Washington State Auditor's Office

Financial Statements Audit Report

Lewis County Public Hospital District No. 1 (Morton General Hospital)

Audit Period
January 1, 2012 through December 31, 2012

Report No. 1011694

Issue Date
April 24, 2014

WASHINGTON
TROY KELLEY
STATE AUDITOR

Washington State Auditor
Troy Kelley

April 24, 2014

Board of Commissioners
Morton General Hospital
Morton, Washington

Report on Financial Statements

Please find attached our report on Morton General Hospital's financial statements.

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

Sincerely,

TROY KELLEY
STATE AUDITOR

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Morton General Hospital
Lewis County
January 1, 2012 through December 31, 2012

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*

Morton General Hospital
Lewis County
January 1, 2012 through December 31, 2012

Board of Commissioners
Morton General Hospital
Morton, 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 Morton General Hospital, Lewis County, Washington, as of and for the year ended December 31, 2012, and the related notes to the financial statements, which collectively comprise the District's basic financial statements, and have issued our report thereon dated March 3, 2014.

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 District's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

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

In addition, we noted certain matters that we have reported to the management of the District in a separate letter dated March 3, 2014.

COMPLIANCE AND OTHER MATTERS

As part of obtaining reasonable assurance about whether the District's financial statements are free from material misstatement, we performed tests of the District's compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion.

The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

PURPOSE OF THIS REPORT

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the District's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the District's internal control and compliance. Accordingly, this communication is not suitable for any other purpose. However, this report is a matter of public record and its distribution is not limited. It also serves to disseminate information to the public as a reporting tool to help citizens assess government operations.

TROY KELLEY
STATE AUDITOR

March 3, 2014

Independent Auditor's Report on Financial Statements

Morton General Hospital
Lewis County
January 1, 2012 through December 31, 2012

Board of Commissioners
Morton General Hospital
Morton, Washington

REPORT ON THE FINANCIAL STATEMENTS

We have audited the accompanying financial statements of Morton General Hospital, Lewis County, Washington, as of and for the year ended December 31, 2012, and the related notes to the financial statements, which collectively comprise the District's basic financial statements as listed on page 5.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Morton General Hospital, as of December 31, 2012, and the changes in financial position and cash flows thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 6 through 12 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 March 3, 2014 on our consideration of the District's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the District's internal control over financial reporting and compliance.

TROY KELLEY
STATE AUDITOR

March 3, 2014

Financial Section

Morton General Hospital
Lewis County
January 1, 2012 through December 31, 2012

REQUIRED SUPPLEMENTARY INFORMATION

Management's Discussion and Analysis – 2012

BASIC FINANCIAL STATEMENTS

Statement of Net Position – 2012
Statement of Revenues, Expenses and Changes in Net Position – 2012
Statement of Cash Flows – 2012
Notes to Financial Statements – 2012

Lewis County Hospital District # 1
doing business as
Morton General Hospital

Management's Discussion and Analysis

Our discussion and analysis of the Lewis County Hospital District # 1, doing business as Morton General Hospital's (District) financial performance provides an overview of the District Hospital's financial activities for the calendar year ended December 31, 2012. Please read it in conjunction with the Hospital's financial statements that follow this analysis.

The District is a governmental entity and a political subdivision of the State of Washington. The District operates a twenty five-bed critical access acute care hospital. The District services include the acute care hospital, emergency room, and related ancillary services (lab, x-ray, etc.) associated with these services.

A five-member board of directors governs the District. The members of the board are elected for a term of six years. Two members are at large positions and three members are from specific locations within the District. The board is required to elect a chairman, vice-chairman and secretary. One of their duties is to hire an administrator. The board delegates the day-to-day operations of the District to the administrator.

The District is a municipal government entity. As such, the District levies, and the county collects property taxes from property owners within the Health Care District. These tax revenues are used to support the purposes of the Hospital, which is to provide health care to the citizens of the District.

The Government Accounting Standards Board prescribes the financial reporting of the Hospital. This is the format followed by the District. The financial statements of the district are audited by the Washington State Auditor's Office.

Financial Highlights

The Hospital had net gain of $1,296,122 in CY 2012 as compared to a net gain in CY 2011 of $292,389.

The Hospital's gross patient revenue was $27,921,244 which is an increase over prior year of $25,933,716. The total operating revenues increased in 2012 by $2,469,243 or 12.74%.

Non-operating revenues (expenses) decreased in 2012 by $114,258 or 10.24%.

The Hospital's total operating expenses increased in 2012 by $1,351,252 or 6.69%. Salary and wages increased in 2012 by $622,141 or 5.71%. Employee benefit expense increased in 2012 by $313,209 or 11.34%.

Total patient accounts receivable decreased from $4,741,866 in 2011 to $4,336,390 in 2012, a reduction of $405,476.

Capital expenditures were $3,996,737. The District has invested in 2012 a total of $2,364,942 in replacement equipment, $3,357,280 was invested in buildings and improvements, and Land and Land Improvements totaled $430,324. Construction in progress was $(2,155,809.)

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 purpose by contributors, grantors, or enabling legislation.

The Statement of Net Position and Statement of Revenue, Expenses and Changes in Net Position

Our analysis of the District finances begins on page three. 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 Revenue, 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 District's Net Position is the difference between its assets and liabilities reported on the Statement of Net Position.

These two statements report the District's net assets and changes in them. You can think of the District's Net Position – the difference between assets and liabilities – as one way to measure the District's financial health, or financial position. Over time, increases or decreases in the District's Net Position is one indicator of whether its financial health is improving or deteriorating. You will need to consider other non-financial factors, however, such as changes in the District's patient base and

measures of the quality of service it provides to the community, as well as local economic factors to assess the overall health of the District.

The Statement of Cash Flows

The final required statement is the Statement of Cash Flows. The 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 and liabilities reported in the Statement of Net Position. The District's Net Position increased in CY 2012 by $1,296,122. as you can see from **Table 1.**

Table 1: Assets, Liabilities, and Net Position

	2012	2011	2010
Assets:			
Current assets	$ 7,080,136	$ 6,620,727	$ 6,489,355
Capital assets, net	$ 15,251,198	$ 12,558,994	$10,723,172
Other noncurrent assets	$ 1,522,399	$ 3,830,536	$ 5,114,836
Total Assets	$ 23,853,733,	$ 23,010,257	$22,327,363
Liabilities:			
Long-term debt outstanding	$13,850,551	$14,275,037	$14,652,844
Deferred revenue	$ 122,860		
Other current and noncurrent liabilities	$ 3,122,788	$ 3,273,808	$ 2,505,496
Total Liabilities	$17,096,199	$17,548,845	$17,158,340
Net Position:			
Restricted for debt service	$ 392,949	$ 303,295	$ 143,239
Restricted for Capital Projects	$ 203	$ 2,615,932	$ 4,061,413
Unrestricted	$ 6,261,442	$ 2,369,980	$ 1,392,816
Capital assets net of related debt	$ 102,940	$ 172,205	$ (428,445)
Total Net Position	$ 6,757,534	$ 5,461,412	$ 5,169,023
Total liabilities and Net Position	$23,853,733	$23,010,257	$22,327,363

Operating Results and Changes in the District's Net Position

The District's excess of revenues over expenses for 2012 is $1,296,122 or 6.12 percent of net patient revenues as compared to 2011 excess revenues over expenses of $292,389 or 1.53 percent of net patient revenue as shown in **Table 2**.

Table 2: Operating Results and Changes in Net Position

	2012	2011	2010
Operating Revenues:			
Net Patient service revenues	$21,196,304	$19,171,141	$17,932,728
Other operating revenues	$ 660,437	$ 216,357	$ 196,590
Total Operating Revenues	$21,856,741	$19,387,498	$18,129,318
Operating Expenses:			
Salaries and benefits	$14,603,010	$13,667,660	$12,017,375
Depreciation and amortization	$ 1,334,106	$ 1,139,156	$ 1,049,668
Supplies	$ 1,909,613	$ 1,832,747	$ 1,882,280
Other operating expenses	$ 3,715,226	$ 3,571,140	$ 3,368,150
Total Operating Expenses	$21,561,955	$20,210,703	$18,317,473
Operating Income (Loss)	$ 294,786	$ (823,205)	$ (188,155)
Nonoperating Gains (Losses)			
Taxation for operations and bond principal and interest	$ 1,571,781	$ 1,643,047	$ 1,544,666
Interest earnings	$ 110,137	$ 111,881	$ 5,227
Interest expense	$ (706,473)	$ (692,063)	$ (565,651)
Grants and contributions	$ 29,942	$ 42,104	$ 37,947
Gain on disposal of assets	$	$ 8,349	$
Clinic physician program	$	$	$ (117,624)
Other	$ (4,051)	$ 2,276	$ 15,453
Total Nonoperating gains,net	$ 1,001,336	$ 1 ,115,594	$ 920,018
Increase in net position, excess of revenues and gains over expenses	$ 1,296,122	$ 292,389	$ 731,863
Net position, beginning of year	$ 5,461,412	$ 5,169,023	$ 4,437,160
Prior Period Adjustment			
Net position end of year	$ 6,757,534	$ 5,461,412	$ 5,169,023

Operating Gains / (Losses)

The first component of the overall change in the District's net position is the operating income (loss), which is the difference between net patient revenues and other operating revenues and the expenses incurred to perform those expenses. In 2012, the District, has reported an operating gain. This is not consistent with the Districts operating history since it was established as a District Hospital. The District has always been dependent on the taxation of property from the property owners within the District to support the operation. The District shows a gain from operations. The net gain from operations in 2012 was 1.35 percent of total operating revenues.

The rate of healthcare inflation has a direct effect on the cost of services provided by the District. The District's salaries and benefits costs have increased in 2012 by $935,350 or 6.85 percent. A majority of the employees in the District are represented by a Union which negotiates the salary and benefit rates with the District. Another significant component of the District's operating costs is depreciation. The District's depreciation increased in 2012 by $194,950 or 17.12 percent.

Nonoperating Revenues and Expenses

Nonoperating revenues consist primarily of property taxes levied by the county assessor's office for the benefit of the District based on property values. Tax revenues in 2012 were $1,571,781 and $1,643,047 in 2011 as described in note #7 to the financial statements.

The District's Cash Flows

Changes in the District's cash flows in 2012 is consistent with the changes in operating losses and non operating revenues and expenses. Cash expenditures for Capital assets were $3,849,633 which is part of the Building and Equipment program.

Capital Asset and Debt Administration

Capital Assets

At the end of 2012, the District had $15,251,198 invested in capital assets, net of accumulated depreciation, as detailed in Note #9 to the financial statements.

Debt

At the end of 2012 the District had $13,850,551 in long term debt, net of current maturities, which is a decrease from 2011 of $424,486 as described in note # 10 to the financial statements. As mentioned earlier, the voters of the District approved a special levy in September of 2002 to pay the principal and interest each year of a $9.8 million Unlimited Tax General Obligation Bond dated December 1, 2002. The District also entered into a Limited Tax General Obligation Bond in 2005 in the amount of $3,000,000. The District entered into a Limited Tax General Obligation Bond in 2010 in the amount of $5,200,000.The proceeds of these bond were used for the retirement of the 1996 Limited General Obligation Bond and expanding, modernizing and equipping the Hospital and clinics.

Other Economic Factors-Issues facing the District

There are several issues facing all healthcare organizations, including the District that could result in material changes in its financial position in the long term. Among those issues are:

Risks related to Medicare and Medicaid Reimbursement
High liability and malpractice insurance premiums
Increasing numbers of uninsured and underinsured patients
Nursing and other healthcare related labor shortages
Increasing employee benefit costs, especially health insurance
Physician recruitment and retainage
Federal and state cuts to Healthcare due to the economic situation in the U.S. Currently.

The District is certified as a provider under both the Medicare program and the Medicaid program. As of July1, 2002, the District became a Critical Access Hospital with the Medicare program and is paid on a cost reimbursement basis for hospital services provided Medicare beneficiaries. The District became eligible to be paid on a cost reimbursement basis from the Medicaid program as of August 1, 2002.

The Health Insurance Portability and Accountability Act (HIPAA) was passed in 1996 with the final rule completed in 2000. Under HIPPA, health plans, healthcare clearinghouses and healthcare providers including hospitals and their business partners must maintain reasonable and appropriate administrative, technical and physical safeguards to ensure the integrity and confidentiality of electronic healthcare information. The hospital must also protect against reasonable threats to the security or integrity of the information and protect against unauthorized use or disclosure.

Contacting the District's 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 or need additional financial information, contact the Administrator's office at Morton General Hospital, 521 Adams Street, Morton Wa. 98356.

Lewis County Public Hospital District No. 1
d/b/a Morton General Hospital

Statements of Net Position

December 31, 2012 and 2011

Assets	2012	2011
Current assets:		
Cash and cash equivalents	$ 3,572,124	$ 2,648,995
Receivables:		
Patient accounts - Net	2,984,151	3,340,741
Taxes	91,363	85,354
Other	60,599	73,609
Inventories	185,689	213,699
Prepaid expenses	186,210	258,329
Total current assets	7,080,136	6,620,727
Noncurrent assets, cash, and cash equivalents:		
Internally designated, construction project fund	-	41,995
Internally designated, capital acquisition	626,140	523,813
Restricted by debt indenture, debt service fund	392,949	303,295
Restricted for capital acquisitions	203	2,615,932
Net noncurrent assets, cash, and cash equivalents	1,019,292	3,485,035
Capital assets:		
Land	935,399	722,635
Construction in progress	158,874	2,314,683
Depreciable capital assets - Net of accumulated depreciation	14,156,925	9,521,676
Total capital assets - Net of accumulated depreciation	15,251,198	12,558,994
Other assets:		
Deferred financing costs - Net	439,182	286,201
Other	63,925	59,300
Total other assets	503,107	345,501
TOTAL ASSETS	$ 23,853,733	$ 23,010,257

Liabilities and Net Position	2012	2011
Current liabilities:		
Current maturities of long-term debt	$ 1,117,629	$ 631,037
Current portion of capital lease obligations	180,281	138,642
Current portion of deferred revenue	40,953	-
Warrants payable	305,193	171,335
Accounts payable - Trade	279,456	662,874
Payroll and related	465,065	507,205
Accrued vacation	595,602	546,168
Third-party payable	135,949	613,487
Patient trust funds	2,660	3,060
Total current liabilities	3,122,788	3,273,808
Noncurrent liabilities:		
Long-term debt - Net of current maturities	13,565,253	13,931,130
Capital lease obligations - Net of current portion	285,298	343,907
Total noncurrent liabilities	13,850,551	14,275,037
Other liabilities:		
Deferred revenue - Net of current portion	122,860	-
Total liabilities	17,096,199	17,548,845
Net position:		
Invested in capital assets - Net of related debt	102,940	172,205
Restricted:		
Restricted for debt service	392,949	303,295
Expendable for capital acquisitions	203	2,615,932
Unrestricted	6,261,442	2,369,980
Total net position	6,757,534	5,461,412
TOTAL LIABILITIES AND NET POSITION	$ 23,853,733	$ 23,010,257

The accompanying notes are an integral part of this financial statement.

Lewis County Public Hospital District No. 1
d/b/a Morton General Hospital

Statements of Revenues, Expenses, and Changes in Net Position

Years Ended December 31, 2012 and 2011

	2012	2011
Operating revenues:		
Net patient service revenue	$ 21,196,304	$ 19,171,141
Other	660,437	216,357
Total operating revenues	21,856,741	19,387,498
Operating expenses:		
Salaries and wages	11,523,537	10,901,396
Employee benefits	3,079,473	2,766,264
Professional fees	705,894	775,329
Supplies	1,909,613	1,832,747
Purchased services	1,412,599	1,259,507
Utilities	311,394	291,904
Depreciation and amortization	1,334,106	1,139,156
Insurance	213,471	221,639
Rent	560,791	508,875
Other	511,077	513,886
Total operating expenses	21,561,955	20,210,703
Gain (loss) from operations	294,786	(823,205)
Nonoperating revenues (expenses):		
Property taxes	1,571,781	1,643,047
Interest expense	(706,473)	(692,063)
Interest revenue	110,137	111,881
Gain on disposal of assets	-	8,349
Grants and contributions	29,942	42,104
Other	(4,051)	2,276
Total nonoperating revenues (expenses)	1,001,336	1,115,594
Increase in net position, excess of revenues over expenses	1,296,122	292,389
Net position - Beginning of year	5,461,412	5,169,023
Net position - End of year	$ 6,757,534	$ 5,461,412

The accompanying notes are an integral part of this financial statement.

Lewis County Public Hospital District No. 1
d/b/a Morton General Hospital

Statements of Cash Flows

Years Ended December 31, 2012 and 2011

	2012	2011
Cash flows from operating activities:		
Cash received from patient services	$ 21,252,179	$ 19,867,883
Cash received from other operating revenues	660,437	216,357
Cash paid for salaries and benefits	(14,595,716)	(13,455,615)
Cash paid for supplies, professional fees, and other operating expenses	(5,774,670)	(5,166,765)
Net cash provided by operating activities	1,542,230	1,461,860
Cash flows from noncapital financing activities:		
Cash received from tax revenue for operations	781,139	870,177
Cash received from donations and other nonoperating revenue	29,942	42,104
Net cash provided by noncapital financing activities	811,081	912,281
Cash flows from capital and related financing activities:		
Proceeds from issuance of long-term debt	7,888,158	-
Proceeds from disposal of capital assets	-	9,089
Principal payments on long-term debt and capital leases	(7,920,098)	(678,596)
Interest paid	(706,473)	(692,063)
Deferred financing costs paid	(193,973)	-
Payments for purchase of capital assets	(3,849,633)	(2,482,321)
Cash received from tax revenue	784,633	772,233
Cash used for clinic acquisition	(4,625)	(59,300)
Net cash used in capital and related financing activities	(4,002,011)	(3,130,958)
Cash flows from investing activities		
Interest received	110,137	111,881
Other nonoperating revenue received (used)	(4,051)	2,267
Net cash provided by investing activities	106,086	114,148
Net decrease in cash and cash equivalents	(1,542,614)	(642,669)
Cash and cash equivalents - Beginning of year	6,134,030	6,776,699
Cash and cash equivalents - End of year	$ 4,591,416	$ 6,134,030

Lewis County Public Hospital District No. 1
d/b/a Morton General Hospital

Statements of Cash Flows (Continued)

Years Ended December 31, 2012 and 2011

	2012	2011
Reconciliation of loss from operations to net cash provided by operating activities:		
Gain (loss) from operations	$ 294,786	$ (823,205)
Adjustments to reconcile loss from operations to net cash provided by operating activities:		
Depreciation and amortization	1,334,106	1,139,156
Provision for bad debts	1,331,953	1,215,637
Change in operating assets and liabilities:		
Receivables:		
Patient accounts - Net	(975,363)	(1,409,205)
Other	13,010	(15,675)
Third-party settlements	-	402,479
Inventories	28,010	(31,784)
Prepaid expenses	72,119	(24,365)
Warrants payable	133,858	(11,664)
Accounts payable	(383,818)	304,935
Payroll and related expenses	(42,140)	167,927
Accrued vacation	49,434	44,118
Third-party settlements	(313,725)	503,506
Total adjustments	1,247,444	2,285,065
Net cash provided by operating activities	$ 1,542,230	$ 1,461,860
Noncash investing and financing activities		
Capital lease obligations	$ 147,104	$ 467,991

The accompanying notes are an integral part of this financial statement.

Lewis County Public Hospital District No. 1 d/b/a Morton General Hospital

Notes to Financial Statements

Note 1 Summary of Significant Accounting Policies

The Entity

Lewis County Public Hospital District No. 1 (the "District") owns and operates Morton General Hospital, a 25-bed acute care hospital and two Medicare certified rural health clinics. The District provides health care services to patients in the Morton, Washington market. The services provided include acute care hospital, long term swing bed care services, emergency room, physician's clinic, and the related ancillary procedures (lab, x-ray, etc.) associated with those services.

The District is a municipal corporation governed by an elected five-member board. It was created on December 2, 1976 by the voters of Lewis County, to operate, control, and manage all matters concerning the County's healthcare functions.

Financial Statement Presentation

The financial statements have been prepared in accordance with accounting principles generally accepted in the United States (GAAP) as prescribed by the Governmental Accounting Standards Board (GASB).

The accounting records of the District are maintained in accordance with methods prescribed by the State Auditor under the authority of Chapter 43.09 RCW and the *Department of Health in the Accounting and Reporting Manual for Hospitals*.

The District's statements are reported using the economic resources measurement focus and full-accrual basis of accounting. Revenues are recorded when earned and expenses are recorded when liability is incurred regardless of the timing of the cash flows. Property taxes are recognized as revenue in the year in which they are levied. Grants and similar items are recognized as revenue as soon as eligibility requirements imposed by the provider have been met.

Tax Status

The District operates under the laws of the State of Washington for Washington municipal corporations. As organized, the District is a nonprofit corporation as described in section 501(c)(3) of the Internal Revenue Code and is exempt from payment of federal income tax. All District assets, liabilities, and financial transactions are included in these financial statements.

Note 1 Summary of Significant Accounting Policies (Continued)

Foundation

Eastern Lewis County Hospital Foundation (the "Foundation") is a legally separate, tax-exempt sponsoring organization of the District. The Foundation acts primarily as a fundraising organization to supplement the resources that are available to the District in support of its programs. The Board of the Foundation is not appointed by the District and is self-perpetuating, but does include a District Board member and its administrator. Although the District does not control the timing or amount of receipts from the Foundation, the majority of resources or income that the Foundation holds and invests are held for the exclusive benefit of the District.

A condensed statement of net position of the Foundation is as follows:

	(Unaudited) 2012	2011
Assets:		
Cash and investments, internally designated for exclusive benefit of the District	$ 52,276	$ 93,847
Liabilities	-	-
Net position - Unrestricted	$ 52,276	$ 93,847

A condensed statement of changes in net position of the Foundation is as follows:

	(Unaudited) 2012	2011
Income	$ 38,110	$ 75,439
Expenses	79,681	44,448
Change in net position	$ (41,571)	$ 30,991

Complete financial statements for the Foundation can be obtained from the Eastern Lewis County Hospital Foundation, P.O. Box 1132, Morton, Washington 98356-1132.

Note 1 Summary of Significant Accounting Policies (Continued)

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

For purposes of the statement of cash flows, the District considers all highly liquid investments, including restricted assets, with a maturity of three months or less when purchased to be cash equivalents.

Patient Accounts Receivable and Credit Policy

Patient accounts receivable are uncollateralized patient obligations that are stated at the amount management expects to collect from outstanding balances. These obligations are primarily from local residents, most of whom are insured under third-party payor agreements. The District bills third-party payors on the patients' behalf, or if a patient is uninsured, the patient is billed directly. Once claims are settled with the primary payor, any secondary insurance is billed, and patients are billed for co-pay and deductible amounts that are the patients' responsibility. Payments on patient accounts receivables are applied to the specific claim identified on the remittance advice or statement. The District does not have a policy to charge interest on past due accounts.

Note 1 Summary of Significant Accounting Policies (Continued)

Patient Accounts Receivable and Credit Policy (Continued)

Patient accounts receivable are recorded in the accompanying statements of net position net of contractual adjustments and allowance for uncollectable accounts which reflect management's best estimate of the amounts that will not be collected. The carrying amounts of patient accounts receivables are reduced by allowances that reflect managements' best estimate of the amounts that will not be collected. Management provides for contractual adjustments under terms of third-party reimbursement agreements through a reduction of gross revenue and a credit to patient accounts receivable. In addition, management provides for probable uncollectible amounts, primarily from uninsured patients and amounts patients are personally responsible for, through a reduction of gross revenue and a credit to the allowances for uncollectable accounts.

In evaluating the collectability of patient accounts receivable, the District analyzes past results and identifies trends for each of its major payor sources of revenue to estimate the appropriate allowance for uncollectable accounts and provision for bad debts. Management regularly reviews data from the major payor sources revenue in evaluating the sufficiency of the allowance for uncollectable accounts. Specifically, for receivables associated with services provided to patients who have third-party coverage, the District analyzes contractually due amounts and provides an allowance for uncollectable accounts and a provision for bad debts 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 includes 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 discounted rates if negotiated) and the amounts actually collected after all reasonable collection efforts have been exhausted is charged off against the allowance for uncollectable accounts.

Note 1 Summary of Significant Accounting Policies (Continued)

Inventories

Inventories are stated at cost on the first-in, first-out method (FIFO), which approximates the market value. Inventories consist of pharmaceutical, medical-surgical, and other supplies used in the operation of the District.

Noncurrent Assets

Such assets include certain cash and other assets whose use is limited under debt indentures, trust agreements, and by the Board of Commissioners for future bond principal and interest payments and future acquisition and replacement of property, buildings, equipment, and other purposes, including unrestricted earnings on those funds.

Capital Assets

Such assets are stated at cost. The District's policy is to capitalize all capital asset expenditures exceeding $5,000. Expenditures for maintenance and repairs not exceeding the capitalization amount are charged to operations as incurred, betterments and major renewals exceeding the amount are capitalized. When such assets are disposed of, the related costs and accumulated depreciation and amortization are removed from the accounts, and the resulting gain or loss is classified in non-operating gains and losses. Donated items are recorded at fair market value at the date of contribution and are subsequently considered as being on the basis of cost. Depreciation and amortization have been computed on the straight-line method over the following estimated useful service lives (Note 9):

Land improvements	3 to 25 years
Buildings and building improvements and fixed equipment	5 to 40 years
Major movable equipment	3 to 25 years

Note 1 Summary of Significant Accounting Policies (Continued)

Asset Impairment

Capital assets are reviewed for impairment when events or changes in circumstances suggest that the service utility of the capital asset may have significantly and unexpectedly declined. Capital assets are considered impaired if both the decline in service utility of the capital asset is large in magnitude and the event or change in circumstance is outside the normal life cycle of the capital asset. Such events or changes in circumstances that may be indicative of impairment include evidence of physical damage, enactment or approval of laws or regulations or other changes in environmental factors, technological changes or evidence of obsolescence, changes in the manner or duration of use of a capital asset, and construction stoppage. The determination of the impairment loss is independent of the event or circumstance in which the impairment occurred. Impairment losses, if any, are recorded in the statements of revenue and expenses and changes in net position. No impairment losses were recorded in 2012 and 2011.

Deferred Financing Costs

Deferred financing costs are legal, accounting, underwriting fees, printing costs, and other expenses associated with the issuance of Unlimited Tax General Obligation Bonds and Limited Tax General Obligation Bonds (Note 10). The costs have been capitalized and are being amortized to expense over the term of the bonds.

Note 1 Summary of Significant Accounting Policies (Continued)

Compensated Absences

Compensated absences are absences for which employees will be paid, such as vacation and sick leave. The District records unpaid leave for compensated absences as an expense and liability when incurred.

Vacation pay, which may be accumulated up to 360 hours, is payable upon resignation, retirement or death. There is no limit to the amount of sick leave an employee may accumulate, however it is not payable to the employee upon conclusion of their employment under any circumstance.

Net Position

Net position of the District is classified in three components. Net position invested in capital assets net of related debt consist of capital assets net of accumulated depreciation and reduced by the current 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, including amounts deposited with trustees as required by revenue bond indentures, if any. Unrestricted net position is remaining net position that does not meet the definition of invested in capital assets net of related debt 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 associated with providing healthcare services – the District's principal activity. Nonexchange revenues, including taxes, grants 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.

Note 1 Summary of Significant Accounting Policies (Continued)

Net Patient Service Revenues

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. Certain third-party payor reimbursement agreements are subject to audit and retrospective adjustments. 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. 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 willing to pay for services provided. Thus, the District records a significant provision for bad debts related to uninsured patients in the period the services are provided.

Budgets

The budget is prepared on an annual basis for approval by the Board of Commissioners. The budget is based on historical information and an estimated percentage increase over the prior year for inflationary purposes.

Charity Care

The District provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than established rates. The District maintains records to identify the amount of charges forgone for services and supplies furnished under the charity care policy. Because the District does not pursue collection of amounts determined to qualify as charity care, they are not reported as net patient service revenue.

Note 1 Summary of Significant Accounting Policies (Continued)

Grants and Contributions

From time to time, the District received grants from the State of Washington as well as contributions from individual and private organizations. Revenue 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 to capital acquisitions are reported after nonoperating revenues and expenses.

Electronic Health Record Incentive Funding

The American Recovery and Reinvestment Act of 2009 ("ARRA") provides for incentive payments under the Medicare and Medicaid programs for certain hospitals and physician practices that demonstrate meaningful use of certified electronic health record (EHR) technology. These provisions of ARRA, collectively referred to as the Health Information Technology for Economic and Clinical Health Act (the "HITECH Act"), are intended to promote the adoption and meaningful use of health information technology and qualified EHR technology.

The District recognizes revenue for EHR incentive payments when there is reasonable assurance that the District will meet the conditions of the program, primarily demonstrating meaningful use of certified EHR technology for the applicable period. The demonstration of meaningful use is based on meeting a series of objectives. Meeting the series of objectives in order to demonstrate meaningful use becomes progressively more stringent as its implementation is phased in through stages as outlined by the Centers for Medicare and Medicaid Services (CMS).

Amounts recognized under the Medicare and Medicaid EHR incentive programs are based on management's best estimates which are based in part on cost report data that is subject to audit by fiscal intermediaries, accordingly, amounts recognized are subject to change. In addition, the District's attestation of its compliance with the meaningful use criteria is subject to audit by the federal government or its designee.

Note 1 Summary of Significant Accounting Policies (Continued)

Electronic Health Record Incentive Funding (Continued)

The District incurs both capital expenditures and operating expenses in connection with the implementation of its EHR initiative. The amount and timing of these expenditures does not directly correlate with the timing of the District's receipt or recognition of the EHR incentive payments.

The District has deferred a portion of the payment received under the Medicare EHR program. The deferred revenue is being amortized and recognized as revenue over five years, which is the period the software would have been depreciated and cost reimbursed through the cost report.

Reclassifications

Certain reclassifications of 2011 amounts have been made in the accompanying financial statements to conform to 2012 presentation.

Note 2 Compliance

Management believes the District is in substantial compliance with current laws and regulations through the year ended December 31, 2012.

Note 3 Cash and Cash Equivalents

The District maintains depository relationships with financial institutions that are Federal Depository Insurance Corporation (FDIC) insured institutions. On November 9, 2010, the FDIC issued a final rule implementing section 343 of the Dodd-Frank Wall Street Report and Consumer Protection Act that provided for unlimited insurance coverage of noninterest-bearing transaction accounts through December 31, 2012. In addition, the District maintains cash in interest-bearing accounts at these institutions which are insured by the FDIC up to $250,000. Beginning January 1, 2013, noninterest-bearing transaction accounts will be added to any of a depositor's other accounts at the applicable financial institution, with the aggregate balance insured up to $250,000. At December 31, 2012, the District did not exceed the insured limits.

Note 3 Cash and Cash Equivalents (Continued)

The Revised Code of Washington, Chapter 39, authorized municipal governments to invest their funds in a variety of investments including federal, state, and local government certificates, notes, or bonds; the Washington State Local Government Investment Pool; savings accounts in qualified public depositories; and certain other investments. All final decisions regarding the purchase and sale of investment securities remain with the District Board. The District maintains an investment policy designed to maximize return and limit the following types of risks:

Custodial credit risk – Custodial credit risk is the risk that, in the event of a failure of the counterparty, the District will not be able to recover the value of the deposits or investments that are in the possession of an outside party. All District deposits are entirely covered by the Federal Deposit Insurance Corporation (FDIC) or by collateral held in a multiple financial institution collateral pool administered by the Washington Public Deposit Protection Commission, and all investments are insured, registered, or held by the District's agent in the District's name. The District's investment policy does not contain policy requirements that would limit the exposure to custodial risk for investments.

Credit risk – The risk that an issuer of an investment will not fulfill its obligation to the holder of the investment. This is typically measured by the assignment of a rating by a nationally recognized statistical rating organization. The District does not have a policy specifically requiring or limiting investments of type.

Concentration of credit risk – The inability to recover the value of deposits, investments, or collateral securities in the possession of an outside party caused by a lack of diversification (investments acquired from a single issuer). The District does not have a policy limiting the amount it may invest in any one issuer or multiple issuers.

Interest rate risk – The possibility than an interest rate change could adversely affect an investment's fair value. The District does not have a policy specifically managing its exposure to fair value losses arising from changing interest rates.

Note 3 Cash and Cash Equivalents (Continued)

The District's cash and cash equivalents are as follows:

	2012	2011
Cash in bank	$ 405,765	$ 96,920
Cash held by County Treasurer	4,185,651	6,037,110
Total	$ 4,591,416	$ 6,134,030
Carrying value	$ 4,591,416	$ 6,134,030

The carrying amounts of deposits with financial institutions shown above are included in the District's balance sheet as follows:

	2012	2011
Current assets - Cash and cash equivalents	$ 3,572,124	$ 2,648,995
Noncurrent assets - Cash and cash equivalents	1,019,292	3,485,035
Total cash and cash equivalents	$ 4,591,416	$ 6,134,030

Note 4 Patients Accounts Receivable

The District grants credit without collateral to its patients, most of who are local residents and are insured under third-party payor agreements. The majority of these patients are geographically concentrated in and around Lewis County. No single patient comprises more than five percent of the total receivable at year-end.

	2012		2011	
Receivable from patients and their insurance carriers	$ 3,081,436	71%	$ 3,186,440	67%
Receivable from Medicare	1,055,148	24%	1,017,433	21%
Receivable from Medicaid	199,806	5%	537,993	11%
Total patient accounts receivable	4,336,390	100%	4,741,866	100%
Less - Allowance for uncollectible amounts and contractual adjustments	(1,352,239)		(1,401,125)	
Patient accounts receivable - Net	$ 2,984,151		$ 3,340,741	

The District's allowance for bad debts for self-pay patients remained consistent at 59% of self-pay accounts receivable at December 31, 2011, and 59% of self-pay accounts receivable at December 31, 2012. In addition, the District's self-pay write-off's increased $123,738 from $1,540,839 in 2011to $1,664,577 in 2012. The District has not changed its charity care or uninsured discount policies during 2011 and 2012. The District does not maintain a material allowance for bad debts from third party payors, nor did it have significant write-offs from third-party payors.

Note 5 Net Patient Service Revenue

The following table sets forth the detail of patient service revenue – net of contractual adjustments, discounts and provision for bad debts for the years ended December 31:

	2012	2011
Gross patient service revenue	$ 27,921,244	$ 25,933,716
Less adjustments to gross patient service		
Contractual adjustments	5,392,987	5,546,938
Provision for bad debts	1,331,953	1,215,637
Total adjustments	6,724,940	6,762,575
Net patient service revenue	$ 21,196,304	$ 19,171,141

The District's percentage of net patient service revenue by payor is as follows for the years ended December 31:

	2012	2011
Medicare and Medicare Advantage Plans	52%	50%
Medicaid and Medicaid HMO Plans	11%	14%
Other third-party payors	36%	34%
Self-Pay	1%	2%
Totals	100%	100%

Note 6 Charity Care

The District provides health care services and other financial support through various programs that are designed, among other matters, to enhance the health of the community including the health of low-income patients. Consistent with the mission of the District, health care is provided to patients regardless of their ability to pay, including providing services to those persons who cannot afford health insurance because of inadequate resources.

Patients who meet certain criteria for charity care, generally based on federal poverty guidelines, are provided care based on criteria defined in the District's charity care policy. The District maintains records to identify and monitor the level of charity care it provides. The amount of charges foregone for services and supplies furnished under the District's charity care policy aggregated $332,987 and $325,202 for the years ended December 31, 2012 and 2011, respectively.

The estimated cost of providing care to patients under the District's charity care policy aggregated $265,000 and $270,000 for the years ended December 31, 2012 and 2011, respectively. The cost was calculated by multiplying the ratio of cost to gross charges for the District times the gross uncompensated charges associated with providing charity care.

Note 7 Taxes

Property taxes are levied by the District and collected by the Lewis County Treasurer. The county treasurer acts as an agent to collect property taxes levied in the county for all taxing authorities. Taxes are levied annually on February 15, on property values listed as of the prior January 1. Assessed values are established by the county assessor at 100 percent 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. Furthermore, tax levies must be authorized by the vote of the residents of Lewis County.

Note 7 Taxes (Continued)

Taxes estimated to be collectible are recorded as revenue in the year of the levy. Taxes levied for operations are recorded as non-operating revenues. No allowance for doubtful taxes receivable is considered necessary. The District received approximately 5.13% and 5.81% of its financial support from property taxes for the years ended December 31, 2012 and 2011, respectively. The funds were used as follows:

	2012	2011
Levied to support operations	$ 787,148	$ 870,814
Levied for debt service	784,633	772,233
Total	$ 1,571,781	$ 1,643,047

Note 8 Reimbursement Arrangements with Third-Party Payors

Hospital

The Hospital has agreements with third-party payors that provide for reimbursement to the Hospital at amounts that vary from its established rates. A summary of the basis of reimbursement with major third-party payors follows:

Medicare - The Hospital is designated as a critical access hospital (CAH). Under this designation, inpatient and outpatient hospital services rendered to Medicare program beneficiaries are paid based upon a cost-reimbursement methodology, with the exception of certain lab and mammography services, which remain on a fee schedule. Professional services provided by physicians and other clinicians are reimbursed based on prospectively determined fee schedules.

Medicaid - Inpatient and outpatient services rendered to Medicaid program beneficiaries are reimbursed under a cost reimbursement methodology. The Hospital is reimbursed at a tentative rate with final settlement determined after the submission of annual cost reports by the Hospital and audits thereof by the Medicaid fiscal intermediary.

Note 8 Reimbursement Arrangements with Third-Party Payors (Continued)

Hospital (Continued)

Others - The Hospital also has entered into payment agreements with certain commercial insurance carriers and preferred provider organizations. The basis for payment to the Hospital on these agreements includes prospectively determined rates per discharge, discounts from established rates, and other payment methods.

Other Nonacute Services

Physician and Professional Services - Certain physician and professional services rendered to Medicare and Medicaid beneficiaries qualify for reimbursement as Medicare-approved rural health clinic services. Qualifying services are reimbursed based on a cost-reimbursement methodology. Under federal law, the rural health clinics are also entitled to receive a wraparound payment for the difference between the cost and the amount paid by Medicaid managed-care plans. All other physician and professional services rendered to Medicare and Medicaid beneficiaries are paid based on prospectively determined fee schedules.

Accounting for Medicare and Medicaid Contractual Arrangements

The Hospital is reimbursed for cost-reimbursable items at interim rates with final settlements determined after audit of the related annual cost reports by the respective Medicare and Medicaid fiscal intermediaries. Estimated provisions to approximate the final expected settlements after review by the intermediaries are included in the accompanying consolidated financial statements. The Hospital's cost reports have been audited by the Medicare fiscal intermediaries through December 31, 2011. The Hospital's Medicaid cost reports have been audited through December 31, 2011.

Electronic Health Record Incentive Funding

As of December 31, 2012, the Hospital received $204,766 in EHR incentive payments from the Medicare program. Based on the District's policy, $40,953 was recorded in 2012 and included in other operating revenue in the accompanying statements of revenues, expenses, and changes in net position.

Note 8 Reimbursement Arrangements with Third-Party Payors (Continued)

Electronic Health Record Incentive Funding (Continued)

As of December 31, 2012, the Hospital received Medicaid EHR incentive payments totaling $346,078. The Medicaid EHR incentive payment is recognized as other operating revenue the year it is received.

Laws and Regulations

The health care 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, accreditation, government health care program participation requirements, reimbursement for patient services, and billing regulations.

Government activity with respect to investigations and allegations concerning possible violations of such regulations by health care providers has increased. Violations of these laws and regulations could result in expulsion from government health care programs together with the imposition of significant fines and penalties, as well as significant repayment for patient services previously billed. Management believes that the District is in compliance with applicable government laws and regulations. While no significant regulatory inquiries have been made of the District, 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.

The Centers for Medicare and Medicaid Services (CMS) has implemented a project using recovery audit contractors (RAC) as part of CMS's further efforts to ensure accurate payments. RACs search for potentially inaccurate Medicare payments that might have been made to health care providers and that were not detected through existing CMS program integrity efforts. Once a RAC identifies a claim it believes is inaccurate, the RAC makes a deduction from or addition to the provider's Medicare reimbursement in an amount estimated to equal the overpayment or underpayment. The District may either accept or appeal the RAC's findings. RAC reviews of the District's Medicare claims are anticipated; however, the outcomes of such reviews are unknown, and any financial impact cannot be reasonably estimated at December 31, 2012.

Note 9 Capital Assets

Capital asset additions, transfers from construction in progress, retirements and balances for the year ended December 31, 2012, are as follows:

	Balance January 1, 2012	Transfers/ Additions	Retirements	Balance December 31, 2012
Land	$ 722,635	$ 212,764	$ -	$ 935,399
Construction in progress	2,314,683	(2,155,809)	-	158,874
Total nondepreciable assets	3,037,318	(1,943,045)	-	1,094,273
Land improvements	1,232,020	217,560	-	1,449,580
Buildings and improvements	13,193,565	3,357,280	-	16,550,845
Equipment	4,035,061	2,364,942	-	6,400,003
Total depreciable assets	18,460,646	5,939,782	-	24,400,428
Total assets before depreciation	21,497,964	3,996,737	-	25,494,701
Less accumulated depreciation for:				
Land improvements	374,312	85,776	-	460,088
Buildings and improvements	5,744,016	757,919	-	6,501,935
Equipment	2,820,642	460,838	-	3,281,480
Total accumulated depreciation	8,938,970	1,304,533	-	10,243,503
Capital assets - Net	$ 12,558,994	$ 2,692,204	$ -	$ 15,251,198

Construction in progress primarily relates to an electronic health record (EHR) project estimated to be complete in December 2013 and a bathroom remodel completed in September 2013.

Note 9 Capital Assets (Continued)

Capital asset additions, transfers from construction in progress, retirements and balances for the year ended December 31, 2011, are as follows:

	Balance January 1, 2011	Transfers/ Additions	Retirements	Balance December 31, 2011
Land	$ 646,845	$ 75,790	$ -	$ 722,635
Construction in progress	447,152	1,867,531	-	2,314,683
Total nondepreciable assets	1,093,997	1,943,321	-	3,037,318
Land improvements	1,009,309	222,711	-	1,232,020
Buildings and improvements	13,262,923	14,979	84,337	13,193,565
Equipment	3,436,920	769,301	171,160	4,035,061
Total depreciable assets	17,709,152	1,006,991	255,497	18,460,646
Total assets before depreciation	18,803,149	2,950,312	255,497	21,497,964
Less accumulated depreciation for:				
Land improvements	296,284	78,028	-	374,312
Buildings and improvements	5,144,834	683,520	84,338	5,744,016
Equipment	2,638,859	347,630	165,847	2,820,642
Total accumulated depreciation	8,079,977	1,109,178	250,185	8,938,970
Capital assets - Net	$ 10,723,172	$ 1,841,134	$ 5,312	$ 12,558,994

Note 10 Long-Term Debt

The District issued a Limited Tax General Obligation Bonds on April 1, 1996, for the purpose of refunding the 1978, 1990, and 1991 (callable portion) Limited Tax General Obligation Bonds; Unlimited Tax General Obligation Bond, dated December 1, 2002, for the purpose of expanding, modernizing, and equipping Morton General Hospital and the District's clinics; Limited Tax General Obligation Bonds dated February 18, 2005, also for the purpose of expanding, modernizing, and equipping Morton General Hospital, Limited Tax General Obligation Bonds, dated October 28, 2010, also for the purpose of expanding, modernizing, and equipping Morton General Hospital and refunding the 1996 Limited Tax General Obligation Bonds; Unlimited Tax General Obligations Refunding Bonds, dated December 1, 2012, for the purpose of refunding the 2002 Unlimited Tax General Obligation Bonds.

All limited and unlimited tax general obligation bonds are general obligations of the District and are secured by an irrevocable pledge of the District that it will have sufficient funds available to pay the bond principal and interest due by levying each year a maintenance and operations tax upon the taxable property within the District.

Note 10 Long-Term Debt (Continued)

Schedule of changes in noncurrent liabilities for the year ended December 31, 2012, is as follows:

	Balance January 1, 2012	Additions	Reductions	Balance December 31, 2012	Amounts Due Within One Year
Bonds and notes payable:					
2002 Unlimited Tax General Obligation Bonds	$ 6,970,000	$ -	$ (6,970,000)	$ -	$ -
2005 Limited Tax General Obligation Bonds	2,375,000	-	(125,000)	2,250,000	130,000
2008 Note Payable Security State Bank	49,999	-	(6,025)	43,974	6,529
2010 Limited Tax General Obligation Bonds	5,185,000	-	(60,000)	5,125,000	60,000
2012 Unlimited Tax General Obligation Bonds	-	7,265,000	(595,000)	6,670,000	535,000
2012 Note Payable - Land and House	-	100,800	-	100,800	33,600
2012 Note Payable - Riffe Clinic Building	-	352,500	-	352,500	352,500
Add - Unamoritized premiums	-	169,858	(12,739)	157,119	-
Less - Unamortized discounts	(17,832)	-	1,321	(16,511)	-
Total bonds and notes payable	14,562,167	7,888,158	(7,767,443)	14,682,882	1,117,629

Note 10 Long-Term Debt (Continued)

	Balance January 1, 2012	Additions	Reductions	Balance December 31, 2012	Amounts Due Within One Year
Capital lease obligations:					
Mammography Equipment	95,028	-	(32,406)	62,622	34,072
Endoscopy Equipment	95,516	-	(33,003)	62,513	34,066
Diagnostic Equipment	183,826	-	(42,417)	141,409	43,689
Glidescope Equipment	28,185	-	(11,505)	16,680	11,808
PacsScan Equipment	19,291	-	(4,829)	14,462	5,084
IV Equipment	60,703	-	(14,481)	46,222	15,244
Versacare Beds	-	86,750	(14,820)	71,930	20,754
X-Ray Equipment	-	49,574	(9,774)	39,800	12,104
Stryker SmartPump	-	10,780	(839)	9,941	3,460
Total capital lease obligations	482,549	147,104	(164,074)	465,579	180,281
Total long-term liabilities	$ 15,044,716	$ 8,035,262	$ (7,931,517)	$ 15,148,461	$ 1,297,910

Note 10 Long-Term Debt (Continued)

Schedule of changes in noncurrent liabilities for the year ended December 31, 2011, is as follows:

	Balance January 1, 2011	Additions	Reductions	Balance December 31, 2011	Amounts Due Within One Year
Bonds and notes payable:					
2002 Unlimited Tax General Obligation Bonds	$ 7,380,000	$ -	$ (410,000)	$ 6,970,000	$ 440,000
2005 Limited Tax General Obligation Bonds	2,495,000	-	(120,000)	2,375,000	125,000
2008 Note Payable Security State Bank	55,581	-	(5,582)	49,999	6,037
2010 Limited Tax General Obligation Bonds	5,220,000	-	(35,000)	5,185,000	60,000
Less - Unamortized discounts	(19,153)	-	1,321	(17,832)	-
Total bonds and notes payable	15,131,428	-	(569,261)	14,562,167	631,037
Capital lease obligations:					
Mammography Equipment	122,572	-	(27,544)	95,028	32,406
Endoscopy Equipment	-	132,694	(37,178)	95,516	33,004
Diagnostic Equipment	-	218,205	(34,379)	183,826	42,417
Glidescope Equipment	-	34,755	(6,570)	28,185	11,505
PacsScan Equipment	-	20,461	(1,170)	19,291	4,829
IV Equipment	-	61,876	(1,173)	60,703	14,481
Total capital lease obligations	122,572	467,991	(108,014)	482,549	138,642
Total long-term liabilities	$ 15,254,000	$ 467,991	$ (677,275)	$ 15,044,716	$ 769,679

Note 10 Long-Term Debt (Continued)

The terms and the due dates of the District's long-term debt at December 31, 2012 and 2011, follow:

Unlimited Tax General Obligation Bonds, dated December 1, 2002, in the original amount of $9,800,000, ranging in principal payments annually of $310,000 in 2007 to $865,000 in 2022. Semi-annual interest payments at a varying rate of 4.00% to 5.25% are due in June and December each year. This bond debt was extinguished in 2012 using proceeds from the issuance of the 2012 UTGO bonds.

Limited Tax General Obligation Bonds (refunding) (tax exempt), dated February 18, 2005, in the original amount of $3,000,000, principal payments due twice annually at June 1 and December 1 in varying amounts from $100,000 in 2007 to $225,000 in 2025 plus interest at the rate of 4.69%.

Promissory Note to Security State Bank, dated July 31, 2008, in the original amount of $67,378, for the purchase of property near the hospital, principal payments due monthly in varying amounts from $371 to $807 plus interest at an annual rate of 7.75%. A final principal payment of $794 plus any accrued interest is due on July 31, 2018.

Limited Tax General Obligation Bonds (refunding) (tax exempt), and Limited Tax General Obligation Bonds (federally taxable) dated October 28, 2010, in the original amount of $5,200,187, used for an addition and remodel of the hospital, principal payments due annually at December 1 in varying amounts from $35,000 in 2011 to $495,000 in 2035 plus interest at various rates from 6.675% and 6.875%.

Unlimited Tax General Obligation Bond (refunding) (tax exempt) dated December 1, 2012, in the original amount of $7,265,000, used to refund the 2002 Unlimited Tax General Obligation Bonds, principal payments due twice annually at June 1 and December 1 in varying amounts from $595,000 in 2012 to $815,000 in 2022, plus interest at various rates of 2.00% to 4.00%.

Promissory Note to the seller of a house and land in Morton, Washington, dated August 8, 2012, in the original amount of $100,800, principal payments due annually in the amount of $33,600 for three years ending in 2015 plus interest at an annual rate of 4.00%.

Note 10 Long-Term Debt (Continued)

Promissory Note to Key Bank/Proximus Temporis LLC, dated December 31, 2012, in the original amount of $352,500, used for the purchase of a clinic building, principal payments due monthly in varying amounts starting at $3,876 in January 2013, with a balloon payment of $336,996 in April 2013 plus interest at 5%.

Capital lease obligation, collateralized by a future purchase of leased Mammography equipment with a cost of $130,815, dated November 2010, due in monthly installments of $3,043 including interest of 5.5%.

Capital lease obligation, collateralized by leased Endoscopy equipment with a cost of $132,695, dated November 2010, due in monthly installments of $2,966 including interest of 3.4%.

Capital lease obligation, collateralized by leased Diagnostic equipment with a cost of $218,206, dated March 2011, due in monthly installments of $3,945 including interest of 3.2%.

Capital lease obligation, collateralized by leased Glidescope equipment with a cost of $34,755, dated June 2011, due in monthly installments of $1,009 including interest of 2.8%.

Capital lease obligation, collateralized by leased PacsScan equipment with a cost of $20,460, dated October 2011, due in monthly installments of $477 including interest of 5.6%.

Capital lease obligation, collateralized by leased IV equipment with a cost of $61,877, dated December 2011, due in monthly installments of $1,442 including interest of 5.6%.

Capital lease obligation, collateralized by leased Versacare Beds with a cost of $86,750, dated April 2012, due in monthly installments of $2,022 including interest of 5.62%.

Capital lease obligation, collateralized by leased X-Ray equipment with a cost of $49,574, dated March 2012, due in monthly installments of $1,107 including interest of 3.44%.

Capital lease obligation, collateralized by leased Stryker SmartPumps with a cost of $10,780, dated October 2012, due in monthly installments of $323 including interest of 4.93%.

Note 10 Long-Term Debt (Continued)

Advance Refunding

The District issued $7,265,000 in Unlimited Tax General Obligation bonds ("2012 UTGO bonds") with interest rates ranging from 2.0% to 4.0% in December 2012. The proceeds were used to advance refund $6,970,000 of outstanding 2002 Unlimited Tax General Obligation bonds ("2002 UTGO bonds"), which had interest rates ranging from 4.0% to 5.25%. Net proceeds of $7,347,678 were derived from the issuance of the 2012 UTGO bonds at par, including a $169,858 premium, and after payment of $87,180 in underwriting fees. $7,293,912 of the net proceeds was deposited in an irrevocable trust with an escrow agent to provide funds for the future debt service payment on the refunded bonds, and $53,766 was used for issuance and other costs. As a result, the 2002 UTGO bonds are considered defeased and the liability for those bonds has been removed from the statement of net position.

The proceeds transferred to the escrow agent included funds for the call of the 2002 UTGO bonds at par plus accrued interest at December 1, 2012. The District advance refunded the 2002 UTGO bonds to reduce its total debt service payments by approximately $760,000 and obtain an economic gain (difference between the present values of the old and new debt service payments) of $675,030.

Note 10 Long-Term Debt (Continued)

A schedule of future debt service payments is as follows:

	Bonds and Notes Payable		
Year Ending December 31	Principal	Interest	Total
2013	$ 1,117,629	$ 612,893	$ 1,730,522
2014	795,661	586,989	1,382,650
2015	831,236	565,363	1,396,599
2016	843,258	536,982	1,380,240
2017	883,931	508,373	1,392,304
2018-2022	5,040,559	2,078,933	7,119,492
2023-2027	1,610,000	1,457,086	3,067,086
2028-2032	1,995,000	908,693	2,903,693
2033-2035	1,425,000	198,688	1,623,688
Total	$ 14,542,274	$ 7,454,000	$ 21,996,274

	Capitalized Lease		
Year Ending December 31	Principal	Interest	Total
2013	$ 180,281	$ 15,723	$ 196,004
2014	166,386	8,436	174,822
2015	103,408	2,910	106,318
2016	15,504	94	15,598
Total	$ 465,579	$ 27,163	$ 492,742

Note 11 Commitments – Non-cancellable Operating Leases

The District leases building space in Morton, Washington to unrelated parties for their medical practices. The lease term was through May 2012 with monthly payments of $2,475 and is subject to annual rent increases of three to seven percent per year. The lease was renewed on similar terms.

Note 12 Retirement Plan

The District has a tax sheltered annuity (TSA) plan that is available to substantially all employees. The deferred compensation plan has been established by the District under section 403(b) of the Internal Revenue Code. The name of the plan is Lewis County Hospital District No. 1 d/b/a Morton General Hospital 403(b) Plan ("the plan"). The plan is a defined contribution plan funded from both employee and employer contributions which are deposited in employee controlled accounts. Employees may contribute to the TSA immediately upon employment. After one year of service with the District, the District will make contributions to the employee's account. The District's contribution is on a matching basis at a rate to be determined annually by the District, and the District maintains sole discretion of how much, if any, it will make as an employer contribution. Employee and employer contributions are 100% vested at the time they are paid. For 2012 and 2011, the amount of pension expense was $431,674 and $309,839, respectively, and the amount of employee contributions to the plan was $564,143 and $404,322, respectively.

Note 13 Risk Management

The District has its professional liability insurance coverage with Lexington Insurance Company. The policy provides protection on a "claims-made" basis whereby only malpractice claims reported to the insurance carriers in the current year are covered by the current policies.

If there are unreported incidents which result in a malpractice claim in the current year, such claims will be covered in the year the claim is reported to the insurance carriers only if the District purchases claims-made insurance in that year or the District purchases "tail" insurance to cover claims incurred before but reported to the insurance carrier after cancellation or expiration of a claims-made policy.

The current malpractice insurance provides $1,000,000 per claim of primary coverage with a $5,000,000 annual aggregate limit plus $4,000,000 annual excess coverage per claim with a $4,000,000 annual aggregate. There are no significant deductibles or coinsurance clauses.

No liability has been accrued for future coverage for acts, if any, occurring in this or prior years. Also, it is possible that claims may exceed coverage available in any given year.

The District is also exposed to various risks of loss from torts; theft of, damage to, and destruction of assets; business interruption; errors and omissions; employee injuries and illnesses; and natural disasters; medical malpractice; 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.

Note 14 Leases

The District is committed under various leases for equipment. These leases are considered operating leases for accounting purposes. Lease expenses for the years ended December 31, 2012 and 2011, amounted to $560,791 and $508,875, respectively. Future minimum payments under noncancellable operating leases with initial or remaining terms in excess of one year are as follows:

	Total
2013	$ 361,181
2014	227,879
2015	168,667
2016	157,293
2017	66,890
	$ 981,910

Note 15 Self-Insured Plans

Unemployment

The District self-insures for unemployment insurance through the Public Hospital District Unemployment Compensation Fund and for workers' compensation benefits through the Public Hospital District Workers' Compensation Trust. Both are administered by the Washington State Hospital Association. Premiums are charged to operations as they are incurred. Total unemployment insurance expense was $103,505 and $86,356 in 2012 and 2011, respectively, and total workers' compensation benefits expense was $275,079 and $286,481 in 2012 and 2011, respectively.

Note 16 Joint Venture

The District is a partner in the Rural Health Quality Network, LLC, a Washington nonprofit corporation. The network was formed to provide quality development, medical staff support, and peer review services to its members, which are other rural healthcare providers in Washington State. The District's investment in the network is immaterial to the District's financial statements as a whole and is not recorded on the balance sheet. The District's portion of any net receipts from the participation in the network, or any other gains or losses related to the investment of the network are immaterial as a whole are not recorded on these statements.

Financial statements for the Rural Health Quality Network, LLC are available upon request at 300 Elliott Avenue West, Suite 300, Seattle, Washington, 98119-4118.

Note 17 Acquisitions

In October of 2011, the District purchased Riffe Medical Center, a Medicare certified Rural Health Clinic located in Mossyrock, Washington. Assets purchased included equipment, inventory, equipment and space leases, clinic name, and other assets. The District assumed no liabilities, debts or obligations of the seller. The related acquisition costs are immaterial to the financial statements as a whole.

Note 18 Other Notes

The District adjusted the balance sheet presentation for the year ended December 31, 2012 to report estimated settlements due to and from third party payors as a single net amount. To conform to the change in presentation, the 2011 third party receivable of $409,033 was netted with the 2011 third the party payable in the accompanying financial statements.

The change in presentation decreased the 2011 total assets by $409,033, decreased the 2011 total liabilities by $409,033, and had no effect on 2011 net position or excess of revenues over expenses.

ABOUT THE STATE AUDITOR'S OFFICE

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

We work with our audit clients and citizens as an advocate for government accountability. As an elected agency, the State Auditor's Office has the independence necessary to objectively perform audits and investigations. Our audits are designed to comply with professional standards as well as to satisfy the requirements of federal, state, and local laws.

The State Auditor's Office employees are located around the state to deliver services effectively and efficiently.

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

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

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

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