,000 assessed valuation for general district purposes. The Washington State Constitution and Washington State law, RCW 84.55.010, limit the rate. The District may also levy taxes at a lower rate. Greater amounts of tax, above the limit, need to be for a specific capital project and authorized by the vote of the people. In both late January 2014 and January 2013, the District received notification from the King County Assessor's Office that the overall statutory aggregate limit (which is $5.90 per assessed $1,000 in property value) had been exceeded in certain District tax levy codes for the calendar years ended December 31, 2013 and 2012. Under Washington state statute, the Assessor's Office must recalculate the property tax levy rates when it is found the aggregate rate of certain senior and junior taxing districts within a given levy code area exceeds the $5.90 limit established by RCW 84.52.043. Any required rate recalculations are performed in a specific order specified within RCW 84.52.010(2). In summary, within these priorities, a hospital district receives the first $0.50 of its levy.

Consequently, as a result of this required rate recalculation, the District's tax levy rate was decreased from $0.54 per assessed $1,000 in property value pursuant to the District's authorized tax levy in November 2013, to $0.50 per assessed $1,000 in property value, resulting in a revised tax levy of $16,983,920. That is a reduction of $1,375,697, or 7.5%, from the original tax levy, in property tax revenues during calendar year 2014.

For calendar year 2013, due to the required rate recalculation, the District's tax levy rate was decreased from $0.57 per assessed $1,000 in property value pursuant to the District's authorized tax levy in November 2012, to $0.50 per assessed $1,000 in property value, resulting in a revised tax levy of $16,052,045. That is a reduction of $2,404,914, or 13%, from the original tax levy, in property tax revenues during calendar year 2013.

Property taxes are recorded as receivables when levied. Because State law allows for the sale of property for failure to pay taxes, no estimate of uncollectible taxes is made. Given property taxes are recorded on a calendar year basis, the property tax receivable balance at June 30, 2014 and 2013 was $8,438,871 and $8,028,709, respectively, and is shown as a current asset on the statements of net position.

Revenues received from taxation was $16,342,394 and $16,253,562 at June 30, 2014 and 2013, for the fiscal 2014 and 2013 years, respectively, and is recorded as nonoperating revenue on the statements of revenues, expenses and changes in net position.

The District has pledged its future tax revenues, as well as operating revenues, to repay its limited tax general obligation and revenue bonds issued in 2004, 2008, 2010, and 2011 to finance construction, other capital improvements, medical equipment and technology, and information technology systems.

(5) Capital Assets

(a) VMC's Capital Assets

The activity in VMC's capital asset and related accumulated depreciation accounts for years ended June 30, 2014 and 2013 is set forth below:

	June 30, 2013	Additions	Transfers	Retirements	June 30, 2014
Nondepreciable capital assets:					
Land	$ 13,299,497	—	—	—	13,299,497
Construction in progress	33,062,351	11,136,216	(32,908,620)	—	11,289,947
Total capital assets, not being depreciated	46,361,848	11,136,216	(32,908,620)	—	24,589,444
Capital assets, being depreciated:					
Land improvements	18,698,859	—	—	—	18,698,859
Buildings, renovations and furnishings	387,401,479	—	29,477,121	(452,463)	416,426,137
Fixed equipment	24,939,548	—	—	(219,532)	24,720,016
Movable equipment	172,943,570	2,518,788	2,951,653	(1,349,301)	177,064,710
Minor equipment	13,888,672	134,812	479,846	(15,620)	14,487,710
Total capital assets, being depreciated	617,872,128	2,653,600	32,908,620	(2,036,916)	651,397,432
Total capital assets at historical cost	664,233,976	13,789,816	—	(2,036,916)	675,986,876

	June 30, 2013	Additions	Transfers	Retirements	June 30, 2014
Less accumulated depreciation for:					
Land improvements	$ (10,524,517)	(352,599)	—	—	(10,877,116)
Buildings, renovations and furnishings	(136,238,502)	(12,961,055)	—	419,878	(148,779,679)
Fixed equipment	(20,922,864)	(576,665)	—	128,060	(21,371,469)
Movable equipment	(101,376,412)	(17,831,040)	—	1,273,557	(117,933,895)
Minor equipment	(8,992,717)	(1,215,357)	—	13,407	(10,194,667)
Total accumulated depreciation	(278,055,012)	(32,936,716)	—	1,834,902	(309,156,826)
Total capital assets, net	$ 386,178,964	(19,146,900)	—	(202,014)	366,830,050

	Balance June 30, 2012	Additions	Transfers	Retirements	Balance June 30, 2013
Nondepreciable capital assets:					
Land	$ 13,299,497	—	—	—	13,299,497
Construction in progress	71,151,194	29,364,152	(67,452,995)	—	33,062,351
Total capital assets, not being depreciated	84,450,691	29,364,152	(67,452,995)	—	46,361,848
Capital assets, being depreciated:					
Land improvements	18,250,335	18,543	429,981	—	18,698,859
Buildings, renovations and furnishings	370,655,858	34,532	16,942,950	(231,861)	387,401,479
Fixed equipment	25,550,850	—	15,967	(627,269)	24,939,548
Movable equipment	135,952,077	4,320,375	49,782,688	(17,111,570)	172,943,570
Minor equipment	13,648,712	—	281,409	(41,449)	13,888,672
Total capital assets, being depreciated	564,057,832	4,373,450	67,452,995	(18,012,149)	617,872,128
Total capital assets at historical cost	648,508,523	33,737,602	—	(18,012,149)	664,233,976

	Balance June 30, 2012	Additions	Transfers	Retirements	Balance June 30, 2013
Less accumulated depreciation for:					
Land improvements	$ (10,179,619)	(344,898)	—	—	(10,524,517)
Buildings, renovations and furnishings	(123,930,835)	(12,522,735)	—	215,068	(136,238,502)
Fixed equipment	(20,829,271)	(720,862)	—	627,269	(20,922,864)
Movable equipment	(100,283,678)	(17,938,438)	—	16,845,704	(101,376,412)
Minor equipment	(7,674,740)	(1,357,351)	—	39,374	(8,992,717)
Total accumulated depreciation	(262,898,143)	(32,884,284)	—	17,727,415	(278,055,012)
Total capital assets, net	$ 385,610,380	853,318	—	(284,734)	386,178,964

Included in major movable equipment at June 30, 2014 and 2013 is $4,619,239 and $4,619,239, respectively, of equipment under capital lease. Accumulated amortization of the equipment under capital lease totaling $4,561,613 and $4,485,793 is included in accumulated depreciation at June 30, 2014 and 2013, respectively.

Depreciation expense was $32,936,716 and $32,884,284 as of June 30, 2014 and 2013, respectively, includes $396,569 and $444,417 of nonoperating depreciation expense. These assets are medical office buildings rented or leased to physician practices and others and, therefore, are not considered within the operations of VMC. Therefore, $32,540,147 and $32,439,867 in depreciation expense is reflected in operating expenses of the statements of revenues, expenses, and changes in net position as of June 30, 2014 and 2013, respectively.

(b) Discretely Presented Component Unit's Capital Assets

The activity in the component unit's capital asset accounts and the related accumulated depreciation accounts for the year ended June 30, 2014 is as follows:

	Balance June 30, 2013	Additions	Transfers	Retirements	Balance June 30, 2014
Nondepreciable capital assets:					
Land	$ —	—	—	—	—
Construction in progress	—	—	—	—	—
Total capital assets, not being depreciated	—	—	—	—	—
Capital assets, being depreciated:					
Land improvements	—	—	—	—	—
Buildings, renovations and furnishings	227,055	99,601	—	—	326,656
Fixed equipment	—	—	—	—	—
Movable equipment	7,464,835	1,281,713	—	(917,937)	7,828,611
Total capital assets, being depreciated	7,691,890	1,381,314	—	(917,937)	8,155,267
Total capital assets at historical cost	7,691,890	1,381,314	—	(917,937)	8,155,267
Less accumulated depreciation for:					
Land improvements	—	—	—	—	—
Buildings, renovations and furnishings	(62,599)	(22,340)	—	—	(84,939)
Fixed equipment	—	—	—	—	—
Movable equipment	(6,104,399)	(599,613)	—	917,937	(5,786,075)
Total accumulated depreciation	(6,166,998)	(621,953)	—	917,937	(5,871,014)
Total capital assets, net	$ 1,524,892	759,361	—	—	2,284,253

	Balance June 30, 2012	Additions	Transfers	Retirements	Balance June 30, 2013
Nondepreciable capital assets:					
Land	$ —	—	—	—	—
Construction in progress	—	—	—	—	—
Total capital assets, not being depreciated	—	—	—	—	—
Capital assets, being depreciated:					
Land improvements	—	—	—	—	—
Buildings, renovations and furnishings	93,472	133,583	—	—	227,055
Fixed equipment	—	—	—	—	—
Movable equipment	6,985,676	479,159	—	—	7,464,835
Total capital assets, being depreciated	7,079,148	612,742	—	—	7,691,890
Total capital assets at historical cost	7,079,148	612,742	—	—	7,691,890
Less accumulated depreciation for:					
Land improvements	—	—	—	—	—
Buildings, renovations and furnishings	(48,519)	(14,080)	—	—	(62,599)
Fixed equipment	—	—	—	—	—
Movable equipment	(5,648,858)	(455,541)	—	—	(6,104,399)
Total accumulated depreciation	(5,697,377)	(469,621)	—	—	(6,166,998)
Total capital assets, net	$ 1,381,771	143,121	—	—	1,524,892

(6) Deposits and Investments

Chapter 39.59 Revised Code of Washington (RCW) authorizes VMC to make investments in accordance with Washington State law. VMC also has a formalized investment policy that VMC may, through formal inter local agreement, invest funds not immediately required for expenditure with the King County Investment Pool (the Pool) and/or the Washington State Treasurer's Local Government Investment Pool (the LGIP), or may separately invest such funds in either actively managed individual portfolio or mutual fund accounts that meet all statutory investment requirements.

Eligible investments include obligations secured by the U.S. Treasury, other obligations of the United States or its agencies, certificates of deposit with approved institutions, eligible bankers' acceptances, eligible commercial paper, and repurchase and reverse repurchase agreements. Investments of debt proceeds are governed by the provisions of the debt agreements, which also must meet statutory requirements.

The related required assessed risks for each type of investment are disclosed below.

At June 30, 2014 and 2013, deposits and investments of VMC consist of the following:

	2014	2013
Unrestricted cash and cash equivalents	$ 24,756,693	11,589,565
Unrestricted investments:		
U.S. Treasury securities and bonds	114,046,290	105,829,760
U.S. government mutual funds	280,533	218,961
Investment pools	10,654,039	9,258,845
Tax-exempt issues	760,593	1,457,907
	125,741,455	116,765,473
Restricted assets:		
Cash and cash equivalents	419,516	352,266
U.S. Treasury securities and bonds	—	—
U.S. government mutual funds	11,630,398	13,233,475
Tax-exempt issues	—	—
Other assets	3,748,960	5,582,954
	15,798,874	19,168,695
	$ 166,297,022	147,523,733

Interest income included in nonoperating revenue totaled approximately $3.2 million and $4.0 million for the years ended June 30, 2014 and 2013, respectively. Investment loss, includes realized and unrealized gains and losses. VMC realized net losses of approximately $(137) thousand and $(1.06) million for the years ended June 30, 2014 and 2013, respectively. VMC's net change in unrealized gains/(losses) on investments during the years ended June 30, 2014 and 2013 is approximately $(279) thousand and $(328) thousand, respectively.

Investments within the other assets category are related to the cash surrender value of life insurance and a unearned compensation plan, the latter of which is self-directed by the participant of the plan which includes money market funds and other eligible investments as authorized by state law. While the investments are currently in VMC's name and available to VMC's creditors, the payment of unearned compensation to the participant will be for the resulting value of the self-directed investments. Therefore, the risk of loss has been transferred to the participant.

(a) Credit Risk

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. VMC's investment policy provides guidelines for its fund managers and lists specific allowable investments as prescribed by state law. The policy provides the ability of portfolio managers to employ varying investment styles so diversification can be maximized within statutory requirements.

Credit risk is measured by the assignment of a rating by a nationally recognized statistical rating organization (NRSRO). VMC follows state statute, which provides that commercial paper, negotiable certificates of deposit, and banker's acceptances must be rated at least A-1 by Standard and Poor's (S&P) and P-1 by Moody's Investors Service, Inc., and fixed income holdings are limited to securities that are issued by or fully guaranteed by the U.S. Treasury, U.S. government-sponsored enterprises, or U.S. government agencies, including U.S. government agency mortgage-backed securities. Money market funds are limited to those with an average credit quality of AAA by S&P.

According to GASB Statements No. 40*, Deposit and Investment Risk Disclosures – an amendment of GASB Statements No. 3*, unless there is information to the contrary, obligations of the U.S. government or obligations explicitly guaranteed by the U.S. government are not considered to have credit risk and do not require disclosure of credit quality.

As of June 30, 2014 and 2013, VMC's investment in the Pool was not rated by a NRSRO. In compliance with state statutes, Pool policies authorize investments in U.S. Treasury securities, U.S. agency and mortgage-backed securities, municipal securities (rated at least A by two NRSROs), commercial paper (rated at least the equivalent of A-1 by two NRSROs), certificates of deposit issued by qualified public depositories, repurchase agreements, and the LGIP managed by the Washington State Treasurer's Office. VMC's share of the impaired investment pool principle was $207,791 at December 31, 2013 and VMC's fair value of these investments was $123,093 at December 31, 2013.

As of June 30, 2014 and 2013, all impaired commercial paper investments have completed enforcement events. The King County Impaired Investment Pool (Impaired Pool) held one commercial paper asset where the Impaired Pool accepted an exchange offer and is receiving the cash flows from the investment's underlying securities, and the residual investments in four commercial paper assets that were part of completed enforcement events where the Impaired Pool accepted the cash out option.

The composition of investments, reported at fair value by investment type and rating at June 30, 2014 and excluding cash balances of $25,176,209 is as follows:

Investment type		Fair value	Ratings	Percentage of totals
Money market mutual fund	$	1,317,751	AAA	0.9%
U.S. Treasury		56,346,682	Not rated	39.9
U.S. agency securities		27,435,578	AAA	19.4
U.S. agency mortgages		30,264,031	AAA	21.4
Tax-exempt issues		760,593	AAA	0.5
Mutual funds invested in U.S. government securities		10,593,179	AAA	7.5
King County investment pool		10,654,039	Not rated	7.5
Other assets		3,748,960	Not rated	2.7
Total	$	141,120,813		100.0%

The composition of investments, reported at fair value by investment type and rating at June 30, 2013 and excluding cash balances of $11,941,831, is as follows:

Investment type		Fair value	Ratings	Percentage of totals
Money market mutual fund	$	1,389,076	AAA	1.0%
U.S. Treasury		58,009,667	Not rated	42.8
U.S. agency securities		22,286,807	AAA	16.4
U.S. agency mortgages		25,533,265	AAA	18.8
Tax-exempt issues		1,457,907	AAA	1.1
Mutual funds invested in U.S. government securities		12,063,360	AAA	8.9
King County investment pool		9,235,024	Not rated	6.8
State (LGIP) investment pool		23,842	Not rated	—
Other assets		5,582,954	Not rated	4.1
Total	$	135,581,902		100.0%

Concentration of credit risk is the risk associated with a lack of diversification, such as having substantial investments in a few individual issuers, thereby exposing the organization to greater risks resulting from adverse economic, political, regulatory, geographic, or credit developments.

VMC's investment policy follows applicable Washington state statutes in defining authorized investments and any required credit ratings.

There are no investments exceeding 5% of total investments that are with any one issuer other than the U.S. Treasury, U.S. agency, or U.S. government-sponsored entities. As of June 30, 2014 and 2013, for those investments that require composition disclosure, VMC holds investments in U.S. government-sponsored entities totaling 15% and 18% of its total investments in Federal National Mortgage Association securities, 8% and 8% of its total investments in Federal Home Loan Mortgage Corporation securities, and 13% and 5%, respectively, of its total investments in Government National Mortgage Association securities.

(b) Custodial Credit Risk

Custodial credit risk is the risk that, in the event of a failure of the custodian, VMC may not be able to recover the value of the investment or collateral securities that are in possession of an outside party.

With respect to investments, custodial credit risk generally applies only to direct investments of marketable securities. Custodial credit risk typically does not apply to VMC's indirect investments in securities through the use of mutual funds or governmental investment pools (such as the Pool and LGIP).

In the individually managed portfolios (which include bond proceeds and tax revenues), VMC's securities are registered in VMC's name by the custodial bank as an agent for VMC.

(c) Interest Rate Risk

Interest rate risk is the risk that changes in interest rates of debt instruments will adversely affect the fair value of an investment. Generally, the longer the maturity of an investment is, the greater the sensitivity of its fair value to changes in market interest rates.

One of the ways VMC manages its exposure to interest rate risk is by purchasing a combination of shorter and longer-term investments and by timing cash flows from maturities so that a portion of the portfolio is maturing or coming close to maturing evenly over time as necessary to provide cash flow and liquidity needed for operations.

As a way of limiting its exposure to fair value losses arising from rising interest rates, VMC's investment policy limits its investment portfolio to maturities as follows:

Issuer/instrument	Maximum length of maturity
U.S. Treasury bonds, certificates, and bills	10 years
Other obligations of the U.S. government or its agencies	10 years
Mutual funds consisting of only U.S. government bonds or U.S. guaranteed bonds	Average maturity < 4 years
Statutorily allowed certificates of deposit	24 months
Commercial paper	180 days
General obligation bonds of any state/local government	10 years

Securities purchased in the Pool must have a final maturity, or weighted average life, of no longer than five years. Although the Pool's market value is calculated on a monthly basis, unrealized gains or losses are not distributed to participants. The Pool distributes earnings monthly using an amortized cost methodology.

The LGIP is an unrated 2a-7 pool, as defined by GASB Statements No. 31. Balances in the LGIP are not subject to material interest rate risk, as the weighted average maturity of the portfolio will not exceed 90 days.

Information about the sensitivity of the fair values of VMC's investments (including investments held by the bond trustee) to market interest rate fluctuations is provided by the following table, which shows the distribution of VMC's investments by maturity. Investments in pooled assets such as mutual funds and investment pools are shown using the weighted average duration of the underlying assets.

2014		Remaining maturity (in months)			
Investment type	**Fair value**	**12 months or less**	**13 to 24 months**	**25 to 48 months**	**More than 48 months**
Money market mutual fund	$ 1,317,751	1,317,751	—	—	—
U.S. Treasury	56,346,682	8,768,202	17,377,685	24,828,600	5,372,195
U.S. agency securities	27,435,578	1,289,174	10,146,708	12,850,496	3,149,200
U.S. agency mortgages	30,264,031	46,360	298,161	2,285,757	27,633,753
Tax-exempt issues	760,593	—	760,593	—	—
Mutual funds invested in U.S. government securities	10,593,179	—	—	10,593,179	—
King county investment pool	10,654,039	—	10,654,039	—	—
State investment pool	—	—	—	—	—
Other assets	3,748,960	—	—	—	3,748,960
	$ 141,120,813	11,421,487	39,237,186	50,558,032	39,904,108

2013					
Investment type	**Fair value**	**12 months or less**	**13 to 24 months**	**25 to 48 months**	**More than 48 months**
Money market mutual fund	$ 1,389,076	1,389,076	—	—	—
U.S. Treasury	58,009,667	18,200,406	19,368,229	17,459,521	2,981,511
U.S. agency securities	22,286,807	1,001,007	2,993,446	13,840,229	4,452,125
U.S. agency mortgages	25,533,265	1,004,589	153,462	391,280	23,983,934
Tax-exempt issues	1,457,907	466,375	—	991,532	—
Mutual funds invested in U.S. government securities	12,063,360	—	—	12,063,360	—
King county investment pool	9,235,024	—	9,235,024	—	—
State investment pool	23,842	23,842	—	—	—
Other assets	5,582,954	—	—	—	5,582,954
	$ 135,581,902	22,085,295	31,750,161	44,745,922	37,000,524

(7) Long-Term Debt and Capital Lease Obligations

(a) Primary Government's Long-Term Debt

Long-term debt, reported as a part of noncurrent liabilities, consists of the following as of June 30:

	2014	2013
Limited tax general obligation bonds:		
2011 term bond, 2.19%, due in June and December, in yearly amounts from $4,550,000 in fiscal year 2014 to $2,035,517 in fiscal year 2022, plus interest due semiannually, net of unamortized loss on refinance of $571,551	$ 25,214,861	29,616,666
2008 series A and B, 4.0% to 5.25%, due serially in December, in amounts from $540,000 in fiscal year 2014 to $17,365,000 in fiscal year 2038, plus interest due semiannually, net of unamortized premium of $472,072 and unamortized loss on refinancing of $2,499,794	213,587,277	214,229,599
2004 series, 3.75% to 4.25%, due serially in December, in amounts from $1,030,000 in fiscal year 2013 to $1,260,000 in fiscal year 2018, plus interest due semiannually, net of unamortized premiums of $9,933 and unamortized loss on refinance of $84,626	4,700,307	5,723,799
Revenue bonds:		
2010 series A, 3.00% to 5.125%, due serially in June, in amounts from $1,445,000 in 2013 to $2,395,000 in 2024, plus interest due semiannually, net of unamortized premium of $6,110, unamortized discount of $157,343, and unamortized loss on refinance of $455,623	18,858,144	20,158,045
Build America bonds:		
2010 series B, 7.90% to 8.00%, due serially in June, in amounts from $2,520,000 in 2025 to $5,485,000 in 2040, plus interest due semiannually	61,155,000	61,155,000
Bonds	323,515,589	330,883,109
Capital lease obligations, stated at present value of future minimum lease payments	63,375	143,746
Note payable:		
2011 note payable, 2.25%, due in two payments in 2013 and 2014, plus interest due annually.	$ —	480,100
Total long-term debt	323,578,964	331,506,955
Less current portion	(7,968,374)	(8,225,472)
Total long-term debt, net of current portion	$ 315,610,590	323,281,483

(i) Long-term Debt Overview

Series 2011 Bond Issue

The 2011 Limited Tax General Obligation Refunding Bond was issued on September 7, 2011 for $35,636,412. The Bond was issued for the purpose of refunding, on a current basis, and defeasing the Limited Tax General Obligation Refunding Bonds, 2001, maturing on and after December 1, 2012. The Series 2011 proceeds were irrevocably deposited, on September 7, 2011, into an escrow fund held by an escrow agent. Upon such deposit, the Series 2001 bonds were deemed defeased and are no longer outstanding.

The Series 2011 Term Bond was issued with fixed interest rates of 2.19%, and has eleven annual maturities of varying amounts between 2011 and 2021. The refunding resulted in a difference between the reacquisition price and the net carrying amount of the old debt of $571,551 and $719,746 for the years ended June 30, 2014 and 2013, respectively, which will be deferred and amortized over the life of the new bonds. The refunding resulted in an economic gain (difference between the present values of the old and new debt service payments) of $5,000,704.

The District has pledged tax revenues to secure the bonds.

2011 Note Payable

In March 2011, the District purchased an infusion center and medical oncology practice from a private physician group. The purchase price for the assets was $3,705,200 and a portion of the purchase price was funded with a note. As of June 30, 2014 and 2013, the outstanding note payable was $0 and $480,100, as the note was paid off in March 2014. The fixed interest rate was 2.25%.

Series 2010 Revenue Bond Issue

The Series 2010 Bonds were issued in two subseries. On June 23, 2010, the District issued $25,145,000 in federally tax-exempt revenue bonds (Series 2010A) and $61,155,000 in federally taxable revenue Build America Bonds (BABs) (Series 2010B). Both series are fixed rate.

The Series 2010A Bonds were used to refund and defease all of the Series 1997 Bonds and the eligible portion of the Series 1998 Bonds, as well as acquire District Hospital facilities and land. Of the total, $9,240,000 of the Series 1998 Bonds could not be legally advance refunded with tax-exempt obligations proceeds. Consequently, the District used its own operational funds to cash defease that portion of the Series 1998 Bonds.

To refund and defease the Series 1997 Bonds and the Eligible Series 1998 Bonds, the District irrevocably deposited a portion of the Series 2010A Bond proceeds, along with District funds, into an escrow fund held by an escrow agent. Upon such deposit, on June 23, 2010, the Series

1997 Bonds and Eligible Series 1998 bonds were deemed defeased and are no longer outstanding.

The Series 2010A consists of serial bonds of $16,255,000, which were issued with interest rates ranging from 3.00% to 5.00% at yields of 2.30% to 4.85%, maturing between 2012 and 2020, and an $8,890,000 5.125% term bond is due in 2024.

The Series 2010B term BAB bonds were issued to construct, renovate, remodel, and equip projects at VMC and satellite facilities, including completion of the top floors of VMC's recently constructed Emergency Services Tower and the construction of a freestanding emergency department within the District's boundaries. The Series 2010B term BAB bonds of $61,155,000 were issued with interest rates ranging from 7.9% to 8.0% and mature in 2030 and 2040.

Under the BAB bonds, the District receives a direct cash subsidy payment from the United States Department of the Treasury equal to 35% of the interest payable on the Series 2010B Bonds as of each Interest Payment Date. For the years ended June 30, 2014 and 2013, the District received $1,583,441 and $1,632,070, respectively, in subsidy payments, which are recorded in other nonoperating revenues in the statements of revenues, expenses, and changes in net position.

Although the refunding of the 1997 and 1998 series resulted in a difference in cash flow requirements of $5.2 million between the defeased debt and the newly issued debt, the District obtained an economic gain (difference between the present values of the old and new debt service payments) of approximately $3.6 million in 2010.

Series 2008 Bond Issue

The District issued $218,220,000 in limited tax general obligation and refunding bonds, Series 2008A and 2008B, in March 2008. The 2008 series refunded two prior bond series, the 2005 revenue bonds and the 2006 limited tax general obligation Series A and B bonds.

Series 2008A was for $113,315,000 and comprised $97,745,000 of 5.0%–5.25% term bonds maturing beginning with $14,730,000 maturing in 2023 to $59,725,000 5.0% bonds maturing in 2037. Within this subseries, $15,570,000 of this subseries was in 4.0%–5.0% serial bonds, which mature for eight consecutive years beginning in 2012. Series 2008A is insured by a rated bond insurer.

Series 2008B was for $104,905,000 5.25% term bonds, beginning with $8,920,000 maturing in 2023 to $69,260,000 maturing in 2037. Series 2008B is uninsured.

The District has pledged tax revenues to secure the bonds.

(ii) Debt Compliance

Under the terms of its financing agreements, the District has agreed to meet certain covenants. Bond covenants related to the Limited Tax General Obligation (LTGO) bonds require including in VMC's budgets and making annual levies of taxes, within constitutional and statutory tax limitations provided by law upon on all property within the District subject to taxation, together with any other money legally available, to be sufficient to pay the principal and interest of the LTGO bonds.

Financing covenants associated with the District's revenue bonds require maintaining an amount within the Reserve Account (a subaccount within the Revenue Bond Fund) equal to the Reserve Requirement for all covered revenue bonds (the 2010 series only). That amount is equal to the lesser of the Maximum Annual Debt Service with respect to the 2010 bond series, an aggregate of the sum of 10% of the initial principal amount of the 2010 bond series, or 125% of the Average Annual Debt Service on the 2010 bond series. There is also a coverage requirement specific to only the 2010 Bond Series that the amount of net income available for debt service (less depreciation) is equal to at least 125% of the maximum annual debt service, reduced by the amount of all Refundable Credits received or due to be received related to the Build America Bond subsidy, within the computation period.

Additional covenants require continued disclosure through the Municipal Securities Rulemaking Board, compliance with limits of encumbrances, indebtedness, disposition of assets, and transfer services.

Management is not aware of any violations with its debt covenants for the years ended June 30, 2014 and 2013.

(iii) Long-Term Debt Maturities

The following schedule shows debt service requirements, excluding capital leases, for the next five years and thereafter, as of June 30, 2014, using the fixed interest rates, for both principal and interest:

		Principal	Interest	Total
2015	$	7,904,999	17,572,202	25,477,201
2016		8,185,000	17,292,025	25,477,025
2017		8,500,000	16,976,784	25,476,784
2018		8,810,000	16,659,555	25,469,555
2019		10,129,509	16,332,489	26,461,998
2020–2024		43,111,903	76,637,642	119,749,545
2025–2029		64,030,000	62,220,549	126,250,549
2030–2034		82,590,000	41,272,121	123,862,121
2035–2039		88,050,000	14,867,819	102,917,819
2040–2043		5,485,000	438,800	5,923,800
Total payments	$	326,796,411	280,269,986	607,066,397

(iv) Capital Leases

VMC acquired certain equipment under capital lease obligations. The imputed interest rate on the equipment under capital lease is 3.5%. These leases are collateralized by the related equipment. These leases had total future minimum lease payments of $64,491 and expire during fiscal year 2015.

(v) Change in Noncurrent Liabilities

Changes in noncurrent liabilities during the fiscal years ended June 30, 2014 and 2013 are summarized below:

	Balance June 30, 2013	Increases	Decreases	Balance June 30, 2014	Due within one year
Limited tax general obligation bonds:					
2011 series	$ 29,616,666	—	(4,401,805)	25,214,861	4,030,000
2008 series	214,229,599	—	(642,322)	213,587,277	1,165,000
2004 series	5,723,799	—	(1,023,492)	4,700,307	1,124,999
Revenue bonds:					
2010 Series A	20,158,045	—	(1,299,901)	18,858,144	1,585,000
Build America bonds:					
2010 Series B	61,155,000	—	—	61,155,000	—
Note payable	480,100	—	(480,100)	—	—
Capital lease obligations	143,746	—	(80,371)	63,375	63,375
Total long-term debt and capital lease obligations	331,506,955	—	(7,927,991)	323,578,964	7,968,374
Unearned compensation	3,525,258	493,892	(270,191)	3,748,959	—
Total noncurrent liabilities	$ 335,032,213	493,892	(8,198,182)	327,327,923	7,968,374

	Balance June 30, 2012	Increases	Decreases	Balance June 30, 2013	Due within one year
Limited tax general obligation bonds:					
2011 series	$ 33,532,148	—	(3,915,482)	29,616,666	4,550,000
2008 series	215,207,453	—	(977,854)	214,229,599	540,000
2004 series	6,722,974	—	(999,175)	5,723,799	1,055,000
Revenue bonds:					
2010 Series A	21,387,281	—	(1,229,236)	20,158,045	1,520,000
Build America bonds:					
2010 Series B	61,155,000	—	—	61,155,000	—
Note payable	960,200	—	(480,100)	480,100	480,100
Capital lease obligations	229,224	—	(85,478)	143,746	80,372
Total long-term debt and capital lease obligations	339,194,280	—	(7,687,325)	331,506,955	8,225,472
Unearned compensation	3,255,699	543,506	(273,947)	3,525,258	—
Total noncurrent liabilities	$ 342,449,979	543,506	(7,961,272)	335,032,213	8,225,472

(vi) Line of Credit

VMC has an unsecured $2.0 million line of credit with its banking institution, with an interest rate set at 1.75% above the daily thee-month LIBOR (London Interbank Offered Rate) in effect at the time the line of credit is utilized. The line of credit was unused during fiscal years 2014 and 2013, and there was no outstanding balance as of June 30, 2014 and 2013. This line of credit expired in September 2013.

(b) Discretely Presented Component Unit's Long-Term Debt and Capital Leases

The component unit has no outstanding long-term debt. The capital lease obligation as of June 30, 2014 and 2013 consists of an equipment lease with a present value of $1,344,284 and $476,039, with total monthly payments of $42,304, including imputed interest of 6.2%, maturing in 2015.

The schedule of changes in capital leases is as follows:

	Balance June 30, 2013	Increases	Decreases	Balance June 30, 2014	Due within one year
Capital lease obligations	$ 476,039	1,250,816	(382,571)	1,344,284	470,966

	Balance June 30, 2012	Increases	Decreases	Balance June 30, 2013	Due within one year
Capital lease obligations	$ 675,151	—	(199,112)	476,039	211,806

Future minimum lease payments and the present value of net minimum lease payments are as follows:

Fiscal year ending June 30:		
2015	$	507,648
2016		311,518
2017		272,292
2018		272,292
2019		55,811
Total minimum lease payments		1,419,561
Less amount representing interest		(75,277)
Net		1,344,284
Less current portion		(470,966)
Present value of capital lease, net of current portion	$	873,318

(8) Risk Management

VMC is exposed to risk of loss related to professional and general liability, employee medical, dental, and pharmaceutical claims, and injuries to employees. VMC maintains a program of purchased insurance and excess insurance coverage for professional and general liability, as well as self-insurance reserves. VMC 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. Commercial insurance coverage is purchased for claims arising from such matters and no claims have exceeded such coverage. As with any company that purchases insurance coverage, in the event a claim exceeds the amount of coverage purchased, the amount exceeding the coverage is the responsibility of the company, in this case, VMC.

The self-insurance reserve represents the estimated ultimate cost of settling claims resulting from events that have occurred on or before the statement of net position date. The reserve includes amounts that will be required for future payments of employee and dependent health benefit claims, as well as workers' compensation claims that have been reported and claims related to events that have occurred but have not been reported.

(a) Professional and General Liability

VMC purchases insurance from a third-party insurance carrier for professional and general liability. Insurance limits are $2,000,000 per claim with an $8,500,000 annual aggregate, on an occurrence basis. VMC also maintains excess commercial insurance above the first layer of $2,000,000/$8,500,000 on a claims-made basis with a limit of liability of $25,000,000 per

occurrence and $25,000,000 annual aggregate. As with any company that purchases insurance coverage, in the event a claim exceeds the amount of coverage purchased, the amount exceeding the coverage is the responsibility of the company, in this case, VMC.

On December 17, 2010, VMC was served with a lawsuit, *Oliver Wuth, et al. v. Valley Medical Center, et al.,* filed in the State Superior Court of King County, Washington. The lawsuit alleges that VMC was negligent in the handling of a pre-natal genetic test order that allegedly resulted in the parents being given incorrect information. The matter was tried to a jury beginning on October 21, 2013. On December 10, 2013, the jury returned a verdict in the plaintiffs' favor in the amount of $50.0 million, with 50% liability apportioned to VMC and 50% of liability apportioned to co-defendant Laboratory Corporation of America. VMC filed post-judgment motions for a new trial, which were denied, and intends to vigorously pursue an appeal of the judgment on multiple grounds. Management believes that VMC has insurance coverage (both primary and excess) in amounts and limits sufficient to cover the potential liability in this case. While one excess carrier has issued a reservation of rights letter, Management also believes that this question will be resolved favorably to VMC.

Other than mentioned above, settlement amounts have not exceeded insurance coverage in the last three years.

(b) Employee Medical

VMC is self-insured for medical and dental benefits. The accrued liabilities for the self-insured component of the plan include the unpaid portion of claims that have been reported and estimates for claims that have been incurred but not reported. VMC also carries stop-loss coverage for claims in excess of the $225,000 specific deductible and $122,000 aggregating specific deductible for 2014 and 2013. VMC has recorded an actuarially estimated liability for health claims that have been incurred but not reported of $3,179,714 and $3,527,662 as of June 30, 2014 and 2013, respectively. These liabilities are included in accrued salaries, wages, and employee benefits in the accompanying VMC statements of net position. The health benefit claims reserve at June 30, 2014 and 2013 is based on undiscounted calculations.

(c) Workers' Compensation

VMC is self-insured for workers' compensation claims. The self-insured retention under the workers' compensation program was $500,000 per claim in 2014 and 2013. Excess insurance coverage is purchased for risk above the per claim self-insured retention level. The accrued liabilities for the self-insured components of this plan include the unpaid portion of claims that have been reported and estimates for claims that have been incurred but not reported. VMC has recorded an actuarially determined estimated liability for workers' compensation claims of $3,691,567 and $3,498,599 at June 30, 2014 and 2013, respectively, which is included in accrued salaries, wages, and benefits in the accompanying VMC statements of net position. The workers' compensation reserve at June 30, 2014 and 2013 is based on undiscounted calculations.

(d) Changes in the Self-Insurance Reserve – Tail Liability

VMC has established a reserve based on the requirement of GASB No. 10, *Accounting and Financial Reporting for Risk Financing and Related Insurance Issues*, which requires that a liability for claims be reported if information prior to the issuance of the financial statements indicates that it is probable that a liability has been incurred at the date of the financial statements and the amount of the loss can be reasonably estimated. The reserve includes the amount that will be required for future payments of claims that have been reported and claims related to events that have occurred but have not been reported and an estimated tail liability for any claims in excess of coverage with the excess insurance policies on a claims-made basis.

Changes in the self-insurance reserve as it relates to the tail liability for professional liability insurance as of June 30, 2014 and 2013 are noted below:

Reserve at June 30, 2012	$	1,290,000
Incurred claims and changes in estimates		—
Claims payments		(30,000)
Reserve at June 30, 2013		1,260,000
Incurred claims and changes in estimates		30,000
Claims payments		—
Reserve at June 30, 2014	$	1,290,000

The self-insurance reserve is included in the interest, patient refunds and other line item on the statements of net position.

(9) Retirement Plans

VMC maintains a defined contribution plan, the Money Purchase Pension Plan, that covers substantially all of its employees. The plan is administered by VMC. VMC's contribution is based on the salaries of active participants in accordance with formulas specified in the plan. Plan provisions and contribution requirements are established by VMC and may be amended by VMC's Board of Trustees. Actuarial assumptions are not used in the determination of costs because benefits are payable only to the extent of available assets derived from contributions and plan earnings.

Employer contributions to the plan were $5,499,657 and $14,674,893 for the years ended June 30, 2014 and 2013, respectively. Employee contributions are permitted within the plan in an amount up to 10% of pay period earnings, capped at the annual amount allowed by federal law, and totaled $326,411 and $911,354 for the years ended June 30, 2014 and 2013, respectively.

VMC offers its employees two deferred compensation plans created in accordance with IRC Sections 403(b) and 457. The plans, available to all employees, permit them to defer a portion of their

salary until future years. Employee contributions to the plans totaled $7,759,024 and $7,521,069 for the years ended June 30, 2014 and 2013, respectively. The deferred compensation is payable to employees upon termination, retirement, death, or unforeseen emergency.

On September 16, 2013, the Board of Trustees passed two resolutions related to VMC's retirement plans. Effective September 29, 2013 and October 27, 2013, respectively, for certain employee groups, the VMC Money Purchase Pension Plan was terminated. As the pension plan was a defined contribution plan, and fully funded, there were no outstanding liabilities related to this termination. Effective the same dates, VMC began contributing a 5% employer contribution into the 403B plan for all eligible employees (10% in excess of the taxable wage base), with an additional 2% employer match on a 2% employee contribution.

On October 21, 2013, the Board of Trustees passed a resolution terminating the Money Purchase Pension Plan for all remaining employee groups, effective November 10, 2013. Subsequently, one of the collectively bargained groups, SEIU 1199, filed three grievances over the termination of the pension plan. VMC and SEIU agreed to arbitration, and signed a Memorandum of Understanding for the interim period, in which SEIU represented members would receive the 5% employer contribution into the 403B plan, but would not receive the 2% match on a 2% employer contribution, pending resolution of the grievance. VMC and SEIU subsequently agreed to mediation in lieu of arbitration. As a result of that mediation, SEIU withdrew its grievances, and agreed the Money Purchase Pension Plan has been terminated. VMC will fund approximately $3.7 million into SEIU members' 403(b) accounts in late October 2014 in settlement of the grievances over the pension plan termination. That settlement is accounted for as a liability on the balance sheet at June 30, 2014, and included in the employee benefit expense line on the income statement.

On several different dates, but retroactive back to November 10, 2013, VMC began contributing a 5% employer contribution into the 403B plan for all remaining employee groups with a 2% match on a 2% employer contribution. The terms of VMC's 403B plan were incorporated into their respective collectively bargained agreements.

Employer contributions into the 403B plan totaled $6,081,982 for the year ended June 30, 2014.

It is the opinion of internal legal counsel that VMC has no uninsured liability for losses under the plans. Under both plans, the participants select investments from alternatives offered by the plans, and the funds are held in trust/custodial accounts with the custodians, who are under contract with VMC to manage the plans. Investment selection by a participant may be changed each pay period. VMC manages none of the investment selections. By making the selections, enrollees accept and assume all risks that pertain to the plan and its administration.

In accordance with the Internal Revenue Service code, and accounted for in accordance with GASB Statements No. 32, *Accounting and Financial Reporting for Internal Revenue Code Section 457 Deferred Compensation Plans*, VMC placed the deferred compensation plan assets of the plans into a trust for the exclusive benefit of plan participants and beneficiaries.

VMC has limited administrative involvement and does not perform the investing function for either plan, as each plan has an investment advisor. VMC does not hold the assets of either plan in a trustee capacity and does not perform fiduciary accountability for the plan.

(10) Related-Party Transactions

VMC has engaged in a number of transactions with related parties. These transactions are recorded by VMC as either revenue or expense transactions because economic benefits are either provided or received by VMC. VMC records cash transfers between VMC and related parties that are not the result of economic benefits and are presented as nonoperating expense within net position.

(a) University of Washington

A total of $992,589 and $1,131,538 was paid by VMC to divisions of University of Washington for the years ended June 30, 2014 and 2013, respectively, for transactions primarily related to reference laboratory work, providing contracted nursing assistance with the Valley Nurse Line, and management assistance with the various pharmacies

(b) Intra-Governmental Transactions

VMC and its discretely presented component unit engage in a number of transactions with each other. These transactions are primarily for lease of medical office space and operational services.

Lease of Medical Office Space

The component unit has several lease agreements with VMC. Office space for three different locations is leased from VMC for approximately $930,789 and $923,000 for the years ended June 30, 2014 and 2013, respectively. The leases expire in December 2014, April 2015, and December 2017, respectively. The component unit has $1,253,000 in total outstanding minimum lease payments due to VMC.

Operational Services

During the years ended June 30, 2014 and 2013, IPV provided radiology services on behalf of VMC, which reimburses IPV for those services. Net patient service revenue for these services was approximately $9.6 million and $13.5 million, respectively. In April 2013, the contract between VMC and IPV was modified. VMC now bills for all IPV patients seen at the Olympic Building location. VMC pays IPV for services rendered, which is represented by the $5.3 million in other operating revenue for 2014.

(11) Commitments and Contingencies

(a) Operating Leases

VMC leases certain medical office space and equipment under operating lease arrangements with its discretely presented component unit and third parties. Similarly, the discretely presented component unit leases certain medical office space and equipment under operating leases with VMC and third parties. Total rental expense in the year ended June 30, 2014 was $7,714,879 and $630,732 for VMC

and the discretely presented component unit, respectively. Total rental expense in the year ended June 30, 2013 was $10,155,178 and $1,015,385 for VMC and the discretely presented component unit, respectively.

The following schedule shows future minimum lease payments by fiscal year for VMC and the discretely presented component unit as of June 30, 2014:

		VMC	Component unit
2015	$	6,821,107	606,000
2016		6,017,282	259,000
2017		5,677,304	259,000
2018		5,495,675	129,000
2019		4,667,995	—
Thereafter		13,081,305	—
Total minimum lease payments	$	41,760,668	1,253,000

(b) Construction Commitments

VMC has current commitments at June 30, 2014 of $3.5 million related to various construction projects, equipment purchases and information technology implementations. VMC intends to use capital funds for these commitments.

(c) Regulatory Environment

The healthcare industry is subject to numerous laws and regulations from 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 from government healthcare programs, together with the imposition of significant fines and penalties, as well as significant repayments for patient services previously billed. Management believes that VMC is in compliance with the fraud and abuse regulations as well as other applicable government laws and regulations. Compliance with such laws and regulations can be subject to future government review and interpretation as well as regulatory actions unknown or unasserted at this time.

(d) Litigation

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

(e) Collective Bargaining Agreements

VMC has a total of approximately 2,602 employees. Of this total, approximately 72% and 73% are covered collective bargaining agreements as of June 30, 2014 and 2013, respectively. Nurses are represented by SEIU 1199 and other healthcare and support workers are represented by OPEIU, UFCW, and IUOE Operating Engineers. The collective bargaining agreements with SEIU 1199 expires on June 30, 2015. OPEIU, UFCW, and IUOW Operating Engineers expire on; June 30, 2017; March 31, 2016 and October 31, 2016, respectively.

MCAG NO. 1469

King County Public Hospital District No. 1

Schedule 16

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

For the Year Ended June 30, 2014

Federal Agency Name/Pass-Through Agency Name	Federal Program Name	CFDA Number	Other Award Number	Expenditures			Footnote Ref
				From Pass-Through Awards	From Direct Awards	Total Amount	
Centers For Disease Control And Prevention, Department Of Health And Human Services/Washington State Department of Health	Immunization Cooperative Agreements	93.268	C16898	830,394		830,394	Note 3
Centers For Disease Control And Prevention, Department Of Health And Human Services/Health Care Without Harm	PPHF: Community Transformation Grants - Small Communities Program financed solely by Public Prevention and Health Funds	93.737	N/A	3,750		3,750	
Centers For Medicare And Medicaid Services, Department Of Health And Human Services/Health Care Authority, Division of Health Care Services	Medical Assistance Program	93.778	1369-72641	91,872		91,872	
Office Of The Secretary, Department Of Health And Human Services/Washington State Hospital Association	National Bioterrorism Hospital Preparedness Program	93.889	5U90TP000559	5,352		5,352	
			Total Federal Awards Expended:	**931,368**	**0**	**931,368**	

The accompanying notes to the Schedule of Expenditures are an integral part of this schedule

PUBLIC HOSPITAL DISTRICT NO. 1 OF KING COUNTY
VALLEY MEDICAL CENTER

NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
For the Year Ended June 30, 2014

NOTE 1 – BASIS OF ACCOUNTING

This schedule is prepared on the same basis of accounting as the District's financial statements. The District reports its financial information in a form which complies with the pronouncements of the Governmental Accounting Standards Board and the "Audit and Accounting Guide for Healthcare Organizations" of the American Institute of Certified Public Accountants.

NOTE 2 – PROGRAM COSTS

The amounts shown as current year expenditures represent only the federal grant portion of the program costs. Entire program costs, including the District's portion, may be more than shown.

NOTE 3 – NONCASH AWARDS - VACCINATIONS

The amount of vaccine reported on the schedule is the value of vaccines received by the District during the current year and priced as prescribed by the Washington State Department of Health.

ABOUT THE STATE AUDITOR'S OFFICE

The State Auditor's Office is established in the state's Constitution and is part of the executive branch of state government. The State Auditor is elected by the citizens of Washington and serves four-year terms.

We work with our audit clients and citizens to achieve our vision of government that works for citizens, by helping governments work better, cost less, deliver higher value, and earn greater public trust.

In fulfilling our mission to hold state and local governments accountable for the use of public resources, we also hold ourselves accountable by continually improving our audit quality and operational efficiency and developing highly engaged and committed employees.

As an elected agency, the State Auditor's Office has the independence necessary to objectively perform audits and investigations. Our audits are designed to comply with professional standards as well as to satisfy the requirements of federal, state, and local laws.

Our audits look at financial information and compliance with state, federal and local laws on the part of all local governments, including schools, and all state agencies, including institutions of higher education. In addition, we conduct performance audits of state agencies and local governments as well as fraud, state whistleblower and citizen hotline investigations.

The results of our work are widely distributed through a variety of reports, which are available on our website and through our free, electronic subscription service.

We take our role as partners in accountability seriously, and provide training and technical assistance to governments, and have an extensive quality assurance program.

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