Office of the Washington State Auditor
Pat McCarthy

February 13, 2017

Board of Commissioners
Kennewick Public Hospital District No. 1
Kennewick, Washington

Contracted CPA Firm's Audit Report on Financial Statements

We have reviewed the audit report issued by a certified public accounting (CPA) firm on Kennewick Public Hospital District No. 1's financial statements for the fiscal year ended December 31, 2015. The District contracted with the CPA firm for this audit under an agreement with the State Auditor's Office.

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

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

Sincerely,

Pat McCarthy

State Auditor

Olympia, WA

Financial Statements and
Management Discussion and Analysis
December 31, 2015 and 2014

Kennewick Public Hospital District

EideBailly
CPAs & BUSINESS ADVISORS

Independent Auditor's Report

The Board of Commissioners
Kennewick Public Hospital District
Kennewick, Washington

Report on the Financial Statements

We have audited the accompanying statements of net position, and the related statements of revenues and expenses and changes in net position, and statements of cash flows for Kennewick Public Hospital District (District), and of its discretely presented component unit, Kennewick General Hospital Foundation, as of and for the years ended December 31, 2015 and 2014, and the related notes to the financial statements, which collectively comprise the District's basic financial statements.

Management's Responsibility for the Financial Statements

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

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 entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of financial statements.

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

Opinions

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective net position of Kennewick Public Hospital District, and of its discretely presented component unit, Kennewick General Hospital Foundation, as of December 31, 2015 and 2014, and the respective changes in net position and cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matter

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 3 through 6 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated May 3, 2016, on our consideration of Kennewick Public Hospital District’s internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, 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 the 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 Kennewick Public Hospital District’s internal control over financial reporting and compliance.

Eide Bailly LLP

Fargo, North Dakota
May 3, 2016

The following discussion and analysis for Kennewick Public Hospital District (District) financial performance provides an overview of the District's financial activities for the years ended December 31, 2015, 2014, and 2013. Please read it in conjunction with the District's financial statements, which follow this analysis.

Financial Highlights

- The District's net position decreased in the current fiscal year from $35,779,357 to $35,384,073. This is a decrease of $395,284 or 1.1%. In the prior fiscal year ending December 31, 2014, net position decreased from $44,958,719 to $35,779,357 for a decrease of $9,206,362 or 20.5%.

- Operating revenue increased by $25,437,037 or 16.1% during the current fiscal year. At the same time, operating expenses increased by $12,124,450 or 7.3%. Operating revenue increased $17,222,788 or 12.2% during the fiscal year ending December 31, 2014 and operating expenses increased by $18,223,081 or 12.3%.

- The District showed an operating income for the current fiscal year of $5,344,613 compared to operating losses of $7,967,974 in 2014 and $6,967,681 in 2013. The operating income is mainly due to the second campus being open a full year in 2015 which resulted in a significant increase in patient volume and better management of expenses during the period of patient volume growth. The significant operating loss in 2014 is due to the increase in operating expenses and the opening of a second campus during the year.

Using This Annual Report

The District's financial statements consist of three statements – a Statement of Net Position; a Statement of Revenues, Expenses and Changes in Net Position; and a Statement of Cash Flows. These financial statements and related notes provide information about the activities of the District including resources held by the District but restricted for specific purposes by contributors, grantors, or enabling legislation.

The Statement of Net Position and Statement of Operations and Changes in Net Position

One of the most important questions asked about the District's finances is, "Is the District as a whole better or worse off as a result of the year's activities?" The Statement of Net Position and the Statement of Revenues, Expenses, and Changes in Net Position report information about the District's resources and its activities in a way that helps answer this question. These statements include all restricted and unrestricted assets and all liabilities using the accrual basis of accounting. All of the current year's revenues and expenses are taken into account regardless of when cash is received or paid.

The Statement of Cash Flows

The final required statement is the Statement of Cash Flows. This statement reports cash receipts, cash payments, and net changes in cash resulting from operations, investing, and financing activities. It provides answers to such questions as "Where did cash come from?", "What was cash used for?", and "What was the change in cash balance during the reporting period?"

The District's Net Position

The District's net position is the difference between its assets, liabilities and deferred inflows of resources as reported in the Statement of Net Position. The District's net position decreased in 2015 by $395,284 or 1.1%.

Table 1 – Assets, Liabilities, Deferred Inflows of Resources, and Net Position

	2015	2014	2013 (restated)
Assets			
Current assets	$ 44,780,202	$ 34,457,673	$ 31,987,177
Capital assets, net of accumulated depreciation	199,596,537	157,556,202	38,162,910
Other noncurrent assets	17,406,410	14,702,785	28,056,429
Total assets	$ 261,783,149	$ 206,716,660	$ 98,206,516
Liabilities			
Current liabilities	$ 31,303,312	$ 29,861,874	$ 20,531,774
Long-term debt, less current maturities	190,747,791	141,075,429	32,689,023
Total liabilities	222,051,103	170,937,303	53,220,797
Deferred Inflows of Resources	4,347,973	-	-
Net Position			
Net investment in capital assets	7,529,849	14,664,840	19,193,055
Restricted:			
Expendable for debt service	7,147,671	4,780,365	1,516,384
Expendable for capital acquisitions and specific operating activities	236,172	227,771	336,892
Nonexpendable	749,435	749,435	749,435
Unrestricted	19,720,946	15,356,946	23,189,953
Total net position	35,384,073	35,779,357	44,985,719
Total liabilities, deferred inflows of resources, and net position	$ 261,783,149	$ 206,716,660	$ 98,206,516

Operating Results and Changes in the District's Net Position

In 2015, net patient service revenue increased $23,880,978 or 15.4% from prior year. The increase is attributed to full year of operations at the Southridge Campus, which increased patient volumes, and increased reimbursement. In 2014, the Southridge Campus opened mid-year which led to an increase in patient volumes for the remainder of 2014. The District's reimbursement levels remained consistent. These two factors contributed to net patient service revenue increasing $18,382,817 or 13.5% from the prior year.

Table 2 – Operating Results and Changes in Net Position

	2015	2014	2013 (restated)
Operating Revenues			
Net patient service revenue	$ 178,918,894	$ 155,037,916	$ 136,655,099
Other operating revenue	4,943,777	3,387,718	4,547,747
Total operating revenue	183,862,671	158,425,634	141,202,846
Operating Expenses			
Salaries, wages, and employee benefits	100,442,973	94,559,056	90,427,800
Supplies and other	65,548,169	62,520,202	50,993,187
Depreciation and amortization	12,526,916	9,314,350	6,749,540
Total operating expenses	178,518,058	166,393,608	148,170,527
Operating Income (Loss)	5,344,613	(7,967,974)	(6,967,681)
Nonoperating Revenues (Expenses)			
Property taxes	1,296,396	1,264,944	1,210,940
Investment income	201,798	197,528	288,720
Interest expense	(12,853,475)	(5,491,752)	(1,068,025)
Noncapital contributions and donations	54,978	83,167	213,009
Other nonoperating revenues/expenses	5,245,095	1,248,209	203,282
Nonoperating revenues (expenses), net	(6,055,208)	(2,697,904)	847,926
Expenses in Excess of Revenues Before Capital Contributions	(710,595)	(10,665,878)	(6,119,755)
Capital Contributions	315,311	1,459,516	57,599
Decrease in Net Position	$ (395,284)	$ (9,206,362)	$ (6,062,156)
Net Position, Beginning of Year, as Previously Reported	$ 35,779,357	$ 48,536,719	$ 51,047,875
Correction of Error	-	(3,551,000)	-
Net Position, Beginning of Year, as Restated	35,779,357	44,985,719	51,047,875
Decrease in Net Position	(395,284)	(9,206,362)	(6,062,156)
Net Position, End of Year	$ 35,384,073	$ 35,779,357	$ 44,985,719

District's Cash Flows

Cash and cash equivalents increased from $3,054,615 in 2014 to $4,527,955 in 2015. Cash and cash equivalents decreased $13,148,678 between 2013 and 2014. This decrease was due to lease funds on hand at 2013 year-end of $16,397,624, which were used during 2014.

Capital Asset and Debt Administration

Capital Assets

The District experienced a net increase in capital assets of $42,040,335 or 26.7% from 2014 to 2015 as compared to a net increase of $119,393,292 or 312.9% from 2013 to 2014. The District spent approximately $55.1 million on new additions in 2015 and entered into capital lease arrangements of approximately $51.3 million, $43.7 million of that relating to the Southridge Care Center. The District spent approximately $15.8 million on new additions in 2014.

Long-Term Debt

At the end of 2015, the District had $190,747,791 in long-term debt and obligations under capital leases, net of the current portion. This is an increase of $49,672,362 or 35.2% from 2014. This increase was due to several new capital equipment leases totaling approximately $7.6 million and the recording of the Southridge Care Center lease of $43.7 million.

Economic Factors

The health care market continues to be a challenge. There are many factors that impact the industry. Some of these factors are as follows:

- National economy
- State budget deficits
- Uninsured and underinsured patients
- Changes in reimbursement
- Physician shortages
- Increases in supply costs
- Facilities at the District that require constant maintenance
- Government regulation and health care reform

Contacting the District Financial Management

This financial report is designed to provide our patients, suppliers, taxpayers, and creditors with a general overview of the District's finances and to show the District's accountability for the money it receives. If you have questions about this report and or need additional financial information, contact the CFO at Trios Health, 3810 Plaza Way, Kennewick, WA 99336.

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	2015	2014
Assets		
Current Assets		
Cash and cash equivalents	$ 4,527,955	$ 3,054,615
Receivables		
Patients, net of estimated uncollectibles of $39,865,000 in 2015 and $39,584,000 in 2014	26,894,841	25,711,149
Other	1,536,651	197,869
Estimated third-party payor settlements	5,051,183	1,184,740
Supplies	3,481,907	3,026,457
Prepaid expenses	3,287,665	1,282,843
Total current assets	44,780,202	34,457,673
Noncurrent Cash and Investments		
Internally designated for capital acquisitions and insurance reserves	564,212	505,291
Other long-term investments	857,347	905,275
Restricted under indenture or lease agreement	7,147,671	4,780,365
Total noncurrent cash and investments	8,569,230	6,190,931
Capital Assets		
Capital assets not being depreciated	3,462,448	5,129,870
Depreciable capital assets, net of accumulated depreciation	196,134,089	152,426,332
Total capital assets	199,596,537	157,556,202
Other Assets		
Investments in joint ventures	8,456,288	8,130,962
Land held for sale	328,919	328,919
Other long-term assets, net	51,973	51,973
Total other assets	8,837,180	8,511,854
Total assets	$ 261,783,149	$ 206,716,660

	2015	2014
Liabilities, Deferred Inflows of Resources, and Net Position		
Current Liabilities		
Note payable	$ 315,738	$ 500,000
Current maturities of long-term debt	7,000,143	3,215,639
Accounts payable		
Trade	11,172,832	16,487,725
Warrants	2,784,119	840,053
Accrued expenses		
Salaries and wages	3,608,106	2,777,116
Vacation	3,043,929	3,238,418
Payroll taxes and other	3,199,326	2,585,851
Interest	179,119	217,072
Total current liabilities	31,303,312	29,861,874
Long-Term Debt, Less Current Maturities	190,747,791	141,075,429
Total liabilities	222,051,103	170,937,303
Deferred Inflows of Resources		
Lease interest	4,347,973	-
Net Position		
Net investment in capital assets	7,529,849	14,664,840
Restricted:		
Expendable for debt service	7,147,671	4,780,365
Expendable for capital acquisitions and specific operating activities	236,172	227,771
Nonexpendable	749,435	749,435
Unrestricted	19,720,946	15,356,946
Total net position	35,384,073	35,779,357
Total liabilities, deferred inflows of resources, and net position	$ 261,783,149	$ 206,716,660

	2015	2014
Assets		
Cash and cash equivalents	$ 1,136,519	$ 452,495
Pledges receivable	687,189	808,067
Investments	576,261	571,042
Total assets	$ 2,399,969	$ 1,831,604
Unrestricted Net Assets	$ 2,399,969	$ 1,831,604

	2015	2014
Operating Revenues		
Net patient service revenue (net of provision for bad debts of $8,532,785 in 2015 and $6,455,831 in 2014)	$ 178,918,894	$ 155,037,916
Electronic health record incentive revenue	1,523,750	1,675,754
Gain from joint ventures, net	526,756	106,156
Other revenue	2,893,271	1,605,808
Total operating revenues	183,862,671	158,425,634
Operating Expenses		
Salaries and wages	80,456,468	76,009,070
Employee benefits	19,986,505	18,549,986
Professional fees	10,633,493	7,998,774
Supplies	29,107,862	27,603,849
Purchased services, utilities	2,293,153	2,006,111
Purchased services, other	14,284,493	15,322,914
Insurance	2,071,273	2,608,733
Rent	3,407,532	3,124,860
Licenses and taxes	2,374,698	2,484,643
Other	1,375,665	1,370,318
Depreciation and amortization	12,526,916	9,314,350
Total operating expenses	178,518,058	166,393,608
Operating Income (Loss)	5,344,613	(7,967,974)
Nonoperating Revenues (Expenses)		
Property taxes	1,296,396	1,264,944
Investment income	201,798	197,528
Interest expense	(12,853,475)	(5,491,752)
Noncapital contributions and donations	54,978	83,167
Gain on sale of assets	1,411,642	960,673
Other	3,833,453	287,536
Nonoperating expenses, net	(6,055,208)	(2,697,904)
Expenses in Excess of Revenues Before Capital Contributions	(710,595)	(10,665,878)
Capital Contributions	315,311	1,459,516
Change in Net Position	(395,284)	(9,206,362)
Net Position, Beginning of Year	35,779,357	44,985,719
Net Position, End of Year	$ 35,384,073	$ 35,779,357

	2015	2014
Unrestricted Net Assets		
Support and revenue		
Contributions	$ 333,460	$ 538,175
Special events	269,292	284,582
Net assets released from restrictions	528,156	1,807,289
Investment income (loss)	(11,282)	20,742
Total support and revenue	1,119,626	2,650,788
Expenses		
Contributions to Kennewick Public Hospital District	315,311	1,489,628
Program and fundraising	75,985	101,421
General services and administrative	159,965	129,703
Total operating expenses	551,261	1,720,752
Increase in Unrestricted Net Assets	568,365	930,036
Temporarily Restricted Net Assets		
Contributions for a specific purpose	528,156	682,431
Net assets released from restrictions	(528,156)	(1,807,289)
Decrease in Temporarily Restricted Net Assets	-	(1,124,858)
Increase (Decrease) in Net Assets	568,365	(194,822)
Net Assets, Beginning of Year	1,831,604	2,026,426
Net Assets, End of Year	$ 2,399,969	$ 1,831,604

	2015	2014
Operating Activities		
Receipts from and on behalf of patients	$ 173,868,759	$ 151,768,562
Payments to suppliers and contractors	(67,953,825)	(53,764,998)
Payments to employees	(99,192,997)	(92,874,269)
Other receipts and payments	3,078,239	4,024,646
Net Cash From Operating Activities	9,800,176	9,153,941
Noncapital Financing Activities		
Noncapital contributions and donations	54,978	83,167
Property taxes	1,296,396	1,264,944
Other	3,833,453	287,536
Net Cash From Noncapital Financing Activities	5,184,827	1,635,647
Capital and Capital Related Financing Activities		
Principal payments on long-term debt	(5,071,680)	(5,152,171)
Repayment of note payable	(184,262)	(1,000,000)
Interest paid	(13,053,682)	(5,506,604)
Purchase and construction of capital assets	(3,741,276)	(15,802,917)
Capital contributions	315,311	1,459,516
Proceeds from sale of capital assets	1,950,000	1,171,755
Proceeds from deferred inflows - lease interest	4,510,227	-
Proceeds from issuance of long-term debt	3,771,031	-
Net Cash Used For Capital and Capital Related Financing Activities	(11,504,331)	(24,830,421)
Investing Activities		
Investment income	201,798	197,528
Sale of investments	188,799	108,037
Purchases of investments	(141,699)	(115,684)
Decrease in noncurrent notes receivable	(32,261)	(79,207)
Distributions from joint ventures	200,687	189,959
Proceeds from sale of land held for sale	-	591,482
Net Cash From Investing Activities	417,324	892,115
Net Change in Cash and Cash Equivalents	3,897,996	(13,148,718)
Cash and Cash Equivalents, Beginning of Year	8,533,303	21,682,021
Cash and Cash Equivalents, End of Year	$ 12,431,299	$ 8,533,303

	2015	2014
Reconciliation of Cash and Cash Equivalents to the Balance Sheets		
Cash and cash equivalents in current assets	$ 4,527,955	$ 3,054,615
Cash and cash equivalents in noncurrent cash and investments	7,903,344	5,478,688
Total cash and cash equivalents	$ 12,431,299	$ 8,533,303
Reconciliation of Operating Income (Loss) to Net Cash From Operating Activities		
Operating income (loss)	$ 5,344,613	$ (7,967,974)
Adjustments to reconcile operating loss to net cash flows from operating activities		
Gain from joint ventures	(526,756)	(106,156)
Depreciation and amortization	12,526,916	9,314,350
Provision for bad debts	8,532,785	6,455,831
Changes in assets and liabilities		
Patient receivables, net of provision for bad debts	(9,716,477)	(9,009,606)
Other receivables	(1,338,782)	743,084
Estimated third-party payor settlements	(3,866,443)	(715,579)
Supplies	(455,450)	(326,771)
Prepaid expenses	(2,004,822)	19,036
Accounts payable	54,616	9,062,939
Accrued expenses	1,249,976	1,684,787
Net Cash From Operating Activities	$ 9,800,176	$ 9,153,941
Supplemental Disclosure of Noncash Activities		
Building and equipment financed through capital lease arrangements	$ 51,332,072	$ 113,135,803
Financing accounts payable	$ 3,425,443	$ -

Note 1 - Reporting Entity and Summary of Significant Accounting Policies

The financial statements of the Kennewick Public Hospital District (District) have been prepared in accordance with generally accepted accounting principles in the United States of America. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles. The significant accounting and reporting policies and practices used by the District are described below.

Reporting Entity

The District owns and operates Trios Health, a 37-bed acute care hospital (Auburn Campus) and a 74-bed acute care hospital (Southridge Campus), medical clinics, and Benton Franklin Elder Services, doing business as Adult Day Services of the Tri-Cities, an adult day care center. The District provides health care services to patients in the Benton and Franklin County markets. The District services include acute care hospital, emergency room, home health, physician clinic, adult day care, and related ancillary procedures (laboratory, radiology, etc.) associated with these services. The District operates under the laws of the State of Washington for Washington municipal corporations. It was created in 1949 by the voters of Benton County to operate, control, and manage all matters concerning the County’s health care functions.

For financial reporting purposes, the District has included all funds, organizations, agencies, boards, commissions, and authorities. The District has also considered all potential component units for which it is financially accountable and other organizations for which the nature and significance of their relationship with the District are such that the exclusion would cause the District’s financial statements to be misleading or incomplete. The GASB has set forth criteria to be considered in determining financial accountability. These criteria include appointing a voting majority of an organization’s body and (1) the ability of the District to impose its will on that organization or (2) the potential for the organization to provide specific benefits to or impose specific financial burdens on the District. Governmental Accounting Standards Board (GASB) No. 61 requires organizations that are “closely related to, or financial integrated” with the primary government be evaluated as potential component units by the primary government.

Blended Component Units

Trios Health and Benton Franklin Elder Services, doing business as Adult Day Services of the Tri-Cities, have been determined to be component units and are presented as blended component units in the District’s financial statements.

Discretely Presented Component Unit

Kennewick General Hospital Foundation d/b/a Trios Foundation (Foundation) was organized to solicit and accept charitable distributions in order to provide support to the District. The Foundation has been determined to be a component unit and is presented as a discretely presented component unit in the District’s financial statements.

Kennewick General Hospital Auxiliary d/b/a Trios Health Auxiliary (Auxiliary) is comprised of members who volunteer their time to benefit the District and hold various fundraisers to raise money. The Auxiliary is not considered a component unit of the District, as the economic resources received or held by the Auxiliary are not considered significant to the District. As the Auxiliary is not considered a component unit, the financial statements are not included in the financial statements of the District.

The Auxiliary provided contributions of $18,222 in 2015. There were no contributions received from the Auxiliary in 2014.

Measurement Focus and Basis of Accounting

Basis of accounting refers to when revenues and expenses are recognized in the accounts and reported in the financial statements. Basis of accounting relates to the timing of the measurements made, regardless of the measurement focus applied.

The accompanying financial statements have been prepared on the accrual basis of accounting in conformity with accounting principles generally accepted in the United States of America. Revenues are recognized when earned, and expenses are recorded when the liability is incurred.

Basis of Presentation

The statement of net position displays the District's assets and liabilities with the difference reported as net position. Net position is reported in the following categories/ components:

> *Net investment in capital assets* consists of net capital assets reduced by the outstanding balances of any related debt obligations attributable to the construction or improvement of those assets or the related debt obligations.
>
> *Restricted net position*:
>
> Expendable net position results when constraints placed on net position use are either externally imposed or imposed through enabling legislation.
>
> Nonexpendable net position is subject to externally imposed stipulations, which require them to be maintained permanently by the District.
>
> *Unrestricted net position* consists of net position not meeting the definition of the preceding categories. Unrestricted net position often has constraints on resources imposed by management, which can be removed or modified.

When an expense is incurred that can be paid using either restricted or unrestricted resources (net position), the District's policy is to first apply the expense toward the most restrictive resources and then toward unrestricted resources.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements. Estimates also affect the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Cash and Cash Equivalents

Cash and cash equivalents include deposits and highly liquid investments with an original maturity of three months or less, excluding internally designated or restricted cash and investments. For purposes of the statements of cash flows, the District considers all cash and highly liquid investments as cash and cash equivalents.

Patient Receivables

Patient receivables are uncollateralized patient and third party payor obligations. Payments of patient receivables are allocated to the specific claims identified in the remittance advice or, if unspecified, are applied to the earliest unpaid claim.

The carrying amount of patient receivables is reduced by a valuation allowance that reflects management's estimate of amounts that will not be collected from patients and third-party payors. Management reviews patient receivables by payor class and applies percentages to determine estimated amounts that will not be collected from third parties under contractual agreements and amounts that will not be collected from patients due to bad debts. Management considers historical write off and recovery information in determining the estimated bad debt provision.

Supplies

Supplies are stated cost (first-in, first-out).

Noncurrent Cash and Investments

Noncurrent cash and investments consist of other long-term investments, amounts restricted under indenture or lease agreements, and amounts that are set aside by the Board of Commissioners for future capital improvements, scholarships, and insurance reserves, over which the Board retains control and may at its discretion subsequently use for other purposes.

The Revised Code of Washington, Chapter 39, authorizes municipal governments to invest their funds in a variety of investments including federal, state, and local government certificates, notes, or bonds; the State of Washington investment pool; savings accounts in qualified public depositories; and certain other investments. The District's investment policy specifies that investments will be limited to collateralized certificates of deposit, collateralized repurchase options, passbook savings, money market checking, U.S. Government Treasury securities, or investments with the Washington State Local Government Investment Pool. The District has elected to be their own treasurer, issuing warrants and making investments.

Investment Income

Interest, dividends, gains and losses, both realized and unrealized, on investments in debt and equity securities are included in nonoperating revenues when earned.

Capital Assets

Capital asset acquisitions in excess of $1,500 are capitalized and recorded at cost. Contributed capital assets are reported at their estimated fair value at the time of their donation. Depreciation is provided over the estimated useful life of each depreciable asset and is computed using the straight-line method. Building and equipment under capital lease obligations are amortized on the straight-line method over the shorter period of the lease term or the estimated useful life of the building or equipment. Amortization is included in depreciation and amortization in the financial statements. The estimated useful lives of capital assets are as follows:

Land Improvements	15 to 20 years
Buildings and Improvements	20 to 40 years
Equipment	3 to 20 years

Gifts of long-lived assets such as land, buildings, or equipment are reported as additions to unrestricted net position, and are excluded from revenues in excess of (less than) expenses. Gifts of long-lived assets with explicit restrictions that specify how the assets are to be used and gifts of cash or other assets that must be used to acquire long-lived assets are reported as restricted net position.

Investments in Joint Ventures

Joint ventures in which the District has an equity interest and either an ongoing financial interest or an ongoing financial responsibility are reported originally at cost and adjusted for changes in the equity interest in accordance with the joint venture agreement and for any other transactions, such as return on capital. Gains and losses resulting from investments in joint ventures directly related to the District's health care activities are recorded as operating revenues.

Compensated Absences

The District's employees earn paid time-off for vacation and sick leave at varying rates depending on years of service. Employees may accumulate paid time-off up to a specified maximum. Employees are paid for accumulated paid time-off upon termination. The liability for compensated absences is included in accrued expenses in the accompanying financial statements.

Estimated Health Claims Payable

The District provides for self-insurance reserves for estimated incurred but not reported claims for its employee health plan. These reserves, which are included in current liabilities on the statement of net position, are estimated based upon historical submission and payment data, cost trends, utilization history, and other relevant factors. Adjustments to reserves are reflected in the operating results in the period in which the change in estimate is identified.

Deferred Inflows of Resources

Deferred inflow of resources represents an increase in net position that applies to future periods and so will not be recognized as an inflow of resources (revenue) until then. The deferred inflow of resource reported in the financial statements relates to money received due to the construction costs of the Southridge Medical Office Building being under budget and will be recognized to offset the interest expense on the lease. This will be amortized over the life of the lease using the effective interest method.

Operating Revenues and Expenses

The District's statement of revenues, expenses, and changes in net position distinguishes between operating and nonoperating revenues and expenses. Operating revenues and expenses of the District result from exchange transactions associated with providing health care services – the District's principal activity, and the costs of providing those services, including depreciation and excluding interest cost. All other revenues and expenses are reported as nonoperating.

Net Patient Service Revenue

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

Charity Care

The District provides health care services to patients who meet certain criteria under its charity care policy without charge or at amounts less that established rates. Since the District does not pursue collection of these amounts, they are not reported as patient service revenue. The estimated cost of providing these services was $1,152,000 and $2,714,000 for the years ended December 31, 2015 and 2014, calculated by multiplying the ratio of cost to gross charges for the District by the gross uncompensated charges associated with providing charity care to its patients.

Grants and Contributions

The District may receive grants as well as contributions from individuals and private organizations. Revenues from grants and contributions (including contributions of capital assets) are recognized when all eligibility requirements, including time requirements, are met. Grants and contributions may be restricted for either specific operating purposes or for capital purposes. Amounts that are unrestricted or that are restricted to a specific operating purpose are reported as nonoperating revenues. Amounts restricted for capital acquisitions are reported after revenues in excess of (less than) expenses.

Electronic Health Record Incentive Payments

The American Recovery and Reinvestment Act of 2009 (ARRA) amended the Social Security Act to establish incentive payments under the Medicare and Medicaid programs for certain hospitals and professionals that demonstrate meaningful use certified Electronic Health Records (EHR) technology.

The District is eligible for incentive payments from both Medicare and Medicaid for hospital services. These incentive payments will be paid out over four years on a transitional schedule. For eligible physicians, the District may choose to participate in either the Medicare or Medicaid program and change once during the process. These incentive payments will be paid out over six years on a transitional schedule. To qualify for the EHR incentive payments, hospitals and physicians must meet designated EHR meaningful use criteria. In addition, for first year payments from Medicaid, the hospital must demonstrate adoption, implementation, or upgrade of health care technology, but is not required to demonstrate meaningful use. For remaining Medicaid incentive payments and all Medicare incentive payments, hospitals must attest that they have used certified EHR technology, satisfied the meaningful use objectives, and specify the EHR reporting period. This attestation is subject to audit by the federal government or its designee. The EHR incentive payment to hospitals for each payment year is calculated as a product of (1) an initial amount; (2) the Medicare or Medicaid share; and (3) a transition factor applicable to that payment year.

The District recognizes EHR incentive payments as revenue when there is reasonable assurance that the District will comply with the conditions attached to the incentive payments. EHR incentive payments are included in other operating revenue in the accompanying financial statements. The amount of EHR incentive payments recognized are based on management's best estimate and those amounts are subject to change with such changes impacting the period in which they occur.

The District recognized revenues of $1,523,750 and $1,675,754 for the years ended December 31, 2015 and 2014 related to EHR incentive payments. These incentive payments are included in operating revenue in the accompanying financial statements.

Property Taxes

Property taxes are levied by the County on the District's behalf. The property taxes are intended to finance the District's activities of the same calendar year. Property taxes are recognized as revenue when received and are used for operations.

Levy date	–	January 1
Lien date	–	May 1
Due dates	–	April 30 and October 31

Reclassifications

Reclassifications have been made to the December 31, 2015 financial information to make it conform to the current year presentation. The reclassifications had no effect on previously reported operating results or changes in net position.

Note 2 - Net Patient Service Revenue

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

Medicare: Inpatient acute care and outpatient services rendered to Medicare program beneficiaries are paid at prospectively determined rates per visit. These rates vary according to a patient classification system based on clinical, diagnostic, and other factors. The District is reimbursed for these services at a tentative rate with final settlement determined after submission of annual cost reports by the District and audits thereof by the Medicare administrative contractor. The District's Medicare cost reports have been audited by the Medicare administrative contractor through the year ended December 31, 2007.

Medicaid – Inpatient acute care services rendered to Medicaid program beneficiaries are paid based on the Medicaid's Disproportionate Share Hospital Program. This program provides adequate financial support to hospitals that serve a significant number of low-income patients with special needs. DSH payments are based on a mathematical formula designed to achieve a predetermined distribution of payments between public and private hospitals. During 2015, the District received a $2,133,358 settlement on 2015. The District also has $2,144,195 included in receivables that is for the 2014 settlement.

Blue Cross: Inpatient and outpatient services rendered to Blue Cross subscribers are paid at established rates except for physician services which are reimbursed based on fee schedules.

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

Concentrations of net revenues by major payor accounted for the following percentages of the District's patient service revenues for the years ended December 31, 2015 and 2014:

	2015	2014
Medicare	41%	34%
Medicaid and Healthy Options	32%	19%
Blue Cross	22%	27%
Group Health	4%	4%
Other	1%	16%
	100%	100%

Laws and regulations governing the Medicare, Medicaid, and other programs are extremely complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term. Occasionally, final settled cost reports are reopened when necessary to appeal specific items. The net patient service revenue for the year ended December 31, 2014 decreased approximately $121,000 due to removal of allowances previously estimated that are no longer necessary as a result of final settlements, adjustments to amounts previously estimated and years that are no longer likely subject to audits, reviews, and investigations.

The Centers for Medicare and Medicaid Services (CMS) has implemented a Recovery Audit Contractor (RAC) program under which claims are reviewed by contractors for validity, accuracy, and proper documentation. A demonstration project completed in several other states resulted in the identification of potential overpayments, some being significant. If selected for audit, the potential exists that the District may incur a liability for a claims overpayment at a future date. The District is unable to determine if it will be audited and, if so, the extent of the liability of overpayments, if any. The District has recorded a reserve of $100,000 for the years ended December 31, 2015 and 2014.

Note 3 - Deposits and Investments

The carrying amounts of deposits and investments as of December 31, 2015 and 2014 are as follows:

	2015	2014
Carrying amount		
Deposits	$ 12,431,299	$ 8,533,303
Investments	665,886	712,243
	$ 13,097,185	$ 9,245,546

Deposits and investments are reported in the following statement of net position captions:

	2015	2014
Included in the following balance sheet captions		
Cash and cash equivalents	$ 4,527,955	$ 3,054,615
Internally designated for capital acquisitions and scholarships	564,212	505,291
Other long-term investments	857,347	905,275
Restricted under indenture agreement	7,147,671	4,780,365
Total	$ 13,097,185	$ 9,245,546

Deposits – Custodial Credit Risk

Custodial credit risk is the risk that in the event of a bank or investment company failure, the District’s deposits may not be returned to it. The District has a general investment policy to minimize custodial credit risk.

The District had bank balances at December 31, 2015 and 2014 as follows:

	2015	2014
Insured (FDIC)	$ 1,038,451	$ 1,209,750
Collateralized by securities held by the pledging financial institution in the financial institution's name	91,602	709,951
Uncollateralized	11,901,583	7,195,363
Total	$ 13,031,636	$ 9,115,064
Carrying value	$ 12,431,299	$ 8,533,303

Investments

The District’s investments are reported at fair value. The District is authorized by statute to invest funds in state or local government bonds and in commercial paper.

The District had the following investments and maturities at December 31, 2015 and 2014:

December 31, 2015			Investment Maturities (in Years)		
Investment Type	Carrying Amount	Rating	0-5	6-10	More Than 10
Mutual funds	$ 468,641	N/A	$ 468,641	$ -	$ -
Mutual funds - international	157,510	N/A	157,510	-	-
Washington State Investment Pool	39,735	N/A	39,735	-	-
Total	$ 665,886		$ 665,886	$ -	$ -

December 31, 2014			Investment Maturities (in Years)		
Investment Type	Carrying Amount	Rating	0-5	6-10	More Than 10
Mutual funds	$ 526,577	N/A	$ 526,577	$ -	$ -
Mutual funds - international	145,996	N/A	145,996	-	-
Washington State Investment Pool	39,670	N/A	39,670	-	-
Total	$ 712,243		$ 712,243	$ -	$ -

Interest Rate Risk

Interest rate risk is the risk that changes in market interest rates will adversely affect the fair value of an investment. Generally, the longer the maturity of an investment, the greater the sensitivity of its fair value to changes in market interest rates. State statutes limit the investment in commercial paper to maturities not to exceed 180 days. The District's investment policy currently does not contain a provision that further limits investment maturities as a means of managing its exposure to fair value losses arising from increasing interest rates. The District will match investment maturities with anticipated cash flow requirements and investments shall not be committed for more than one year without the advance approval of the Finance and Audit Committee.

Credit Risk

The District's investment policy and State statutes limit investments in state or local government bonds to bonds with one of the three highest credit ratings of a nationally recognized rating agency and the investment in commercial paper to those with the highest short-term credit rating of any two nationally recognized statistical rating organizations. The District's investment policy currently does not contain a specific provision that further limits credit risk.

Concentration of Credit Risk

The District will limit credit risk, the risk of loss due to the failure of the security issuer or backer, by diversifying in the investment portfolio so that potential losses on individual securities will be minimized. The District places a limit that the amount that may be invested with any one bank or institution may not exceed 30%. If the maximum limit of 30% would require splitting a fund then this can be waived by the Finance and Audit Committee. Because of the diversified nature of the Washington State Local Government Investment Pool, there is no maximum limit necessary.

Investment Income

Investment income on cash equivalents, investments, and notes receivable consists of the following for the years ended December 31, 2015 and 2014:

	2015	2014
Nonoperating income		
Interest income and realized gains and losses	$ 201,798	$ 197,528

Note 4 - Capital Assets

Capital assets additions, retirements, transfers, and balances for the year ended December 31, 2015 are as follows:

	Balance December 31, 2014	Additions	Transfers and Retirements	Balance December 31, 2015
Capital assets not being depreciated				
Land	$ 1,580,987	$ -	$ -	$ 1,580,987
Construction in progress	3,548,883	3,350,520	(5,017,942)	1,881,461
Total capital assets, not being depreciated	$ 5,129,870	$ 3,350,520	$ (5,017,942)	$ 3,462,448
Capital assets being depreciated				
Land improvements	$ 2,501,845	$ -	$ -	$ 2,501,845
Building and improvements	166,855,292	43,842,184	(1,752,429)	208,945,047
Leasehold improvements	7,931,434	4,543,674	478,411	12,953,519
Equipment	73,122,713	7,478,305	(129,919)	80,471,099
Total capital assets being depreciated	250,411,284	$ 55,864,163	$ (1,403,937)	304,871,510
Less accumulated depreciation for				
Land improvements	(2,414,575)	$ (21,106)	$ -	(2,435,681)
Building and improvements	(43,390,615)	(6,167,440)	1,306,636	(48,251,419)
Leasehold improvements	(1,872,300)	(752,608)	310,306	(2,314,602)
Equipment	(50,307,462)	(5,553,501)	125,244	(55,735,719)
Total accumulated depreciation	(97,984,952)	$ (12,494,655)	$ 1,742,186	(108,737,421)
Net capital assets being depreciated	$ 152,426,332			$ 196,134,089
Capital assets, net	$ 157,556,202			$ 199,596,537

Construction in progress at December 31, 2015 represents costs related to information technology projects, and equipment purchased and not placed into service at December 31, 2015.

Capital assets additions, retirements, transfers, and balances for the year ended December 31, 2014 are as follows:

	Balance December 31, 2013	Additions	Transfers and Retirements	Balance December 31, 2014
Capital assets not being depreciated				
Land	$ 1,774,528	$ -	$ (193,541)	$ 1,580,987
Construction in progress	9,128,100	2,076,860	(7,656,077)	3,548,883
Total capital assets not being depreciated	$ 10,902,628	$ 2,076,860	$ (7,849,618)	$ 5,129,870
Capital assets being depreciated				
Land improvements	$ 2,501,845	$ -	$ -	$ 2,501,845
Building and improvements	56,737,644	110,031,672	85,976	166,855,292
Leasehold improvements	2,543,868	-	5,387,566	7,931,434
Equipment	57,261,365	17,200,540	(1,339,192)	73,122,713
Total capital assets being depreciated	119,044,722	$ 127,232,212	$ 4,134,350	250,411,284
Less accumulated depreciation for				
Land improvements	(2,364,237)	$ (50,338)	$ -	(2,414,575)
Building and improvements	(39,853,580)	(3,537,035)	-	(43,390,615)
Leasehold improvements	(1,574,637)	(297,663)	-	(1,872,300)
Equipment	(47,991,986)	(5,318,503)	3,003,027	(50,307,462)
Total accumulated depreciation	(91,784,440)	$ (9,203,539)	$ 3,003,027	(97,984,952)
Net capital assets being depreciated	$ 27,260,282			$ 152,426,332
Capital assets, net	$ 38,162,910			$ 157,556,202

Note 5 - Investment in Joint Ventures

Tri-Cities Cancer Center

The District is one of three members of the Tri-Cities Cancer Center (TCCC). TCCC is a nonprofit organization formed to establish, maintain, and operate a coordinated regional system of cancer prevention and care in the Tri-Cities, Washington area. The other two members are Lourdes Health Network and Kadlec Regional Medical Center. Each member initially contributed $415,000 to TCCC to begin operations. Community donations account for the majority of the capital of TCCC.

The District has recorded losses of $(637) and $(199,485) as its equity share of the earnings of TCCC for the years ended December 31, 2015 and 2014. The District has an investment balance in TCCC of $5,654,383 and $5,655,021 as of December 31, 2015 and 2014.

Summarized unaudited financial information for TCCC as of and for the years ended December 31, 2015 and 2014 is as follows:

	December 31,	
	2015	2014
Total assets	$ 24,031,055	$ 20,198,736
Total liabilities	7,067,905	3,233,673
Total equity	16,963,150	16,965,063

	Years Ended December 31,	
	2015	2014
Total revenues	$ 9,523,166	$ 8,127,042
Total expenses	9,525,079	8,725,498
Net income (loss)	(1,913)	(598,456)

Tri-Cities Laboratory, LLC

The District is an equal member with Kadlec Regional Medical Center, Lourdes Health Network, and Bourget Health Services, Inc., a Washington corporation, doing business as Pathology Associates Medical Laboratories (PAML) in Tri-Cities Laboratory, LLC (a Washington limited liability company). This investment is accounted for on the equity method.

The District has recorded a net investment in Tri-Cities Laboratory, LLC, of $2,512,889 and $2,184,333 at December 31, 2015 and 2014. The District has recorded its equity share of the earnings of this company as a gain of $328,556 and $112,640 for the years ended December 31, 2015 and 2014. The District did not receive any distributions from Tri-Cities Laboratory, LLC during 2015 and 2014.

Summarized unaudited financial information for Tri-Cities Laboratory, LLC as of and for the years ended December 31, 2015 and 2014 is as follows:

	December 31, 2015	December 31, 2014
Total assets	$ 11,251,734	$ 10,543,952
Total liabilities	1,200,179	1,806,622
Total equity	10,051,555	8,737,330

	Years Ended December 31, 2015	Years Ended December 31, 2014
Total revenues	$ 21,061,928	$ 19,521,469
Total expenses	19,747,703	19,074,132
Net income	1,314,225	450,560

High Desert Surgery Center, LLC

In June 2008, the District transferred equipment totaling $330,000 for an ownership interest in High Desert Surgery Center, LLC (Surgery Center). The District maintains a 40% share of equity, including a 40% interest in the Surgery Center’s earnings and losses. This investment is accounted for on the equity method.

The District has recorded a net investment in the Surgery Center of $289,016 and $291,608 as of December 31, 2015 and 2014. The District has recorded its equity share in the earnings of this company as a gain of $198,837 and $193,001 for the years ended December 31, 2015 and 2014. The District received distributions from the Surgery Center of $200,687 and $189,959 during 2015 and 2014.

Note 6 - Note Payable and Long-Term Debt

The short-term note payable at December 31, 2015 of $315,738 consists of amounts financed to pay insurance premiums. The note payable is due in monthly installments of $32,329, including interest at a rate of 4.75%, to October 2016, and is uncollateralized. Insurance premiums paid with this note are included in prepaid expenses.

The short-term note payable at December 31, 2014 of $500,000 consisted of a variable rate line of credit with a bank with an effective interest rate of 3.95% at December 31, 2014. The line of credit could not exceed $1,500,000 and was due in monthly installments of interest only through April 2015, when the outstanding balance was due. The line of credit was not renewed during 2015.

The District also has a standby letter of credit available for use as needed. The letter of credit is for a maximum amount of $4,902,456 and expires September 2018. This letter of credit is required in the lease agreement for the Southridge Hospital building. As of December 31, 2015, there is no outstanding balance.

Long-term debt additions, payments, current maturities, and balances for the year ended December 31, 2015 consist of the following:

	Balance December 31, 2014	Additions	Payments	Balance December 31, 2015	Due within One Year
Bonds and Notes Payable					
2001 Revenue bonds	$ 5,165,000	$ -	$ (325,000)	$ 4,840,000	$ 370,000
2006 LTGO bonds	5,900,000	-	(700,000)	5,200,000	750,000
Kania Clinic building note	431,398	-	(37,541)	393,857	39,794
Noridian note	737,873	-	(186,464)	551,409	206,245
Retail Property Management note #2	3,625	-	(1,374)	2,251	2,251
Real estate contract KID land, Vista Field	219,200	-	(7,228)	211,972	7,805
Real estate contract Grandridge, Evergreen	108,881	-	(108,881)	-	-
Real estate contract Southridge mortgage	54,543	-	(26,477)	28,066	28,066
Real estate contract Auburn mortgage	21,301	-	(21,301)	-	-
McKesson financing	-	3,425,443	(1,566,606)	1,858,837	1,328,141
University of Puget Sound note	-	3,271,000	-	3,271,000	1,323,002
Total bonds and notes	12,641,821	6,696,443	(2,980,872)	16,357,392	4,055,304
Capital Leases Payable					
US Bank #1	10,465	-	(10,465)	-	-
Southridge Lease Agreement	110,000,000	-	-	110,000,000	-
Philips Medical	20,468,582	4,604,540	(1,482,594)	23,590,528	2,736,335
Insight Investment	1,170,200	-	(358,674)	811,526	318,505
Medical Office Building Agreement	-	44,239,804	-	44,239,804	(637,105)
Cisco	-	1,964,730	(182,613)	1,782,117	367,313
Various others	-	1,023,029	(56,462)	966,567	159,791
Total capital leases	131,649,247	51,832,103	(2,090,808)	181,390,542	2,944,839
Total long-term debt	$ 144,291,068	$ 58,528,546	$ (5,071,680)	$ 197,747,934	$ 7,000,143

Long-term debt additions, payments, current maturities, and balances for the year ended December 31, 2014 consist of the following:

	Balance December 31, 2013	Additions	Payments	Balance December 31, 2014	Due within One Year
Bonds and Notes Payable					
2001 Revenue bonds	$ 5,470,000	$ -	$ (305,000)	$ 5,165,000	$ 325,000
2006 LTGO bonds	5,915,000	-	(15,000)	5,900,000	700,000
1999 LTGO bonds	643,686	-	(643,686)	-	-
Kania Clinic building note	466,814	-	(35,416)	431,398	37,541
Noridian note	939,958	-	(202,085)	737,873	186,465
Retail Property Management note #2	43,371	-	(39,746)	3,625	3,625
Real estate contract KID land, Vista Field	225,893	-	(6,693)	219,200	7,229
Real estate contract Grandridge, Evergreen	162,570	-	(53,689)	108,881	57,579
Real estate contract Southridge mortgage	79,521	-	(24,978)	54,543	26,477
Real estate contract Auburn mortgage	51,881	-	(30,580)	21,301	21,301
Total bonds and notes	13,998,694	-	(1,356,873)	12,641,821	1,365,217
Capital Leases Payable					
US Bank #1	215,584	-	(205,119)	10,465	10,465
US Bank #2	132,128	-	(132,128)	-	-
Southridge Lease Agreement	-	110,000,000	-	110,000,000	-
Philips Medical	20,711,764	2,886,659	(3,129,841)	20,468,582	1,478,785
Insight Investment	1,249,266	249,144	(328,210)	1,170,200	361,172
Total capital leases	22,308,742	113,135,803	(3,795,298)	131,649,247	1,850,422
Total long-term debt	$ 36,307,436	$ 113,135,803	$ (5,152,171)	$ 144,291,068	$ 3,215,639

Long-Term Debt

Hospital System Revenue Improvement and Refunding Bonds, 2001, due in varying annual principal installments, plus semiannual interest at rates from 6% to 6.3%, to January 2025. As part of the Bond Agreement, the District is to maintain a debt service reserve fund at a specified level, as well as certain other financial covenants.

Limited Tax General Obligation Bonds, dated December 21, 2006, due in varying semi-annual principal installments, including interest at a rate of 5.07%, to December 2021.

Limited Tax General Obligation Bonds, 1999, interest rate of 5.4% (fully repaid in 2014).

Note payable (Kania Clinic Building note), dated April 1, 2008, due in annual installments of $63,425, including interest at a rate of 6%, to April 2023, collateralized by real estate.

Noridian note payable, due in monthly installments of $20,930, including interest at a rate of 10.125%, to May 2018, uncollateralized.

Note payable (Retail Property Management note #2), including interest at a rate of 10%, to be fully paid in January 2016.

Real estate contract, KID Land, Vista Field, due in annual installments of $24,765, including interest at a rate of 8%, to May 2030, collateralized by land.

Grandridge Mortgage, Evergreen Community Development, interest at a rate of 7.02%, (fully repaid in 2015)

Southridge Land–7 acres Mortgage, due in monthly installments of $29,750, including interest at a rate of 6%, to May 2016, collateralized by real estate.

Real estate contract, 921 S. Auburn, interest at a rate of 9%, (fully repaid in 2015).

McKesson financing arrangements, due in varying monthly installments, including interest at an imputed rate 12.50%, maturing at various dates from July 2016 to August 2017, uncollateralized.

University of Puget Sound Settlement Agreement, due in monthly installments of $43,046 beginning March 2016, with one balloon payment for $1 million plus one half of income earned on proceeds in March 2016, and another balloon payment of $1 million due August 2017, including interest at a rate of 6.5% to September 2018.

Capital Leases Payable

U.S. Bank equipment lease #1, interest at a rate of 3.86% (fully repaid in 2015).

U.S. Bank equipment lease #2, interest rate of 4.18%, (fully repaid in 2014).

Southridge lease agreement, monthly interest payments in the amount of $817,076, and increasing 2.5% each calendar year, to June 2022 when the District will purchase the building for $110,000,000.

Philips Medical Master Lease, due in varying monthly installments, including interest at imputed rates of 1.3% to 5.0%, maturing at various dates from February 2016 to September 2022, collateralized by equipment. As part of the Master Lease Agreement, the District is to maintain certain financial covenants.

Insight Investments equipment lease, due in varying monthly installments, including interest at imputed rates of 2.62% to 4.35%, maturing at various dates from May 2016 to May 2019, collateralized by equipment.

Medical Office Building agreement, monthly interest payments in the amount of $354,167, and increasing 2.35% each year, to June 2045. The District has the option to purchase the building 15 years from the commencement of the lease.

Cisco lease, due in monthly installments of $33,441, including interest at an imputed rate of 4.40% to April 2020, collateralized by equipment.

Other leases, due in varying monthly installments, including interest at an imputed rate of 4.23%, maturing at various dates August 2016 to November 2020, collateralized by equipment.

Capital Lease Assets

The District is obligated under leases for certain building and equipment that are accounted for as capital leases. The cost of assets under capital leases at December 31, 2015 and 2014 is as follow:

	2015	2014
Building	$ 153,739,773	$ 110,000,000
Equipment	28,952,571	21,701,563
	182,692,344	131,701,563
Less accumulated amortization (included as depreciation on the accompanying financial statements)	(13,057,421)	(4,810,425)
	$ 169,634,923	$ 126,891,138

Long-Term Debt and Capital Lease Maturities

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

Years Ending December 31,	Bonds and Notes Payable Principal	Bonds and Notes Payable Interest	Capital Leases Payable Principal	Capital Leases Payable Interest
2016	$ 4,055,304	$ 873,385	$ 2,944,839	$ 15,658,329
2017	3,429,533	660,359	4,306,518	15,580,135
2018	1,921,350	469,379	4,962,151	15,476,860
2019	1,417,214	380,006	5,031,189	15,357,804
2020	1,465,860	299,831	5,015,933	15,237,770
2021-2025	3,306,225	541,294	109,681,441	56,772,433
2026-2030	716,554	51,957	591,807	27,834,511
2031-2035	45,352	1,834	48,856,664	54,919,967
	$ 16,357,392	$ 3,278,045	$ 181,390,542	$ 216,837,809

Note 7 - Pension Plan

The District has a defined contribution money purchase pension plan. The plan is available to substantially all employees who are 21 years of age and have completed one year of service. Full vesting of District contributions is achieved over a 7-year period.

Pension costs include only current service costs, which are accrued to the extent of 5% of eligible employee compensation and funded on a current basis. Employees must contribute 2.5% of their compensation to participate in the plan. Special contributions are allowed for members of senior management and physicians pursuant to certain employment agreements. Pension expense, net of forfeitures, for the years ended December 31, 2015 and 2014, was $3,398,866 and $3,694,004.

Note 8 - Concentration of Credit Risk

The District grants credit without collateral to its patients, most of whom are insured under third-party payor agreements. The mix of receivables from third-party payors and patients at December 31, 2015 and 2014 was as follows:

	2015	2014
Medicare	27%	30%
Medicaid and Healthy Options	24%	29%
Blue Cross	16%	18%
Commercial and other	18%	16%
Self pay	15%	7%
	100%	100%

Note 9 - Self-Insured Workers Compensation

The District has a self-insured workers' compensation plan for its employees through the Public Hospital District Workers' Compensation Trust, which is administered by the Washington State Hospital Association. The District pays its share of actual injury claims, maintenance of reserves, administrative expenses, and reinsurance premiums. Amounts paid by the District for workers' compensation expense were $1,003,452 and $1,294,759 in 2015 and 2014. The District has cash of $523,870 and $465,000 as of December 31, 2015 and 2014, designated for the use of payment of potential claims.

Note 10 - Commitments and Contingencies

Risk Management

The District is exposed to various risks of loss from torts; theft of, damage, of assets; business interruptions; errors and omissions; employee injuries and illnesses; natural disasters; and employee health, dental, and accident benefits. Commercial insurance coverage is purchased for claims arising from such matters other than employee health claims. Settled claims have not exceeded this commercial coverage in any of the three preceding years.

Malpractice Insurance

The District has malpractice insurance coverage to provide protection for professional liability losses on a claims-made basis subject to a limit of $1 million per claim with an annual aggregate limit of $5 million. The District also has excess liability coverage in the amount of $29 million. For claims made prior to November 15, 2009, the District has a $50,000 deductible per claim. Claims made after November 15, 2009, regardless of date of incurrence, are not subject to a deductible. Should the claims-made policy not be renewed or replaced with equivalent insurance, claims based on occurrences during its term, but reported subsequently, would be uninsured.

Litigations, Claims, and Disputes

The District is subject to the usual contingencies in the normal course of operations relating to the performance of its tasks under its various programs. In the opinion of management, the ultimate settlement of litigation, claims, and disputes in process will not be material to the financial position, operations, or cash flows of the District.

The health care industry is subject to numerous laws and regulations of federal, state, and local governments. Compliance with these laws and regulations, specifically those relating to the Medicare and Medicaid programs, can be subject to government review and interpretation, as well as regulatory actions unknown and unasserted at this time. Federal government activity has increased with respect to investigations and allegations concerning possible violations by health care providers of regulations, which could result in the imposition of significant fines and penalties, as well as significant repayments of previously billed and collected revenues from patient services.

Self-Funded Health Plan

The District became self-funded, effective January 1, 2014, for health benefits for eligible employees and their dependents. The District, in connection with this plan, recognizes health benefit expenses on an accrual basis. An accrued liability is recorded at year-end, which estimates the incurred but not reported claims that will be paid by the District. The District has stop loss insurance to cover catastrophic claims in excess $210,000 per claim and an annual aggregate limit of $9,602,494 for the plan year ended December 31, 2015.

The District expenses amounts representing the employer's portion of actual claims paid, adjusted for the estimates of liabilities relating to claims resulted from services provided prior to the fiscal year end not to exceed the annual aggregate expense. The estimated liability is included in accrued expenses in the financial statements. These amounts have been estimated based on historical trends and actuarial analysis. Changes in the balance of claims liabilities during the past year are as follows:

Year	Beginning Liability	Current Year Claims and Changes in Estimates	Claim Payments	Ending Liability
2015	$ 724,941	$ 9,667,496	$ (9,557,042)	$ 835,395
2014	-	7,735,021	(7,010,080)	724,941

Operating Leases

The District leases certain equipment under operating leases having terms of more than one year. Total operating lease expense for the years ended December 31, 2015 and 2014 for all operating leases was $2,727,165 and $2,040,132. Minimum future lease payments for these operating leases are as follows:

Years Ending December 31,	Amount
2016	$ 805,660
2017	573,086
2018	301,102
2019	7,766
Total minimum lease payments	$ 1,687,614

Collective Bargaining Agreement

Some of the District's labor force is subject to three collective bargaining agreements. The collective bargaining agreements cover the District's Registered Nurses, Licensed Practical Nurses/Operating Room Technicians, and certain technical and clerical employees. As of December 31, 2015 and 2014, the collective bargaining agreements were as follows:

Bargaining Agreement	Percentage of Workforce	Effective Dates
Registered Nurses	21.25%	November 1, 2012 – October 31, 2015 (1)
Licensed Practical Nurses/Operating Room Technicians	0.90%	October 1, 2012 – September 30, 2015 (2)
Certain Technical and Clerical Employees	20.61%	September 24, 2013 – March 31, 2016

(1) The contracts have been ratified effective March 2016. The new contract dates are effective November 1, 2015 through October 31, 2018.
(2) The contracts remain in negotiations.

Medicare Cost Report Contingencies

The District's Medicare cost reports for the years ended December 31, 2008 and 2009 are in the process of review by the Medicare administrative contractor. Currently, differences in interpretation of certain matters are being investigated. Management is accumulating supporting documentation for its position and communicating this information with the Medicare administrative contractor. Management has analyzed potential results and impacts, with a maximum estimated potential payback of $2,500,000. Based on this analysis, the District has not recorded a liability for potential changes in submitted cost reports, as fact and circumstances have changed significantly since 2007. During 2013, the District began repayment of a Medicare cost report settlement relating to the year ended December 31, 2007 totaling $1,257,091. Repayment has been structured as a long-term note payable with the District's administrative contractor (Note 6). Management is still considering options to appeal this ruling.

CPAs & BUSINESS ADVISORS

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*

The Board of Commissioners
Kennewick Public Hospital District
Kennewick, 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 Kennewick Public Hospital District (District), and its discretely presented component unit, Kennewick General Hospital Foundation, as of and for the year ended December 31, 2015, and the related notes to the financial statements, which collectively comprise the District's basic financial statements, and have issued our report thereon dated May 3, 2016.

Internal Control over Financial Reporting

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

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over financial reporting that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as described in the accompanying Schedule of Findings and Responses, we identified certain deficiencies in internal control that we consider to be material weaknesses and significant deficiencies.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. We consider deficiencies 2015-A, 2015-B, and 2015-C in the accompanying Schedule of Findings and Responses to be material weaknesses.

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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 charges with governance. We consider deficiency 2015-D in the accompanying Schedule of Findings and Responses to be a significant deficiency.

Compliance and Other Matters

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

District's Responses to Findings

The District's responses to the findings identified in our audit are described in the accompanying Schedule of Findings and Responses. The District's responses were not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on them.

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.

Eide Bailly LLP

Fargo, North Dakota
May 3, 2016

Financial Statement Findings

2015-A **Preparation of Financial Statements**
Material Weakness in Internal Control over Financial Reporting

Criteria A properly designed system of internal control over financial reporting includes preparation of an entity's financial statements and accompanying notes by internal personnel of the entity. Management is responsible for establishing and maintaining internal control over financial reporting and procedures related to the fair presentation of the financial statements in accordance with GAAP.

Condition The District does not have an internal control system designed to provide for the preparation of financial statements being audited, including related disclosures and preparation of the cash flow statement in accordance with U.S. generally accepted accounting principles (GAAP).

Cause This deficiency is partially due to the limited resources in the financial reporting process due to budgetary constraints. Furthermore, management has elected to have the financial statements and footnotes prepared by the auditors as part of the audit.

Effect This control deficiency could result in required information being omitted from the financial statements. Furthermore, it is possible that new standards may not be adopted and applied timely to the interim financial reporting.

Recommendation We recommend that management continue reviewing operating procedures in order to obtain the maximum internal control over financial reporting possible under the circumstances to enable staff to draft the financial statements internally. It is the responsibility of management and those charged with governance to make the decision whether to accept the degree of risk associated with this condition because of cost or other considerations.

Managements Response
And Corrective Plan Management accepts the risk associated with assistance with the preparation of the audited financial statements by the independent auditor. Due to cost constraints, management will continue to have the auditors draft the financial statements and accompanying notes to the financial statements.

2015-B **Audit Adjustments**
Material Weakness in Internal Control over Financial Reporting

Criteria A good system of internal control contemplates an adequate system for recording and processing adjusting journal entries material to the financial statements.

Condition As part of our audit, we proposed significant audit adjustments to the financial statements that were not identified by management as a result of the District's existing internal controls. In addition, we received several adjustments from management during our audit as accounts had not been completely reconciled before the start of our procedures.

Cause A proper reconciliation between the District's general ledger and subsidiary accounts was not performed on all accounts including investments in joint ventures and accounts payables, resulting in significant audit adjustments. There was also a proposed adjustment for proper recognition of the reimbursed funds for the Southridge Medical Office Building and related capital lease obligation.

Effect The deficiency resulted in misstatements to the financial statements that were not prevented, or detected and corrected, by internal personnel in a timely manner.

Recommendation We recommend that management continue reviewing operating procedures including month-end and year-end closing processes, to ensure that accounts are reconciled and necessary adjustments are recorded by management throughout the year.

Managements Response And Corrective Plan Management agrees with the finding and will review current reporting procedures to identify all significant adjustments and transactions so that they will be recorded in the accounting records on a timely basis.

2015-C **Account Reconciliations**
Material Weakness in Internal Control over Financial Reporting

Criteria A good system of internal control should provide for timely detection and correction of misstatements to the financial statements. Procedures to identify possible misstatements include timely reconciliations of accounts to the general ledger.

Condition Account reconciliations were completed timely for cash, patient receivables, prepaid expenses, and property accounts while reconciliations for accounts payable were not completed timely and resulted in audit adjustments.

In addition, there is a Purchase Order Liability accounts, which gets included with accounts payable in the District's financial statements that has not been reconciled. This account is used by the accounting system to match purchase orders with invoices. When there are differences, the activity does not zero out as it should. This account, and others need to be reconciled monthly to ensure proper recording of expenses as well as ensure accurate and timely payments to the District's vendors.

Cause The deficiency is partially due to the limited resources in the accounting department due to budgetary constraints.

Effect The possibility that a misstatement would not be detected and corrected in a timely matter. In addition, the District has significant agreements that require audited financial statements within a specified period of time and delayed reconciliations may result in delayed audits and ultimately noncompliance with these agreements.

Recommendation We recommend that management continue to review its current processes related to timely reconciliations for the specified account balances. In addition to review of the process surrounding the reconciliations, review of other related processes may provide for more timely completion.

Managements Response And Corrective Plan	Management agrees with the finding.
2015-D	**Controls over Manual Journal Entries** **Significant Deficiency in Internal Control over Financial Reporting**
Criteria	A good system of internal control contemplates an adequate segregation of duties so that no one individual handles a transaction from its inception to completion, including manual journal entries.
Condition	Manual journal entries at the District are not properly reviewed and approved before being posted to the general ledger.
Cause	The District's size and budget constraints limit the number of personnel and does not facilitate the segregation of duties necessary to offer review and approval of manual journal entries prior to be posting.
Effect	The lack of a review and approval process for manual journal entries increases the risk of material misstatement in the financial statements, either due to error or fraud, which would not be detected and corrected on a timely basis.
Recommendation	We recommend that the procedures and policies over manual journal entries be reviewed to limit the number of personnel that can make entries and identify those personnel that can review and approve manual journal entries.
Managements Response And Corrective Plan	Management agrees with the finding and will continue to monitor the District's policy over manual journal entries.