Office of the Washington State Auditor
Pat McCarthy

March 19, 2018

Board of Commissioners
Prosser Memorial Hospital
Prosser, 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 the Prosser Memorial Hospital's financial statements for the fiscal year ended December 31, 2016 and 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

Prosser Public Hospital District
doing business as
PMH Medical Center

Basic Financial Statements and
Independent Auditors' Reports

December 31, 2016 and 2015

DINGUS | ZARECOR & ASSOCIATES PLLC
Certified Public Accountants

Prosser Public Hospital District
doing business as PMH Medical Center
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DINGUS | ZARECOR & ASSOCIATES PLLC
Certified Public Accountants

INDEPENDENT AUDITORS' REPORT

Board of Commissioners
Prosser Public Hospital District
doing business as PMH Medical Center
Prosser, Washington

Report on the Financial Statements

We have audited the accompanying financial statements of Prosser Public Hospital District doing business as PMH Medical Center (the District) as of and for the years ended December 31, 2016 and 2015, and the related notes to the financial statements, which collectively comprise the District's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

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

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

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

12015 East Main Avenue | Spokane Valley, WA 99206 | 509.242.0874 | www.dzacpa.com

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the District as of December 31, 2016 and 2015, and the changes in its financial position and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

Management has omitted the management's discussion and analysis that accounting principles generally accepted in the United States of America require to be presented to supplement the basic financial statements. Such missing 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. Our opinion on the basic financial statements is not affected by this missing information.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated June 15, 2017, 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 for the year ended December 31, 2016. We issued a similar report for the year ended December 31, 2015, dated June 18, 2016, which has not been included with the 2016 financial and compliance report. The purpose of these reports is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing for each year, and not to provide an opinion on internal control over financial reporting or on compliance. Those reports are 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.

Dingus, Zarecor & Associates PLLC

Spokane Valley, Washington
June 15, 2017

Prosser Public Hospital District
doing business as PMH Medical Center
Statements of Net Position
December 31, 2016 and 2015

ASSETS	2016	2015
Current assets		
Cash and cash equivalents	**$ 15,358,869**	$ 12,118,492
Receivables:		
Patients, less allowances for uncollectible accounts of $1,516,520 and $1,542,678, respectively	**6,878,811**	6,695,420
Estimated third-party payor settlements	**72,844**	378,254
Electronic health records incentive payment	**-**	1,651,000
Taxes	**26,065**	14,531
Grants	**-**	52,456
Other	**75,438**	12,531
Inventories	**201,216**	197,654
Prepaid expenses	**375,390**	143,768
Total current assets	**22,988,633**	21,264,106
Noncurrent assets		
Cash and cash equivalents limited as to use for capital acquisitions	**1,108,279**	1,103,934
Cash and cash equivalents restricted by bond agreement for capital acquisitions	**973,969**	1,799,262
Capital assets, net	**12,087,487**	13,198,571
Total noncurrent assets	**14,169,735**	16,101,767
Total assets	**$ 37,158,368**	$ 37,365,873

See accompanying notes to basic financial statements.

Prosser Public Hospital District
doing business as PMH Medical Center
Statements of Net Position (Continued)
December 31, 2016 and 2015

LIABILITIES, DEFERRED INFLOW OF RESOURCES, AND NET POSITION		**2016**		**2015**
Current liabilities				
Accounts payable	**$**	**1,539,941**	$	1,431,512
Accrued payroll and related liabilities		**751,863**		795,675
Accrued leave		**811,520**		861,642
Estimated third-party payor settlements		**1,214,797**		582,075
Accrued interest payable		**21,099**		21,099
Current portion of long-term debt		**230,000**		242,000
Total current liabilities		**4,569,220**		3,934,003
Noncurrent liabilities				
Long-term debt, net of current portion		**6,821,028**		7,055,440
Total liabilities		**11,390,248**		10,989,443
Deferred inflow of resources				
Deferred electronic health records incentive revenue		**1,320,800**		1,651,000
Net position				
Net investment in capital assets		**5,989,329**		7,679,294
Unrestricted		**18,457,991**		17,046,136
Total net position		**24,447,320**		24,725,430
Total liabilities, deferred inflow of resources, and net position	**$**	**37,158,368**	$	37,365,873

See accompanying notes to basic financial statements.

Prosser Public Hospital District
doing business as PMH Medical Center
Statements of Revenues, Expenses, and Changes in Net Position
Years Ended December 31, 2016 and 2015

	2016	2015
Operating revenues		
Net patient service revenue, net of provision for bad debts of $1,461,191 and $2,623,708, respectively	**$ 42,766,039**	$ 42,993,763
Electronic health records incentive payments	**322,747**	60,813
Grants	**57,334**	326,227
Other	**445,487**	476,004
Total operating revenues	**43,591,607**	43,856,807
Operating expenses		
Salaries and wages	**19,573,401**	19,573,766
Employee benefits	**3,716,382**	3,202,052
Professional fees	**7,905,694**	6,403,831
Purchased services	**3,597,372**	3,671,812
Supplies	**3,911,537**	3,904,007
Insurance	**362,087**	482,824
Utilities	**476,345**	472,512
Depreciation	**1,897,948**	1,220,902
Repairs and maintenance	**318,028**	267,896
Licenses and taxes	**344,137**	293,818
Leases and rentals	**1,878,800**	1,725,839
Other	**425,139**	485,078
Total operating expenses	**44,406,870**	41,704,337
Operating income (loss)	**(815,263)**	2,152,470
Nonoperating revenues (expenses)		
Taxation for maintenance and operations	**781,210**	762,583
Investment income	**15,002**	8,787
Interest expense	**(253,318)**	(92,290)
Gain (loss) on disposal of assets	**(5,741)**	5,027
Total nonoperating revenues (expenses), net	**537,153**	684,107
Excess of revenues (expenses) over expenses (revenues) before capital contributions	**(278,110)**	2,836,577
Capital contributions	**-**	914,489
Change in net position	**(278,110)**	3,751,066
Net position, beginning of year	**24,725,430**	20,974,364
Net position, end of year	**$ 24,447,320**	$ 24,725,430

See accompanying notes to basic financial statements.

Prosser Public Hospital District
doing business as PMH Medical Center
Statements of Cash Flows
Years Ended December 31, 2016 and 2015

	2016	2015
Increase in Cash and Cash Equivalents		
Cash flows from operating activities		
Cash received from and on behalf of patients	**$ 43,520,780**	$ 42,940,262
Cash received from electronic health records incentive payments	**1,643,547**	260,813
Cash received from other revenue	**382,580**	597,634
Cash received from operating grants	**109,790**	339,136
Cash paid to and on behalf of employees	**(23,383,717)**	(22,442,063)
Cash paid to suppliers and contractors	**(19,345,894)**	(17,173,669)
Net cash provided by operating activities	**2,927,086**	4,522,113
Cash flows from noncapital financing activities		
Taxes received for maintenance and operations	**769,676**	766,698
Cash flows from capital and related financing activities		
Purchase of capital assets	**(792,605)**	(2,877,055)
Principal payments on long-term debt	**(242,000)**	(228,000)
Interest paid	**(257,730)**	(261,383)
Net cash used in capital and related financing activities	**(1,292,335)**	(3,366,438)
Cash flows from investing activities		
Interest received	**15,002**	4,383
Net increase in cash and cash equivalents	**2,419,429**	1,926,756
Cash and cash equivalents, beginning of year	**15,021,688**	13,094,932
Cash and cash equivalents, end of year	**$ 17,441,117**	$ 15,021,688

See accompanying notes to basic financial statements.

Prosser Public Hospital District
doing business as PMH Medical Center
Statements of Cash Flows (Continued)
Years Ended December 31, 2016 and 2015

	2016	2015
Reconciliation of Cash and Cash Equivalents to the Statements of Net Position		
Cash and cash equivalents	**$ 15,358,869**	$ 12,118,492
Cash and cash equivalents limited as to use	**1,108,279**	1,103,934
Cash and cash equivalents restricted by bond agreement	**973,969**	1,799,262
Total cash and cash equivalents	**$ 17,441,117**	$ 15,021,688
Reconciliation of Operating Income (Loss) to Net Cash Provided by Operating Activities		
Operating income (loss)	**$ (815,263)**	$ 2,152,470
Adjustments to reconcile operating income (loss) to net cash provided by operating activities		
Depreciation	**1,897,948**	1,220,902
Provision for bad debts	**1,461,191**	2,623,708
Decrease (increase) in assets:		
Receivables:		
Patient accounts, net	**(1,644,582)**	(2,546,298)
Estimated third-party payor settlements	**305,410**	(304,868)
Electronic health records incentive payments	**1,651,000**	(1,451,000)
Grants	**52,456**	12,909
Other	**(62,907)**	121,630
Inventories	**(3,562)**	1,682
Prepaid expenses	**(231,622)**	21,891
Increase (decrease) in liabilities and deferred inflow of resources:		
Accounts payable	**108,429**	510,375
Accrued payroll and related liabilities	**(43,812)**	271,032
Accrued leave	**(50,122)**	62,723
Estimated third-party payor settlements	**632,722**	173,957
Deferred electronic health records incentive revenue	**(330,200)**	1,651,000
Net cash provided by operating activities	**$ 2,927,086**	$ 4,522,113

See accompanying notes to basic financial statements.

1. Reporting Entity and Summary of Significant Accounting Policies:

a. Reporting Entity

Prosser Public Hospital District doing business as PMH Medical Center (the District) is organized as a municipal corporation pursuant to the laws of the state of Washington for municipal corporations. The primary purpose of the District is to operate PMH Medical Center (the Hospital), the principal provider of acute healthcare services for Prosser, Washington, and surrounding communities. The District also operates a surgical clinic (PMH Surgical Group) and an ambulance service in Prosser, Washington, as well as a rural health clinic (PMH Family Medicine) located in Benton City, Washington.

As organized, the District is exempt from federal income tax. The Board of Commissioners is made up of seven community members elected to six-year terms. The District is not considered to be a component unit of Benton County.

b. Summary of Significant Accounting Policies

Use of estimates – The District's accounting policies conform to accounting principles generally accepted in the United States of America as applicable to proprietary funds of governments. The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets 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.

Enterprise fund accounting – The District's accounting policies conform to accounting principles generally accepted in the United States of America as applicable to proprietary funds of governments. The District uses enterprise fund accounting. Revenue and expenses are recognized on the accrual basis using the economic resources measurement focus.

Cash and cash equivalents – Cash and cash equivalents include investments in highly liquid debt instruments with an original maturity of three months or less.

Inventories – Inventories consist of medical supplies, drugs, and food and are stated at cost using the first-in, first-out method.

Assets limited as to use – Assets limited as to use include assets set aside by the Board of Commissioners for future capital improvements and other uses over which the Board retains control and could subsequently use for other purposes.

Capital assets – The District capitalizes assets whose costs exceed $5,000 and with an estimated useful life of at least one year, lesser amounts are expensed. Donated capital assets are stated at cost or estimated fair value at the date of donation. Expenditures for maintenance and repairs are charged to operations as incurred; betterments and major renewals are capitalized. When such assets are disposed of, the related costs and accumulated depreciation are removed from the accounts and the resulting gain or loss is classified in nonoperating revenues or expenses.

1. Reporting Entity and Summary of Significant Accounting Policies (continued):

b. Summary of Significant Accounting Policies (continued)

Capital assets (continued) – All capital assets, other than land and construction in progress, are depreciated using the straight-line method over the shorter period of the lease term or the estimated useful life of the equipment. Useful lives have been estimated as follows:

Land improvements	5 to 25 years
Buildings and improvements	5 to 40 years
Equipment	3 to 20 years

Accrued leave – The District's employees earn vacation days at varying rates depending on years of service. Employees also earn sick leave benefits based on varying rates depending on years of service. Employees may accumulate sick leave days up to a specified maximum.

Net position – Net position of the District is classified into three components. *Net investment in capital assets* consists of capital assets net of accumulated depreciation and reduced by the balances of any outstanding borrowings used to finance the purchase or construction of those assets. *Restricted net position* is noncapital net position that must be used for a particular purpose, as specified by creditors, grantors, or contributors external to the District. The District had no restricted net position at either December 31, 2016 or 2015. *Unrestricted net position* is the remaining net position that does not meet the definition of *net investment in capital assets* or *restricted*.

Operating revenues and expenses – The District's statements of revenues, expenses, and changes in net position distinguish between operating and nonoperating revenues and expenses. Operating revenues result from exchange transactions, including grants for specific operating activities associated with providing healthcare services, the District's principal activity. Nonexchange revenues, including taxes and contributions received for purposes other than capital asset acquisition, are reported as nonoperating revenues. Operating expenses are all expenses incurred to provide healthcare services, other than financing costs.

Restricted resources – When the District has both restricted and unrestricted resources available to finance a particular program, it is the District's policy to use restricted resources before unrestricted resources.

Grants and contributions – From time to time, the District receives grants from the state of Washington and others, 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 are met. Grants and contributions may be restricted for either specific operating purposes or for capital purposes. Amounts that are restricted to specific capital acquisitions are reported after nonoperating revenues and expenses. Grants that are for specific projects or purposes related to the District's operating activities are reported as operating revenue. Grants that are used to subsidize operating deficits are reported as nonoperating revenue. Contributions, except for capital contributions, are reported as nonoperating revenue.

Subsequent events – The District has evaluated subsequent events through June 15, 2017, the date on which the financial statements were available to be issued.

2. Bank Deposits and Investments:

Custodial credit risk is the risk that, in the event of a depository institution failure, the District's deposits may not be refunded to it. The District's deposit policy for custodial credit risk is determined by Washington State law.

All cash and cash equivalents held by the County Treasurer, or deposited with qualified public depositories, are protected against loss by the State of Washington Public Deposit Protection Commission, as provided by RCW Chapter 39.58, subject to certain limitations. Qualified public depositories including US Bank, pledge securities with this commission, which are available to insure public deposits within the state of Washington. The cash on deposit with these banks is also insured through the Federal Deposit Insurance Corporation.

The Revised Code of Washington, Chapter 39, authorizes municipal governments to invest their funds in a variety of investments including federal, state, and local government certificates, notes, or bonds; the Washington State Local Government Investment Pool; savings accounts in qualified public depositories; and certain other investments. The District has elected to use the County Treasurer to be its treasurer to issue warrants and make investments. Amounts invested in the Washington State Local Government Investment Pool at December 31, 2016 and 2015, were $1,219,481 and $1,213,845, respectively. The Washington State Local Government Investment Pool consists of investments in federal, state, and local government certificates and savings accounts in qualified public depositories.

3. Patient Accounts Receivable:

Patient accounts receivable are reduced by an allowance for uncollectible accounts. In evaluating the collectibility of accounts receivable, the District analyzes its past history and identifies trends for each of its major payor sources of revenue to estimate the appropriate allowance for uncollectible accounts and provision for bad debts. Management regularly reviews data about these major payor sources of revenue in evaluating the sufficiency of the allowance for uncollectible accounts. For receivables associated with services provided to patients who have third-party coverage, the District analyzes contractually due amounts and provides an allowance for uncollectible accounts and a provision for bad debts, if necessary (for example, for expected uncollectible deductibles and copayments on accounts for which the third-party payor has not yet paid, or for payors who are known to be having financial difficulties that make the realization of amounts due unlikely). For receivables associated with self-pay patients (which include both patients without insurance and patients with deductible and copayment balances due for which third-party coverage exists for part of the bill), the District records a significant provision for bad debts in the period of service on the basis of its past experience, which indicates that many patients are unable or unwilling to pay the portion of their bill for which they are financially responsible. The difference between the standard rates (or the discounted rates if negotiated) and the amounts actually collected after all reasonable collection efforts have been exhausted is charged off against the allowance for uncollectible accounts.

The District's allowance for uncollectible accounts has not significantly changed from the prior year. The District does not maintain a material allowance for uncollectible accounts from third-party payors, nor did it have significant writeoffs from third-party payors.

3. Patient Accounts Receivable (continued):

Patient accounts receivable reported as current assets by the District consisted of these amounts:

	2016	2015
Patients and their insurance carriers	**$ 6,181,217**	$ 5,688,968
Medicare	**1,332,992**	1,156,136
Medicaid	**881,122**	1,392,994
Total patient accounts receivable	**8,395,331**	8,238,098
Less allowance for uncollectible accounts	**1,516,520**	1,542,678
Patient accounts receivable, net	**$ 6,878,811**	$ 6,695,420

4. Capital Assets:

Capital asset additions, retirements, transfers, and balances were as follows:

	Balance December 31, 2015	Additions	Retirements	Transfers	Balance December 31, 2016
Capital assets not being depreciated					
Land	$ 78,396	$ -	$ -	$ -	**$ 78,396**
Construction in progress	220,392	431,734	-	(46,123)	**606,003**
Land held for investment	982,506	-	-	-	**982,506**
Total capital assets not being depreciated	1,281,294	431,734	-	(46,123)	**1,666,905**
Capital assets being depreciated					
Land improvements	537,254	-	-	-	**537,254**
Buildings and improvements	17,010,884	1,869	-	32,648	**17,045,401**
Equipment	12,517,616	359,004	(85,296)	13,475	**12,804,799**
Buildings held for investment	1,025,755	-	-	-	**1,025,755**
Total capital assets being depreciated	31,091,509	360,873	(85,296)	46,123	**31,413,209**
Less accumulated depreciation for					
Land improvements	(310,315)	(39,754)	-	-	**(350,069)**
Buildings and improvements	(12,230,928)	(548,554)	-	-	**(12,779,482)**
Equipment	(6,023,090)	(1,285,002)	79,553	-	**(7,228,539)**
Buildings held for investment	(609,899)	(24,638)	-	-	**(634,537)**
Total accumulated depreciation	(19,174,232)	(1,897,948)	79,553	-	**(20,992,627)**
Total capital assets being depreciated, net	11,917,277	(1,537,075)	(5,743)	46,123	**10,420,582**
Capital assets, net	**$ 13,198,571**	**$ (1,105,341)**	**$ (5,743)**	**$ -**	**$ 12,087,487**

4. Capital Assets (continued):

	Balance December 31, 2014	Additions	Retirements	Transfers	Balance December 31, 2015
Capital assets not being depreciated					
Land	$ 78,396	$ -	$ -	$ -	**$ 78,396**
Construction in progress	1,944,753	3,622,753	(44,800)	(5,302,314)	**220,392**
Land held for investment	982,506	-	-	-	**982,506**
Total capital assets not being depreciated	3,005,655	3,622,753	(44,800)	(5,302,314)	**1,281,294**
Capital assets being depreciated					
Land improvements	537,254	-	-	-	**537,254**
Buildings and improvements	16,345,076	-	(251,706)	917,514	**17,010,884**
Equipment	7,908,163	388,598	(163,945)	4,384,800	**12,517,616**
Buildings held for investment	1,025,755	-	-	-	**1,025,755**
Total capital assets being depreciated	25,816,248	388,598	(415,651)	5,302,314	**31,091,509**
Less accumulated depreciation for					
Land improvements	(269,739)	(40,576)	-	-	**(310,315)**
Buildings and improvements	(11,933,976)	(548,660)	251,708	-	**(12,230,928)**
Equipment	(5,579,118)	(607,028)	163,056	-	**(6,023,090)**
Buildings held for investment	(585,261)	(24,638)	-	-	**(609,899)**
Total accumulated depreciation	(18,368,094)	(1,220,902)	414,764	-	**(19,174,232)**
Total capital assets being depreciated, net	7,448,154	(832,304)	(887)	5,302,314	**11,917,277**
Capital assets, net	**$ 10,453,809**	**$ 2,790,449**	**$ (45,687)**	**$ -**	**$ 13,198,571**

Construction in progress as of December 31, 2016, consisted of various ongoing remodel projects and information system implementation. These remodel projects have all been placed on hold, pending a decision by the Board of Commissioners. As such, the dates of completion, and costs to complete, cannot be estimated at this time. The information system implementation projects are expected to be placed into service in 2017 without material additional cost.

Interest costs on borrowed funds are capitalized during the construction period as a component of the cost of acquiring those assets. Interest costs of $0 and $169,293 were capitalized during 2016 and 2015, respectively.

5. Long-term Debt:

A schedule of changes in the District's long-term debt is as follows:

	Balance December 31, 2015	Additions	Reductions	Balance December 31, 2016	Amounts Due Within One Year
2001 LTGO Bonds	$ 242,000	$ -	$ (242,000)	$ -	$ -
2014 LTGO Bonds	7,000,000	-	-	7,000,000	230,000
Bond Premiums	55,440	-	(4,412)	51,028	-
Total long-term debt	**$ 7,297,440**	**$ -**	**$ (246,412)**	**$ 7,051,028**	**$ 230,000**

	Balance December 31, 2014	Additions	Reductions	Balance December 31, 2015	Amounts Due Within One Year
2001 LTGO Bonds	$ 470,000	$ -	$ (228,000)	$ 242,000	$ 242,000
2014 LTGO Bonds	7,000,000	-	-	7,000,000	-
Bond Premiums	59,844	-	(4,404)	55,440	-
Total long-term debt	**$ 7,529,844**	**$ -**	**$ (232,404)**	**$ 7,297,440**	**$ 242,000**

Long-term debt – The terms and due dates of the District's long-term debt are as follows:

- Limited Tax General Obligation Bonds, dated June 28, 2001, in the original amount of $2,000,000, for the purpose of improvements and expansion of District facilities and the refinancing of existing debt. The bonds were fully paid off in 2016.
- Limited Tax General Obligation Bonds, dated May 28, 2014, in the original amount of $7,000,000, for the purpose of improvements and expansion of District facilities. The bonds are payable semiannually on June 1 and December 1 in the remaining principal amounts ranging from $230,000 to $600,000 through 2034. The bonds are subject to redemption prior to their stated maturities. Interest is at a variable rate between 2% and 4%. The District has irrevocably pledged to include in its budget and levy taxes annually on all of the property within the District subject to taxation in amounts that will be sufficient to pay the principal and interest on the bonds as they become due.

5. Long-term Debt (continued):

Aggregate annual principal and interest payments over the terms of long-term debt are as follows:

Years Ending December 31,	Principal	Interest	Total Payments
2017	$ 230,000	$ 253,188	$ **483,188**
2018	245,000	248,587	**493,587**
2019	255,000	243,688	**498,688**
2020	270,000	236,038	**506,038**
2021	285,000	227,938	**512,938**
2022-2026	1,725,000	968,765	**2,693,765**
2027-2031	2,285,000	612,788	**2,897,788**
2032-2034	1,705,000	139,000	**1,844,000**
	$ 7,000,000	**$ 2,929,992**	**$ 9,929,992**

6. Commitments Under Noncancelable Operating Leases:

Following is a summary of future minimum obligations under noncancelable operating leases for equipment and buildings:

Years Ending December 31,	Amount
2017	$ 1,200,000
2018	1,268,000
2019	1,270,000
2020	1,169,000
2021	998,000
2022-2026	3,728,000
2027-2031	2,738,000
2032	181,000
	$ 12,552,000

The summary of future minimum obligations under noncancelable operating leases includes additional and amended leases as of May 1, 2017, for the 326 Chardonnay Blvd. building.

7. Commitment:

The District entered into a contract with Quorum Health Resources, LLC (QHR), dated June 29, 2012. Compensation for consulting services beginning June 29, 2013, is $269,000 annually and is increased annually starting on the second effective year by 3% at each effective year.

Total payments to QHR for the years ended December 31, 2016 and 2015, were approximately $292,000 and $276,000, respectively.

8. Net Patient Service Revenue:

The District recognizes patient service revenue associated with services provided to patients who have third-party payor coverage on the basis of contractual rates for the services rendered. For uninsured patients that do not qualify for charity care, the District recognizes revenue on the basis of its standard rates for services provided (or on the basis of discounted rates, if negotiated or provided by policy). On the basis of historical experience, a significant portion of the District's uninsured patients will be unable or unwilling to pay for the services provided. Thus, the District records a significant provision for bad debts related to uninsured patients in the period the services are provided. The District has not changed its charity care or uninsured discount policies during fiscal years 2016 or 2015. Patient service revenue, net of contractual adjustments and discounts (but before the provision for bad debts), recognized in the period from these major payor sources, is as follows:

	2016	2015
Patient service revenue (net of contractual adjustments and discounts):		
Medicare	**$ 14,336,118**	$ 15,175,548
Medicaid	**10,819,262**	10,835,375
Other third-party payors	**17,914,863**	15,533,034
Supplemental payment programs	**(722,635)**	359,792
340b contract pharmacy	**41,075**	75,244
Patients	**2,919,108**	5,030,305
	45,307,791	47,009,298
Less:		
Charity care	**(1,080,561)**	(1,391,827)
Provision for bad debts	**(1,461,191)**	(2,623,708)
Net patient service revenue	**$ 42,766,039**	$ 42,993,763

8. Net Patient Service Revenue (continued):

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

- *Medicare* – The District has been designated a critical access hospital by Medicare and is reimbursed for inpatient and outpatient services and rural health clinic visits on a cost basis as defined and limited by the Medicare program. Physician services outside the rural health clinic are paid on a fee schedule. The District is reimbursed for cost reimbursable items at a tentative rate with final settlement determined after submission of annual cost reports by the District and audits thereof by the Medicare administrative contractor.
- *Medicaid* – Inpatient and outpatient services provided to Medicaid program beneficiaries are reimbursed under a cost reimbursement methodology. The District is reimbursed at a tentative rate with final settlement determined after submission of annual cost reports by the District and review thereof by the Washington State Health Care Authority. Rural health clinic services are paid on a prospectively set rate per visit.
- *Other Commercial Payors* – The District also has entered into payment agreements with certain commercial insurance carriers, health maintenance organizations, and preferred provider organizations. The basis for payment to the District under these agreements includes prospectively determined rates per discharge, discounts from established charges, and prospectively determined daily rates.

Laws and regulations governing 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. Net patient service revenue decreased by approximately $63,000 and $106,000 in 2016 and 2015, respectively, due to differences between original estimates and final settlements or revised estimates.

The District provides charity care to patients who are financially unable to pay for the healthcare services they receive. The District's policy is not to pursue collection of amounts determined to qualify as charity care. Accordingly, the District does not report these amounts in net operating revenues or in the allowance for uncollectible accounts. The District determines the costs associated with providing charity care by aggregating the applicable direct and indirect costs, including salaries and wages, benefits, supplies, and other operating expenses, based on data from its costing system. The costs of caring for charity care patients for the years ended December 31, 2016 and 2015, were approximately $510,000 and $637,000, respectively.

9. Property Taxes:

The County Treasurer acts as an agent to collect property taxes levied in Benton County (County) for all taxing authorities. Taxes are levied annually on January 1 on property values listed as of the prior May 31. Assessed values are established by the County Assessor at 100% of fair market value. A revaluation of all property is required every four years.

Taxes are due in two equal installments on April 30 and October 31. Collections are distributed monthly to the District by the County Treasurer.

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

9. Property Taxes (continued):

For 2016, the District's regular tax levy was $0.33 per $1,000 on a total assessed valuation of $2,286,387,271 for a total regular levy of $766,838. For 2015, the District's regular tax levy was $0.34 per $1,000 on a total assessed valuation of $2,217,672,673 for a total regular levy of $752,987.

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

10. Electronic Health Records Incentive Payment:

The District recognized Medicare and Medicaid electronic health records (EHR) incentive payments during the years ended December 31, 2016 and 2015. The EHR incentive payments are provided to incent hospitals and eligible providers to become meaningful users of EHR technology, not to reimburse providers for the cost of acquiring EHR assets. EHR incentive payments are therefore reported as operating revenue.

The District attested to meaningful use with Centers for Medicare and Medicaid Services (CMS) in 2016 and 2015. The Medicare EHR reporting period is through December 31 of each year.

The Medicare incentive payment recognized is an estimate and subject to audit by CMS. The Medicare EHR incentive payment is based on the days and charity care reported in the Medicare cost report, and the undepreciated cost of the EHR equipment submitted to CMS. Medicare incentive revenue of $322,747 and $49,053 was recognized in 2016 and 2015, respectively.

The District has elected to defer recognition of its 2015 Medicare incentive payment over a 5 year period that matches the estimated useful lives of the related assets starting in 2016. Revenue of $330,200 will be recognized in each year through 2020.

The District also received $0 and $11,760 of Medicaid incentive payments for eligible providers in 2016 and 2015, respectively.

11. Retirement Savings Plan:

The District contributes to the Prosser Public Hospital District 403(b) Plan (the Plan), a defined contribution pension plan, for its full-time general administrative employees. The Plan is administered by the District. Benefit terms, including contribution requirements, for the Plan are established and may be amended by the Board of Commissioners. The District is required to contribute 3% of annual salary, exclusive of overtime pay, to individual employee accounts for each participating employee. Employees are permitted to make contributions up to applicable Internal Revenue Code limits. Employer contributions to the Plan totaled approximately $442,000 and $390,000 for the years ended December 31, 2016 and 2015, respectively. Employee contributions totaled approximately $730,000 and $628,000 in 2016 and 2015, respectively.

Employees are immediately vested in their own contributions and earnings on those contributions. Employees become eligible for District contributions and earnings on District contributions if they are 21 years of age and have completed one year of service. District contributions and earnings on the District contributions are vested immediately.

12. Risk Management and Contingencies:

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

Medical malpractice claims – The District has professional liability insurance coverage with Washington Casualty Company (WCC). The policy provides protection on a "claims-made" basis whereby claims filed in the current year are covered by the current policy. If there are occurrences in the current year, these will only be covered in the year the claim is filed if claims-made coverage is obtained in that year or if the District purchases insurance to cover prior acts.

The current professional liability insurance provides $1,000,000 per claim of primary coverage with an annual aggregate limit of $5,000,000. The policy has no deductible per claim.

The District also has excess professional liability insurance with WCC on a "claims-made" basis. The excess malpractice insurance provides $2,000,000 per claim of primary coverage with an annual aggregate limit of $2,000,000. The policy has no deductible per claim.

Industry regulations – The healthcare industry is subject to numerous laws and regulations of federal, state, and local governments. These laws and regulations include, but are not necessarily limited to, matters such as licensure, accreditations, and government healthcare program participation requirements, reimbursement for patient services, and Medicare and Medicaid fraud and abuse. Government activity continues with respect to investigations and allegations 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 the District is in compliance with fraud and abuse statutes, as well as other applicable government laws and regulations.

While no regulatory inquiries have been made, 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.

Workers' compensation – The District has a self-insured workers' compensation plan. The District participates in the Public Hospital District Workers' Compensation Trust, which is a risk transfer pool administered by the Washington State Hospital Association. The District pays its share of actual workers' compensation claims, maintenance of reserves, and administrative expenses. Payments by the District charged to workers' compensation expense were approximately $62,000 (net of a $201,921 dividend) and $132,000 (net of a $153,791 dividend) in 2016 and 2015, respectively.

Retirement plan – In 2017, emergency medical technicians were granted retroactive eligibility from July 1, 2005, forward to participate in the Washington Law Enforcement Officers' and Firefighters' Retirement System Plan 2 by the Washington State Legislature. The District's pension liability under this rule change has not yet been determined.

13. Concentration of Risk:

Receivables – The District grants credit without collateral to its patients, most of whom are local residents, and are insured under third-party payor agreements. The majority of these patients are geographically concentrated in and around Benton County.

The mix of receivables from patients was as follows:

	2016	2015
Medicare	**25 %**	21 %
Medicaid	**18**	25
Other third-party payors	**33**	26
Patients	**24**	28
	100 %	100 %

Physicians – The District is dependent on local physicians practicing in its service area to provide admissions and utilize hospital services on an outpatient basis. A decrease in the number of physicians providing these services or changes in their utilization patterns may have an adverse effect on operations.

Collective bargaining unit – The District has collective bargaining agreements with Washington State Council of County and City Employees and Service Employees Union Healthcare 1199NW through December 31, 2016. The Service Employees Union Healthcare 1199NW collective bargaining agreement has been renewed through June 30, 2018. As of December 31, 2016 and 2015, approximately 73% of the District's employees were represented by the collective bargaining units.

DINGUS | ZARECOR & ASSOCIATES PLLC
Certified Public Accountants

INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

Board of Commissioners
Prosser Public Hospital District
doing business as PMH Medical Center
Prosser, Washington

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of Prosser Public Hospital District doing business as PMH Medical Center (the District) as of and for the year ended December 31, 2016, and the related notes to the financial statements, which collectively comprise the District's basic financial statements, as listed in the table of contents, and have issued our report thereon dated June 15, 2017.

Internal Control Over Financial Reporting

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

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

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

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Compliance and Other Matters

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

Purpose of this Report

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

Dingus, Zarecor & Associates PLLC

Spokane Valley, Washington
June 15, 2017

Prosser Public Hospital District
doing business as PMH Medical Center
Summary Schedule of Prior Audit Findings
Year Ended December 31, 2016

The audit for the year ended December 31, 2016, reported no audit findings, nor were there any unresolved findings from periods ended December 31, 2015, or prior. Therefore, there are no matters to report in this schedule for the year ended December 31, 2016.