



Office of the Washington State Auditor
Pat McCarthy

Financial Statements Audit Report
Grays Harbor County Public Hospital
District No. 1
(Summit Pacific Medical Center)

For the period January 1, 2014 through December 31, 2015

Published March 13, 2017

Report No. 1017798





**Office of the Washington State Auditor
Pat McCarthy**

March 13, 2017

Board of Commissioners
Summit Pacific Medical Center
Elma, Washington

Report on Financial Statements

Please find attached our report on Summit Pacific Medical Center's financial statements.

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

Sincerely,

Pat McCarthy
State Auditor
Olympia, WA

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**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**

**Summit Pacific Medical Center
January 1, 2014 through December 31, 2015**

Board of Commissioners
Summit Pacific Medical Center
Elma, 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 Summit Pacific Medical Center, Washington, as of and for the years ended December 31, 2015 and 2014, and the related notes to the financial statements, which collectively comprise the District's basic financial statements, and have issued our report thereon dated October 20, 2016.

INTERNAL CONTROL OVER FINANCIAL REPORTING

In planning and performing our audits of the financial statements, we considered the District's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our 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.

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.



Pat McCarthy

State Auditor

Olympia, WA

October 20, 2016

INDEPENDENT AUDITOR'S REPORT ON FINANCIAL STATEMENTS

Summit Pacific Medical Center January 1, 2014 through December 31, 2015

Board of Commissioners
Summit Pacific Medical Center
Elma, Washington

REPORT ON THE FINANCIAL STATEMENTS

We have audited the accompanying financial statements of Summit Pacific Medical Center, Washington, as of and for the years ended December 31, 2015 and 2014, and the related notes to the financial statements, which collectively comprise the District's basic financial statements as listed on page 9.

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the District's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of

expressing an opinion on the effectiveness of the District's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Summit Pacific Medical Center, as of December 31, 2015 and 2014, and the changes in financial position and cash flows thereof for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 10 through 14 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 October 20, 2016 on our consideration of the District's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of

internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the District's internal control over financial reporting and compliance.

A handwritten signature in black ink that reads "Pat McCarthy". The signature is written in a cursive, flowing style.

Pat McCarthy

State Auditor

Olympia, WA

October 20, 2016

FINANCIAL SECTION

Summit Pacific Medical Center January 1, 2014 through December 31, 2015

REQUIRED SUPPLEMENTARY INFORMATION

Management's Discussion and Analysis – 2015 and 2014

BASIC FINANCIAL STATEMENTS

Statement of Net Position – 2015 and 2014

Statement of Revenues, Expenses and Changes in Net Position – 2015 and 2014

Statement of Cash Flows – 2015 and 2014

Notes to Financial Statements – 2015 and 2014

Grays Harbor County Public Hospital District No. 1

Management's Discussion and Analysis

December 31, 2015

This report is a discussion and analysis of Grays Harbor County Public Hospital District No. 1's financial performance, providing an overview of the District's financial activities for the fiscal year ended on December 31, 2015. Please read it in conjunction with the District's financial statements that follow this analysis.

Grays Harbor County Public Hospital District No. 1 is a governmental entity which owns and operates Summit Pacific Medical Center and three rural health clinics — Mark Reed Healthcare Clinic, Summit Pacific Healthcare Clinic (including Urgent Care), and Elma Family Medicine. It is a subdivision of the State of Washington. The Washington legislature voted to allow Public Hospital Districts to be formed within the state. The District was created by a public vote and began operating the hospital in January of 1982. The hospital, which was first licensed in 1956, had previously been owned and operated by the Mark E. Reed Memorial Hospital, a Washington non-profit corporation. A new facility was completed in 2013. Summit Pacific Medical Center opened to the public on Sunday, February 17, 2013. As a result of the new facility opening, the District changed its doing business as name from Mark Reed Health Care District to Summit Pacific Medical Center.

The District owns and operates a 15-bed acute-care unit, and three rural health clinics. Hospital services include inpatient care, skilled nursing care, observation care, 24-hour emergency department, laboratory, and diagnostic imaging services. In addition, the three rural health clinics provide primary care. A five member Board of Commissioners governs the District. The members of the Board are commissioners who are elected for six year terms. Elections are staggered every two years so that no more than one or two positions are up for election at one time. The Board elects a President and Secretary for two-year terms with the election in the odd years. It also appoints the District's Superintendent, or CEO, to whom the day-to-day operations of the hospital and clinics are delegated. The current CEO has dutifully served the District in this role since 2007.

The District is a municipal governmental entity. As such, it levies taxes from various activities within Grays Harbor County Public Hospital District No. 1, which are collected by the county. The most significant tax revenue is the maintenance and operations tax, which is levied on property held within the District. These and other tax revenues are used to support the operations of the hospital and clinics — providing health care services to residents of the District. Total tax revenues accounted for approximately 2% percent of the District's net revenue in 2015.

The Governmental Accounting Standards Board prescribes the financial reporting format followed by the District. The books were compiled internally and will be audited by the State Auditor's Office of the State of Washington.

Grays Harbor County Public Hospital District No. 1

Management's Discussion and Analysis (Continued)

December 31, 2015

Financial Highlights

The District's overall business generated total operating revenues of \$24,607,495 in 2015 and finished the year with an excess of revenue over expenses of \$1,983,337 — a margin of just over eight percent. This compares to an excess of revenue over expenses of \$1,200,377 in 2014.

The District experienced an increase of patient care volumes in 2015, continuing the trend experienced in 2014. The District moved the hospital operations in early 2013, seven miles west from McCleary to Elma, Washington. The new location is closer to a larger population-base and patient volumes increased as a result. The volumes continued to climb during 2015 due to the District continuing to increase our positive reputation with the surrounding community – broadening our service area. The emergency department visits increased by 13 percent compared to 2014 volumes, ending at 12,064 visits. The emergency department is the District's largest revenue source and generates the largest dollar margin. Based on a zip code analysis that was completed, it was determined that the District is seeing more patient from the western portion of Grays Harbor up to 30 miles away. The inpatient unit had 2,073 patient days of acute care, swing bed, and observation stays. This created an average daily census of 5.7 compared to 4.6 during 2014. The three rural health clinics also experienced strong growth with a total 31,681 visits – a 26 percent increase over 2014's 25,060 visits. This was of course largely aided by the opening of urgent care in February of 2015, which is part of our Summit Pacific Healthcare Clinic.

Uncompensated care (bad debt and charity care write offs) continued to decline in 2015 compared to 2014. In 2014, the uncompensated care was approximately \$3.15 million, or 6.4 percent of gross revenue. In 2015, the provisions for uncompensated care declined to approximately \$2.65 million, or 4.6 percent of gross revenue. This is largely due to the expanded insurance coverage under the Patient Protection and Affordable Care Act causing more patients to have third party coverage.

The following table shows the payer mix for the District services.

| | 2015 | 2014 |
|------------------|------|------|
| Medicare | 37% | 37% |
| Medicaid | 35% | 34% |
| Commercial/Other | 25% | 25% |
| Self-Pay | 3% | 4% |

Medicaid increased due to the state's focus and District's efforts to sign up Medicaid eligible citizens into the Medicaid program. These focused efforts had a direct correlation to the decrease of uninsured patients.

The District's financial statements consist of three statements – a "Statement of Net Position", a "Statement of Revenues, Expenses, and Changes in Fund Net Position"; and a "Statement of Cash Flows". These financial statements and related notes provide information about the activities of the District.

Grays Harbor County Public Hospital District No. 1

Management's Discussion and Analysis (Continued)

December 31, 2015

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 made a deliberate decision to conserve and build up cash, which is the primary reasoning for the increase in total assets. During the year ending December 31, 2015, the District strategically did not increase debt, or make significant capital asset purchases. The District is in the process of installing a new, integrated electronic medical records system (see footnote disclosure related to the electronic medical records system), which will be implemented on January 1, 2017. The cash reserves will be used to purchase the system and pay a contractor to build the system during 2016, and host it thereafter.

The change in other receivables was largely related to a \$316,000 Medicare receivable in 2015. However, total due-to-third party liabilities increased in 2015 compared to 2014 due to the increase in volumes and especially the increase in Medicaid payer mix. Additionally, the increase in full-time equivalent employees (noted below) resulted in an increase of accrued payroll related liabilities. These changes in 2015 increased the other current and non-current liabilities compared to 2014.

Statement of Revenues and Expense and Change in Net Position:

Net patient service revenue for 2015 was \$23,582,860 compared \$18,627,865 in 2014. The primary reason for the increase in revenue was a result of our increased volumes. It is also noteworthy to mention that in July of 2015 the District expanded urgent care services to the community from three days a week to seven days a week. The District's ancillary service revenue has a direct correlation with our out-patient volumes which also contributed to the increased revenue for the year ending December 31, 2015. In addition, in November of 2015 the District began offering out-patient physical therapy services to our rural health clinic patients. The District also received additional grant income in 2015 compared to 2014, which is reflected in the non-operating revenue variance.

The District's total operating expenses increased in 2015 compared to 2014. The most notable is with expenses related to salaries, wages, and benefits, professional fees, and purchased services. Salaries, wages, and benefits expenses increased due to an increase in staffing to accommodate the increased patient care volumes. The District had 164 full-time equivalent employees in 2015 compared to 129 in 2014. In addition, in July of 2015, the District implemented a wage increase to ensure wages are competitive with the Puget Sound market. Purchased service expenses also increased in 2015. The District pays a third party company as a central billing office. The billing office is paid based on the percent of payments collected from payers. As patient care volumes grew, so did the expense to collect payments related to those volumes. In addition, the District increased the payments to physicians that staff the emergency department. These physicians are independent contractors, and, as such, the expenses are reflected in professional fees.

Statement of Cash Flows:

Total Cash and Cash Equivalents at end of the year 2015 were \$10,116,326 and \$6,698,192 at the end of 2014. Cash is being conserved to purchase a new electronic medical records system which has an anticipated go-live date of January 1, 2016. In addition, the District is beginning to transition the organization in a way that helps facilitate a move from volume to value based patient care. Cash is reserved to help the District's position as it enters into new payment contracts with payers.

Grays Harbor County Public Hospital District No. 1

Management's Discussion and Analysis (Continued)

December 31, 2015

The increase in cash between 2014 and 2015 was a result of an increase in patient volumes and the revenue generated from those volumes. In addition, the District had less long-term debt payments in 2015 than 2014, due to the expiration of debt. In 2014, the final land payment was made, as well as the final payment for the 2001 LTGO bond (see long-term debt footnote). Finally, the District generally had fewer days of accounts receivable in 2015 compared to 2014.

Condensed financial information for the years ended December 31, 2015, 2014 and 2013 are as follows:

| | 2015 | 2014 | 2013 |
|---|----------------------|----------------------|----------------------|
| Assets: | | | |
| Current assets | \$ 12,223,765 | \$ 8,334,485 | \$ 5,596,796 |
| Other non-current assets | 1,573,423 | 1,919,721 | 1,339,641 |
| Capital assets, net | 18,061,893 | 19,125,602 | 20,653,432 |
| Total Assets | 31,859,081 | 29,379,808 | 27,589,869 |
| Liabilities: | | | |
| Other current and non-current liabilities | 4,387,085 | 3,289,918 | 3,233,711 |
| Long-term debt outstanding | 19,410,048 | 20,011,279 | 19,477,924 |
| Total Liabilities | 23,797,133 | 23,301,197 | 22,711,635 |
| Net Position: | | | |
| Net Investment in Capital Assets | (1,949,352) | (1,465,578) | 267,792 |
| Restricted | 1,573,423 | 1,339,432 | 1,339,432 |
| Unrestricted | 8,437,877 | 6,204,757 | 3,271,010 |
| Total Net Position | 8,061,948 | 6,078,611 | 4,878,234 |
| Total Liabilities and Net Position | \$ 31,859,081 | \$ 29,379,808 | \$ 27,589,869 |

Grays Harbor County Public Hospital District No. 1

Management's Discussion and Analysis (Continued)

December 31, 2015

| | 2015 | 2014 | 2013 |
|---|--------------|--------------|--------------|
| Total operating revenue | \$24,607,495 | \$19,485,552 | \$16,022,971 |
| Total non-operating revenues (expenses)-net | 10,380 | (194,391) | 392,246 |
| Total operating expenses | 22,634,538 | 18,090,784 | 16,279,665 |
| Excess or (deficiency) | 1,983,337 | 1,200,377 | 135,552 |
| Change in net position | 1,983,337 | 1,200,377 | 135,552 |
| Ending net position | \$8,061,948 | \$6,078,611 | \$4,878,234 |

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. For questions about this report, or for additional information, please contact the Chief Financial Officer, by phone at 360-346-2244 or by writing to: Grays Harbor County Public Hospital District No. 1, 600 E. Main Street, Elma, WA 98541.

Grays Harbor County Public Hospital District No. 1

Statement of Net Position

December 31, 2015 and 2014

| Assets | 2015 | 2014 |
|--|---------------------|---------------------|
| Current assets: | | |
| Cash and cash equivalents | \$8,542,903 | \$4,778,471 |
| Receivables: | | |
| Patient accounts - Less allowance for uncollectible amounts and contractual adjustments of \$7,932,175 in 2015 and \$6,920,106 in 2014 | 2,921,518 | 2,965,890 |
| Taxes | 36,850 | 49,227 |
| Other | 395,316 | 264,157 |
| Prepaid expenses | 120,039 | 98,348 |
| Inventories | 207,139 | 178,392 |
| Total current assets | 12,223,765 | 8,334,485 |
| Non current cash and cash equivalents: | | |
| Supervisory account | -- | 580,289 |
| Restricted for construction in progress | 233,991 | -- |
| Restricted by bond covenants | 1,339,432 | 1,339,432 |
| Total non current assets | 1,573,423 | 1,919,721 |
| Capital assets: | | |
| Land | 1,652,029 | 1,652,029 |
| Construction in progress | 171,844 | 25,072 |
| Depreciable capital assets - Net of accumulated depreciation | 16,238,020 | 17,448,501 |
| Total capital assets - Net of accumulated depreciation | 18,061,893 | 19,125,602 |
| TOTAL ASSETS | \$31,859,081 | \$29,379,808 |

Please see accompanying notes to the basic financial statements.

Grays Harbor County Public Hospital District No. 1

Statement of Net Position

December 31, 2015 and 2014

| Liabilities and Net Position | 2015 | 2014 |
|---|---------------------|---------------------|
| Current liabilities: | | |
| Warrants payable | \$ -- | \$1,478 |
| Accounts payable | 782,537 | 447,401 |
| Employee compensation and related liabilities | 600,609 | 443,279 |
| Accrued leave | 426,283 | 336,931 |
| Third-party settlement payable | 1,776,959 | 1,126,796 |
| Other current liabilities | 199,500 | 354,132 |
| Current maturities of long-term debt | 601,197 | 579,901 |
| Total current liabilities | 4,387,085 | 3,289,918 |
| Non current liabilities: | | |
| Long-term debt - Less current maturities | 19,410,048 | 20,011,279 |
| Total non current liabilities | 19,410,048 | 20,011,279 |
| Total liabilities | 23,797,133 | 23,301,197 |
| Net position: | | |
| Net investment in capital assets | (1,949,352) | (1,465,578) |
| Restricted for bond reserve fund | 1,573,423 | 1,339,432 |
| Unrestricted | 8,437,877 | 6,204,757 |
| Total net position | 8,061,948 | 6,078,611 |
| TOTAL LIABILITIES AND NET POSITION | \$31,859,081 | \$29,379,808 |

Please see accompanying notes to the basic financial statements.

Grays Harbor County Public Hospital District No. 1

Statements of Revenues, Expenses, and Changes in Fund Net Position Years Ended December 31, 2015 and 2014

| | 2015 | 2014 |
|---|---------------------|---------------------|
| Operating revenues: | | |
| Patient service revenues: | | |
| Daily hospital care | \$ 2,638,355 | \$ 2,278,291 |
| Outpatient and ancillary services | 55,344,623 | 46,640,784 |
| Total patient service revenues | 57,982,978 | 48,919,075 |
| Revenue deductions and allowances, including provisions for bad debts | (34,400,118) | (30,291,210) |
| Net patient service revenues | 23,582,860 | 18,627,865 |
| Other operating revenues | 1,024,635 | 857,687 |
| Total operating revenues | 24,607,495 | 19,485,552 |
| Operating expenses: | | |
| Salaries and wages | 10,931,661 | 8,395,331 |
| Employee benefits | 1,933,142 | 1,596,132 |
| Supplies | 1,615,532 | 1,316,613 |
| Professional fees | 2,240,233 | 1,857,433 |
| Purchased services - utilities | 365,572 | 351,448 |
| Purchased services - other | 2,861,106 | 2,062,449 |
| Insurance | 133,687 | 179,639 |
| Other | 698,728 | 511,173 |
| Rent | 125,403 | 117,458 |
| Depreciation and amortization | 1,729,474 | 1,703,108 |
| Total operating expenses | 22,634,538 | 18,090,784 |
| Operating income (loss) | 1,972,957 | 1,394,768 |
| Non operating revenues (expenses)- net | 10,380 | (194,391) |
| Excess of revenues over expenses | 1,983,337 | 1,200,377 |
| Net position - Beginning of year | 6,078,611 | 4,878,234 |
| Net Position - End of year | \$ 8,061,948 | \$ 6,078,611 |

Please see accompanying notes to the basic financial statements.

Grays Harbor County Public Hospital District No. 1

Statement of Cash Flows

Years Ending December 31, 2015 and 2014

| | 2015 | 2014 |
|--|----------------------|---------------------|
| Cash flows from operating activities: | | |
| Receipts from and on behalf of patients | \$ 24,040,829 | \$ 19,054,579 |
| Receipts from other operating activities | 1,089,078 | 1,575,459 |
| Payments to employees | (12,593,516) | (10,171,504) |
| Payment to suppliers, contractors, and others | (7,888,068) | (6,319,844) |
| Net cash (used in) provided by operating activities | 4,648,323 | 4,138,690 |
| Cash flows from noncapital financing activities: | | |
| Property and other taxes | 567,302 | 542,848 |
| Cash received from noncapital, grants contributions and non operating revenues | 159,587 | 38,636 |
| Net cash provided by noncapital financing activities | 726,889 | 581,484 |
| Cash flows from capital and related financing activities: | | |
| Proceeds from the issuance of long-term debt | - | 1,112,284 |
| Principal payments on long-term debt | (579,935) | (1,081,954) |
| Principal payments on capital lease obligations | - | - |
| Interest paid | (759,497) | (776,049) |
| Payments for purchase of capital assets | (665,765) | (175,068) |
| Net cash used in capital and related financing activities | (2,005,197) | (920,787) |
| Cash flows from investing activities: | | |
| Interest income | 48,119 | 12,769 |
| Net (decrease) increase in cash and cash equivalents | 3,418,134 | 3,812,156 |
| Cash and cash equivalents - Beginning of year | 6,698,192 | 2,886,036 |
| Cash and cash equivalents - End of year | 10,116,326 | 6,698,192 |
| Cash and cash equivalents: | | |
| Current cash and cash equivalents | 8,542,903 | 4,778,471 |
| Non current cash and cash equivalents | 1,573,423 | 1,919,721 |
| Total cash and cash equivalents | \$ 10,116,326 | \$ 6,698,192 |

Please see accompanying notes to the basic financial statements.

Grays Harbor County Public Hospital District No. 1

Statement of Cash Flows (Continued)

Years Ending December 31, 2015 and 2014

| | 2015 | 2014 |
|---|---------------------|---------------------|
| Reconciliation from income from operations to net cash provided by operating activities: | | |
| Operating income (loss) | \$ 1,972,957 | \$ 1,394,768 |
| Adjustments to reconcile income from operations to net cash provided by operating activities: | | |
| Depreciation and amortization | 1,729,474 | 1,703,108 |
| Bad debt expense | 2,168,587 | 2,375,957 |
| Change in operating assets and liabilities: | | |
| Patient accounts receivable - Net | (2,124,215) | (2,501,859) |
| Prepaid expenses | (21,691) | (72,644) |
| Other receivables | (128,041) | 717,772 |
| Inventories | (28,747) | (37,643) |
| Warrants payable | (1,478) | 1,053 |
| Accounts payable | 335,136 | 140,778 |
| Employee compensation and related liabilities | 157,330 | (198,892) |
| Accrued vacation | 89,352 | 18,851 |
| Third-party (settlement) payable | 650,163 | 552,616 |
| Other current liabilities | (150,504) | 44,825 |
| Total adjustments | 2,675,366 | 2,743,922 |
| Net cash (used in) provided by operating activities | \$4,648,323 | \$4,138,690 |

Please see accompanying notes to the basic financial statements.

Grays Harbor County Public Hospital District No. 1

Notes to Financial Statements

Note 1 Reporting Entity and Summary of Significant Accounting Policies

a. Reporting Entity

Grays Harbor County Public Hospital District No.1 (The District), doing business as, Summit Pacific Medical Center, owns and operates a 15-bed acute care hospital, and three certified rural health clinics. The District provides healthcare services to patients in the Grays Harbor County, Washington market. The services provided include acute care hospital, skilled nursing care, emergency room, outpatient primary care clinics, and the related ancillary procedures (lab, CT, ultrasound, MRI, x-ray, etc.) associated with those services.

The District operates under the laws of the State of Washington for Washington municipal corporations. The District was created in 1982, by the County of Grays Harbor to operate, control and manage all matters concerning the District's health care functions. The District is governed by an elected five-member board. As organized, the District is exempt from payment of federal income tax. All District assets, liabilities, and financial transactions are included in these financial statements.

Grays Harbor County Public Hospital District No. 1

Notes to Financial Statements

Note 1 **Reporting Entity and Summary of Significant Accounting Policies** (Continued)

b. Summary of Significant Accounting Policies

Basis of Accounting and Presentation

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.

Related Organization

Summit Pacific Medical Foundation (the Foundation), is a separate tax-exempt Washington corporation, and received its foundation designation in 1988. The Foundation is not considered a component unit of the District for financial statement purposes. Donations of approximately \$25,868 and \$16,622 were contributed to the District by the Foundation for the year ended December 31, 2015 and 2014, respectively.

Use of Estimates

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, 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.

The District considers critical accounting estimates to be those that require more significant judgments and include the valuation of accounts receivable, including contractual adjustments, an allowance for doubtful accounts, and estimated third-party settlements.

Grays Harbor County Public Hospital District No. 1

Notes to Financial Statements

Note 1 Summary of Significant Accounting Policies (Continued)

b. Summary of Significant Accounting Policies (Continued)

Cash and Cash Equivalents

The District considers all highly liquid investments, including restricted assets, with an original maturity of three months or less to be current cash and cash equivalents.

Patient Accounts Receivable

Receivables arising from patient service revenues are reduced by an allowance for uncollectible accounts and contractual adjustments, based on experience, third-party contractual arrangements, and any unusual circumstances which may affect the ability of patients to meet their obligations. Accounts deemed uncollectible are charged against this allowance (Note 4).

Inventories

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

Noncurrent Cash and Cash Equivalents

Noncurrent cash and cash equivalents may include funds that are internally considered designated for capital acquisitions and/or future expenditures, and that are restricted by bond covenants.

The District had a supervisory account included for the year ending December 31, 2014 in the amount of \$580,289 in a supervisory bank account. These funds were supervised by the United States Department of Agriculture (USDA) and related to funds drawn on the Limited Tax Federal Obligation Bond (LTGO – Bond 2012). Funds withdrawn from this account required approval from the USDA Rural Development office, approval of such was received during the year ending 2015. There were no supervisory bank accounts for the year ending December 31, 2015.

Grays Harbor County Public Hospital District No. 1

Notes to Financial Statements

Note 1 Summary of Significant Accounting Policies (Continued)

b. Summary of Significant Accounting Policies (Continued)

Net Position

Net position of the District is classified into three components. Net investment in capital assets, which consists 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. Unrestricted net position is remaining net position that does not meet the definition of net investment in capital assets or restricted (GASB 63).

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.

Reclassifications

Certain reclassifications have been made to the 2014 financial statements to conform to the classifications used in the 2015 financial statements, with no effect on previously reported change in net position.

Subsequent Events

Subsequent events have been reviewed through the report date, which is the date the financial statements were available to be issued and any such events requiring disclosure have been noted within the relevant section of these notes to the financial statements.

Grays Harbor County Public Hospital District No. 1

Notes to Financial Statements

Note 1 **Summary of Significant Accounting Policies (Continued)**

b. Summary of Significant Accounting Policies (Continued)

Capital Assets

Capital asset acquisitions and expenditures exceeding \$5,000 are capitalized and recorded at cost. 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 and amortization are removed from the accounts and the resulting gain or loss is classified in Non Operating Revenues (Expenses)-Net on the Statement of Revenues, Expenses, and Changes in Fund Net Position. Depreciation and amortization have been computed on the straight-line method over the estimated useful service lives of the assets.

The estimated lives associated with the District's assets are as follows:

| | |
|----------------------------|---------------|
| Land improvements | 5 to 10 years |
| Buildings and improvements | 2 to 40 years |
| Major moveable equipment | 3 to 20 years |

Leases

The District accounts for its lease agreements as capital or operating leases in accordance with the criteria established by GASB 62.

Grays Harbor County Public Hospital District No. 1

Notes to Financial Statements

Note 1 Summary of Significant Accounting Policies (Continued)

b. Summary of Significant Accounting Policies (Continued)

Accrued Leave

Effective January 1, 2009, the District implemented a paid time off (PTO) policy and converted all employees into the plan. The District records PTO as an expense and current liability when earned as it is deemed a short term liability. Accrued leave amounts are absences for which employees will be paid, such as vacation, holiday and sick leave. In addition to the PTO policy, there is also an extended illness benefit, which employees can use in the event that the employee, or one of their immediate family members, suffers an extended illness or injury. However, there is no liability for extended illness benefit due to the fact that the District's policy does not require payout of this benefit when an employee separates from service, to the District.

Grants and Contributions

From time to time, the District receives grants from the Federal Government and the State of Washington as well as contributions from individuals and private organizations. Revenues from grants and contributions (including contributions of capital assets) are recognized when all eligibility requirements, including time requirements are met. Grants and contributions may be restricted for either specific operating purposes or for capital purposes. Amounts that are unrestricted or that are restricted to a specific operating purpose are reported as non operating revenues in the year received.

Operating and Non Operating Revenues and Expenses

The District's statement of revenues, expenses and changes in fund net position distinguishes between operating and non-operating revenues and expenses. Operating revenues result from exchange transactions associated with providing health care services – the District's principle activity. Operating expenses are all expenses incurred to provide health care services, other than financing costs. Non operating revenues and expenses, including but not limited to, interest income, rental payments, grants, tax revenue, 340b program revenue and related 340b program expense, and contributions received for purposes other than capital asset acquisition, are reported as non-operating revenues (expenses) net. The 340B Drug Discount Program is a U.S federal government program created in 1992 that requires drug manufacturers to provide outpatient drugs to eligible health care organizations/covered entities at reduced prices.

Grays Harbor County Public Hospital District No. 1

Notes to Financial Statements

Note 1 Summary of Significant Accounting Policies (Continued)

b. Summary of Significant Accounting Policies (Continued)

Patient Service Revenues

Revenues from patient services are reported on the accrual basis in the period in which services are provided at established rates whether or not collection in full is anticipated. Contractual adjustments, the results of arrangements to provide services for other than established rates, are reported as revenue deductions and allowances, including provision for bad debts. Contractual allowances include differences between established rates and amounts estimated by management as reimbursable under various reimbursement programs in effect. Normal estimation differences between final settlements and amounts accrued in previous years are reported as adjustments of the current year's contractual allowances.

Budgets

The budget is prepared on an annual basis for approval by the Board of Commissioners. The budget is based on historical information, forecasted service volumes, anticipated expenses, and an estimated percentage increase or decrease over the prior year for inflationary purposes, while taking into account the related year's strategic plan.

Community Care

The District provides care to patients who meet certain criteria under its community care policy without charge or at amounts less than established rates. The District maintains records to identify and monitor the level of community care provided. These records include the amount of charges foregone for services and supplies furnished under its community care policy. Charges associated with community care of \$485,792 and \$771,821 were provided for the years ended December 31, 2015 and 2014, respectively. On a percentage basis, this represents .8 percent and 1.6 percent, respectfully, of total patient service revenues for the two years. The continued decline in community care is due to new healthcare insurance coverage options made available by the Affordable Care Act.

Grays Harbor County Public Hospital District No. 1

Notes to Financial Statements

Note 2 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 community 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. Net patient service revenue, recognized in the period, is comprised of the following:

| | Years Ended December 31, | |
|---|---------------------------------|---------------------|
| | 2015 | 2014 |
| Patient service revenue (net of contractual adjustments and discounts): | | |
| Medicare | \$ 9,473,028 | \$ 7,833,493 |
| Medicaid | 4,132,075 | 4,647,794 |
| Other third-party payors | 10,834,708 | 7,211,958 |
| Self-pay patients | 1,797,428 | 2,082,398 |
| Total Patient Service Revenue | 26,237,239 | 21,775,643 |
| Less: | | |
| Community care | 485,792 | 771,821 |
| Provision for bad debts | 2,168,587 | 2,375,957 |
| Net patient service revenue | \$23,582,860 | \$18,627,865 |

The patient service revenue amounts shown in the graph above for Medicare, Medicaid, and other third-party payors include patient responsibility balances consisting of co-payments, co-insurance, and deductible amounts.

Grays Harbor County Public Hospital District No. 1

Notes to Financial Statements

Note 2 Net Patient Service Revenue (continued)

The District provides services to patients under contractual agreements with the Medicare and Medicaid programs. Differences between gross revenues charged and reimbursement under each of the various programs are included in revenue deductions and allowances. Gross revenues billed under the programs totaled approximately \$41,652,000 and \$34,650,000 for 2015 and 2014, respectively.

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 most inpatient and outpatient services on a cost basis as defined and limited by the Medicare program. 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. The District is reimbursed for physician services on a fee schedule. The Medicare program's administrative procedures preclude final determination of amounts due to the District, for such services billed, for up to three years from the date the District's cost reports were filed with the Medicare intermediary. Medicare has tentatively reviewed and settled cost reports through 2013.
- Medicaid – Reimbursement for most inpatient and outpatient services rendered to Medicaid program beneficiaries is reimbursed on a cost basis as defined by the State of Washington. 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 review thereof by the Washington State Department of Social and Health Services. The District is reimbursed for physician services on a fee schedule. Medicaid hospital cost reports have been reviewed and tentatively settled for years through 2013.
- 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, fee schedule, and prospectively determined daily rate.

Grays Harbor County Public Hospital District No. 1

Notes to Financial Statements

Note 2 Net Patient Service Revenue (continued)

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.

Bad debt expense, and the allowance for bad debt, is included in the revenue deductions and allowances provision in the amount of \$2,168,587 and \$2,375,957 for 2015 and 2014, respectively. The cost to the District associated with these bad debts for 2015 and 2014 are estimated to be approximately \$889,121 and \$957,088, respectively.

The District's three physician clinics are certified as rural health clinics and are reimbursed by Medicare on a cost basis as defined and limited by the Medicare program. Medicaid reimburses for these services based on a prospectively established rate per visit, which is based on historical cost.

Note 3 Custodial Risk

Custodial credit risk is the risk that in the event of a depository institution failure, the District's deposits may not be returned. The District's deposits are entirely covered up to Federal Deposit Insurance Corporation (FDIC) limit or by collateral that has been pledged, by the related financial institution. In addition, the District has funds invested in the Washington State Local Government Investment Pool, which is administered by the Washington Public Deposit Protection Commission (PDPC), which broadly diversifies the District's deposit sources.

The Revised Code of Washington, Chapter 39, authorizes 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 had investments of \$249,223 and \$248,814 in the Washington State Local Government Investment Pool at December 31, 2015 and 2014, respectively.

Grays Harbor County Public Hospital District No. 1

Notes to Financial Statements

Note 4 Patient Accounts Receivable

Patient accounts receivable are reduced by an allowance for uncollectible accounts. In evaluating the collectability of patient 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 doubtful 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 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 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 has not materially changed its community care or patient account collection policies during 2015 or 2014. The District does not maintain a material allowance for doubtful accounts from third-party payors, nor did it have significant write offs from third-party payors.

Grays Harbor County Public Hospital District No. 1

Notes to Financial Statements

Note 4 Patient Accounts Receivable (Continued)

The District grants credit without collateral to its patients, most of whom are local residents and maybe insured under third-party payor agreements. No single patient comprises more than 5% of the total receivable at year-end. The mix of patient receivables at December 31 is as follows:

| | 2015 | 2014 |
|---|--------------------|--------------------|
| Receivable from patients and related to commercial insurances or third party payors | \$3,614,695 | \$4,308,824 |
| Receivable from Medicare | 3,085,693 | 2,817,534 |
| Receivable from Medicaid | 4,153,305 | 2,759,638 |
| Total patient accounts receivable | 10,853,693 | 9,885,996 |
| Less allowance for uncollectible amounts | 7,932,175 | 6,920,106 |
| Net patient accounts receivable | \$2,921,518 | \$2,965,890 |

Effective December 1, 2011 the District began outsourcing the billing, credit and collections functions, in an effort to improve collection timing and to ultimately reduce our bad debt write off amounts.

Grays Harbor County Public Hospital District No. 1

Notes to Financial Statements

Note 5 Electronic Health Records

Incentives

The state has two electronic health records (EHR) incentive payment programs for Medicaid — one for providers and one for the hospital. No provider incentive payments were received for the year ending December 31, 2015 or the year ending December 31, 2014.

The Medicaid hospital incentive payment will be applied for once the hospital achieves the meaningful use criteria. The criteria will be met when an EHR software system is acquired for the inpatient unit. To date, the hospital is able to achieve 93 percent of the meaningful use criteria via the electronic T-System in the emergency department.

Electronic Medical Record Purchase

In June 2015, the District signed a contract with Medical Information Technology, Inc. (MediTech) to purchase a new organization wide integrated health care information system. The contract identifies the purchase price, as well as fees related to the ongoing maintenance and support of the new system, in the amount of \$2,747,096, which is payable over the following years:

| | | Payment |
|--------------|-----------|------------------|
| Year | | Amount |
| 2015 | \$ | 171,845 |
| 2016 | \$ | 1,748,575 |
| 2017 | \$ | 124,826 |
| 2018 | \$ | 127,017 |
| 2019 | \$ | 133,368 |
| 2020 | \$ | 140,037 |
| 2021 | \$ | 147,038 |
| 2022 | \$ | 154,390 |
| Total | \$ | 2,747,096 |

Grays Harbor County Public Hospital District No. 1

Notes to Financial Statements

Note 5 Electronic Health Records (Continued)

The District also signed a contract Inland Northwest Health Services (INHS) to remotely host and manage the new system, through December 31, 2022 at a total cost of \$4,388,130 payable over the following years:

| Year | | Payment Amount |
|--------------|-----------|---------------------------|
| 2015 | \$ | 18,300 |
| 2016 | \$ | 1,259,996 |
| 2017 | \$ | 457,200 |
| 2018 | \$ | 480,060 |
| 2019 | \$ | 504,063 |
| 2020 | \$ | 529,266 |
| 2021 | \$ | 555,729 |
| 2022 | \$ | 583,516 |
| Total | \$ | 4,388,130 |

The district anticipates that approximately \$2,961,000 of the total amounts paid to Medical Information Technology, Inc. and INHS will be capitalized in 2017 as a capital asset. In addition, the District used the \$233,991 designated at December 31, 2015 on the related Statement of Net Position, as restricted for future construction in progress, towards the 2017 payments to INHS.

Grays Harbor County Public Hospital District No. 1

Notes to Financial Statements

Note 6 Taxes

During the year end December 31, 2015 and 2014, the District received approximately 2% and 3%, respectively, of its financial support from property and other taxes. The funds were used as follows:

| | 2015 | 2014 |
|---|------------|------------|
| Tax income recorded as non operating revenue (expenses) | \$ 549,379 | \$ 530,253 |

Property taxes are levied by the District and collected by the Grays Harbor 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 January 1 on property values assessed as of the same date and are intended to finance the District's activities of same calendar year. Assessed values are established by the County Assessor at 100% of fair market values. A revaluation of all property is required annually.

Taxes are due in two equal installments on April 30 and October 31. Collections are distributed monthly to the District by the county treasurer, for the tax amount collected during the previous month.

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 need to be authorized by the vote of the people. The levies are used towards supplementing the payment of our long term general obligation bonds (see the long-term debt footnote).

For 2015, the District's regular tax levy was approximately \$.50 per \$1,000 on a total assessed valuation of \$964,870,032 for a total levy of \$482,435. The District received \$473,620 in regular levy taxes and \$75,759 in timber and other tax categories in 2015.

For 2014, the District's regular tax levy was approximately \$.50 per \$1,000 on a total assessed valuation of \$908,786,720 for a total regular levy of \$454,393. The District received \$450,970 in regular tax levy taxes and \$79,283 in timber and other tax categories in 2014.

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 (expenses) - net. No allowance for doubtful taxes receivable is considered necessary.

Grays Harbor County Public Hospital District No. 1

Notes to Financial Statements

Note 7 Capital Assets

Capital asset additions, transfers from construction in progress, retirements, and balances for the year ended December 31, 2015, are as follows:

| | Balance January 1, 2015 | Additions | Retirements/ (Transfers) | Balance December 31, 2015 |
|---|----------------------------|-----------------------|-----------------------------|---------------------------------|
| Non depreciable capital assets: | | | | |
| Land | \$ 1,652,029 | -- | \$ -- | \$ 1,652,029 |
| Construction in progress** | 25,072 | 171,844 | (25,072) | 171,844 |
| Total non depreciable capital assets | 1,677,101 | 171,844 | (25,072) | 1,823,873 |
| Depreciable capital assets: | | | | |
| Land improvements | 65,147 | 299,525 | -- | 364,672 |
| Buildings and improvements | 18,090,230 | 79,413 | -- | 18,169,643 |
| Equipment | 3,747,978 | 114,983 | 25,072 | 3,888,033 |
| Total depreciable capital assets | 21,903,355 | 493,921 | 25,072 | 22,422,348 |
| Total capital assets before depreciation | 23,580,456 | 665,765 | -- | 24,246,221 |
| Less accumulated depreciation for: | | | | |
| Land improvements | 49,081 | 3,866 | -- | 52,947 |
| Buildings and improvements | 2,875,302 | 1,140,962 | -- | 4,016,264 |
| Equipment | 1,530,471 | 584,646 | -- | 2,115,117 |
| Total accumulated depreciation | 4,454,854 | 1,729,474 | -- | 6,184,328 |
| Net capital assets | \$ 19,125,602 | \$ (1,063,709) | \$ -- | \$ 18,061,893 |

**Construction in progress at December 31, 2015, consisted of the following:

- Facility wide - Electronic Medical Record system which will be placed into service on January 1, 2017 and had \$171,844 of accumulated costs incurred as of December 31, 2015 (see Electronic Health Records footnote for more information).

Grays Harbor County Public Hospital District No. 1

Notes to Financial Statements

Note 7 Capital Assets (Continued)

Capital asset additions, transfers from construction in progress, retirements, and balances for the year ended December 31, 2014, are as follows:

| | Balance January 1, 2014 | Additions | Retirements/ Transfers | Balance December 31, 2014 |
|---|----------------------------|-----------------------|---------------------------|------------------------------|
| Non depreciable capital assets: | | | | |
| Land | \$ 1,623,605 | -- | \$ 28,424 | \$ 1,652,029 |
| Construction in progress*** | -- | 25,072 | -- | 25,072 |
| Total non depreciable capital assets | 1,623,605 | 25,072 | 28,424 | 1,677,101 |
| Depreciable capital assets: | | | | |
| Land improvements | 65,147 | -- | -- | 65,147 |
| Buildings and improvements | 18,118,654 | -- | (28,424) | 18,090,230 |
| Equipment | 3,597,981 | 149,997 | -- | 3,747,978 |
| Total depreciable capital assets | 21,781,782 | 149,997 | (28,424) | 21,903,355 |
| Total capital assets before depreciation | 23,405,387 | 175,069 | -- | 23,580,456 |
| Less accumulated depreciation for: | | | | |
| Land improvements | 44,617 | 4,464 | -- | 49,081 |
| Buildings and improvements | 1,755,817 | 1,119,486 | -- | 2,875,303 |
| Equipment | 951,312 | 579,158 | -- | 1,530,470 |
| Total accumulated depreciation | 2,751,746 | 1,703,108 | -- | 4,454,854 |
| Net capital assets | \$ 20,653,641 | \$ (1,528,039) | -- | \$ 19,125,602 |

***Construction in progress at December 31, 2014, consisted of the following:

- Medical Unit – Verathon Bladder Scanner was placed into service in 2015, with a cost of \$14,669.
- Diagnostic Imaging – NPI Ultrasound Gurney was placed into service in 2015 with a cost of \$10,403.

Grays Harbor County Public Hospital District No. 1

Notes to Financial Statements

Note 8 Long-Term Debt, Leases Payable, and Other Noncurrent Liabilities

A schedule of changes in the District's noncurrent liabilities for the year ended December 31, 2015, is as follows:

| | Balance January 1, 2015 | Additions | Reductions | Balance December 31, 2015 | Amounts Due Within One Year |
|-----------------------------|-------------------------------|-----------|----------------|---------------------------------|-----------------------------------|
| Bonds payable: | | | | | |
| LTGO Bond - 2011 | \$9,308,505 | -- | \$204,162 | \$9,104,343 | \$211,875 |
| Revenue Bond - 2011 | 9,306,717 | -- | 204,229 | 9,102,488 | 211,945 |
| LTGO Bond-2012 | 1,975,958 | -- | 171,544 | 1,804,414 | 177,377 |
| Total long-term debt | 20,591,180 | -- | 579,935 | 20,011,245 | 601,197 |

A schedule of changes in the District's noncurrent liabilities for the year ended December 31, 2014, is as follows:

| | Balance January 1, 2014 | Additions | Reductions | Balance December 31, 2014 | Amounts Due Within One Year |
|-----------------------------|-------------------------------|------------------|------------------|---------------------------------|-----------------------------------|
| Bonds and notes payable: | | | | | |
| LTGO Bonds - 2001 | \$ 175,000 | -- | \$ 175,000 | \$ -- | \$ -- |
| Note Payable - Land | 350,000 | -- | 350,000 | -- | -- |
| LTGO Bond - 2011 | 9,494,687 | -- | 186,182 | 9,308,505 | 204,147 |
| Revenue Bond - 2011 | 9,492,966 | -- | 186,249 | 9,306,717 | 204,215 |
| LTGO Bond-2012 | 1,048,197 | 1,112,284 | 184,523 | 1,975,958 | 171,539 |
| Total long-term debt | 20,560,850 | 1,112,284 | 1,081,954 | 20,591,180 | 579,901 |

Grays Harbor County Public Hospital District No. 1

Notes to Financial Statements

Note 8 Long-Term Debt, Leases Payable, and Other Noncurrent Liabilities (Continued)

Long-Term Debt

The terms and due dates of the District's long-term debt, including capital lease obligations, at December 31, 2015 and 2014 are as follows:

Limited Tax General Obligation Bonds (LTGO Bonds – 2001), dated April 16, 2001, payable in varying principal installments on December 1 of \$150,000 in 2011 to \$175,000 in 2014, plus semiannual interest at rates from 4.75% to 5.45% payable June 1 and December 1 of each year. The funds received were used to help fund District operations. This bond was paid in full during 2014.

Note payable to Grays Harbor County (Note Payable – Land), dated October 29, 2010, payable in three installments of \$250,000 on October 29, 2010; \$300,000 on October 31, 2012; and \$350,000 on October 31, 2014, for purchase of land for the new facility that was built in Elma, WA, which was completed in early 2013. This note payable was paid in full during 2014.

Limited Tax General Obligation Bond (LTGO Bond -2011) dated October 28, 2011, is payable in two annual varying interest only payments followed by fifty-six \$275,660 semiannual principal and interest payments, beginning October of 2012. The interest rate on the bond is locked in at 3.75% and is due in full by October 28, 2041. The initial two interest payment amounts were determined at the time the required interest payment was due, based on the amount drawn on this bond at the time the interest payments were due. The bond was for \$9,505,500, and the funds were used to construct the replacement facility, and related equipment, in Elma, WA, which was completed in early 2013.

Grays Harbor County Public Hospital District No. 1

Notes to Financial Statements

Note 8 Long-Term Debt, Leases Payable, and Other Noncurrent Liabilities (Continued)

Long-Term Debt (Continued)

Revenue Bond (Revenue Bond - 2011), dated October 28, 2011, due in two annual varying interest only payments followed by fifty-six \$275,660 semi-annual principal and interest payments, beginning October of 2012. The interest rate on the bond is locked in at 3.75% and is due in full by October 28, 2041. The initial two interest payment amounts were determined at the time the required interest payment was due, based on the amount drawn on this bond at the time. The bond was for \$9,505,500, and the funds were to construct the replacement facility in Elma, WA, which was completed in early 2013.

Limited Tax General Obligation Bond (LTGO-Bond 2012) dated October 1, 2012 is payable in one annual varying interest only payment followed by twenty-two \$118,396 semi-annual payments, beginning October 1, 2013. The interest rate on the bond is locked in at a rate of 3.375%. The initial two interest payment amounts were determined at the time the required interest payment was due, based on the amount drawn on this bond at the time. The bond was for a total of \$2,160,500 which, was fully drawn in 2014. The District used the full loan amount available, to fund purchases, including capital assets that enhance the services available at the replacement facility.

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

Grays Harbor County Public Hospital District No. 1

Notes to Financial Statements

Note 8 Long-Term Debt, Leases Payable, and Other Noncurrent Liabilities (Continued)

Scheduled principal and interest payments on long-term debt are as follows:

| Year Ending December 31, | Bonds and Notes Payable | | |
|-----------------------------|-------------------------|---------------------|---------------------|
| | Principal | Interest | Total |
| 2016 | \$601,197 | \$738,235 | \$1,339,432 |
| 2017 | \$623,277 | \$716,155 | \$1,339,432 |
| 2018 | \$646,169 | \$693,263 | \$1,339,432 |
| 2019 | \$669,903 | \$669,529 | \$1,339,432 |
| 2020 | \$694,512 | \$644,920 | \$1,339,432 |
| 2021-2025 | \$3,607,381 | \$2,825,504 | \$6,432,885 |
| 2026-2030 | \$3,314,164 | \$2,199,036 | \$5,513,200 |
| 2031-2035 | \$3,990,710 | \$1,522,490 | \$5,513,200 |
| 2036-2040 | \$4,805,365 | \$707,835 | \$5,513,200 |
| 2041 | \$1,058,567 | \$29,731 | \$1,088,298 |
| Total | \$20,011,245 | \$10,746,698 | \$30,757,943 |

Operating Lease Obligation

On June 26, 2015 the District entered into a twenty year operating lease with Grenville/McCleary, LLC. This lease is for a medical office space lease for one of the District's rural health clinics.

The commencement date of the lease term is April 11, 2016 and has an expiration date of April 10, 2036. The lease term does include an option to extend the term for four additional periods of five years each. The lease is payable in monthly payments of approximately \$14,092 for the first through fifth lease years and \$15,504 for the sixth through tenth lease years. The monthly payment for the additional years will be calculated at such time using the Consumer Price Index for the Seattle-Tacoma-Bremerton region (CPI-U). The future minimum lease payments will be included on the District's Statement of Revenues, Expenses and changes in Fund Net Position as operating expenses.

Grays Harbor County Public Hospital District No. 1

**Note 8 Long-Term Debt, Leases Payable, and Other Noncurrent Liabilities
(Continued)**

Scheduled annual operating lease payments are as follows:

| Year Ending December 31, | Total |
|-------------------------------------|--------------------|
| 2016 | \$112,736 |
| 2017 | \$169,104 |
| 2018 | \$169,104 |
| 2019 | \$169,104 |
| 2020 | \$169,104 |
| 2021-2025 | \$924,592* |
| 2026-2030 | \$1,010,985* |
| 2031-2035 | \$1,105,014* |
| 2036 | \$74,088* |
| Total | \$3,903,831 |

*These amounts include estimated annual operating lease payments based on an increase CPI-U percentage factor of 9.3% compounded for each of the respective periods based on the lease terms described above.

Note 9 Retirement Plans

Defined Contribution Plans

The District maintains a defined contribution plan under the Internal Revenue Code Section 401(a) Money Purchase Plan. The administrator of the plan is Principal Financial Group. Under the Federal Insurance Contributions Act (FICA), no new hires or employees under fifty years of age could participate in the Money Purchase Plan, but rather must participate in social security. Effective January 1, 2010 all current employees fifty years old and older had the option to continue in the Money Purchase Plan or to participate in social security under the (FICA). Under the terms of the plan, the employee contributes 3.85% and the District contributes 3.65%. This plan includes a 414(h) pick-up contribution feature which requires eligible employees after three years of service to contribute an additional 3.50% and the District increases its contribution an additional 5.00%. Pension plan expense was \$48,067 and \$56,279 for the years ended December 31, 2015 and 2014, respectively. Participants of this plan who could no longer participate were able to leave their funds in the plan.

Grays Harbor County Public Hospital District No. 1

Notes to Financial Statements

Note 9 Retirement Plans (Continued)

Defined Contribution Plans (Continued)

The District offers employees the option to participate in a deferred compensation plan under Section 457(b). The plan is administered by Principal Financial Group. The plan is available to those employees that are benefit eligible. Through December 31, 2012, the plan only allowed for employee deferrals to be contributed; however, effective January 1, 2013, the District amended the plan to allow a discretionary employer matching contribution. Eligible participants can contribute to the plan 100% of their compensation up to the maximum annual IRS limit. Participants are fully vested in their salary deferrals as well as the District's discretionary employer matching contribution. Participant contributions to the plan during the years ending December 31, 2015 and 2014 were \$275,955 and \$193,202, respectively. The District accrued employer matching contributions to the plan of \$69,808 and \$74,247 for the year ending December 31, 2015 and 2014 respectively. The discretionary employer match contributions are paid annually by June 30, based on the prior year's employee contributions amounts.

The District offers an Individual Secured Executive Reward program (iSERP) to qualifying executives, providers and to any other employed leader appointed by the executive team, as a way to recruit and retain key positions that are essential to the organization. Participant and employer matching contributions to this plan are on an after-tax basis. The plan is administered by New York Life, and became effective on July 1, 2012. Employees of the District who are participating in both the iSERP and 457(b) plans are only eligible to receive the iSERP matching employer contribution. The District's match is calculated as follows:

| Years of Service | District Match for CEO & Providers | District Match for Executive Team and Others appointed by E-Team |
|------------------|--|---|
| 0 - 4.9 Years | 100% of employee deferrals up to 2.25% of the employees prior year Box 1 W-2 wages | 100% of employee deferrals up to 1.5% of the employees prior year Box 1 W-2 wages |
| 5 - 9.9 Years | 100% of employee deferrals up to 3.75% of the employees prior year Box 1 W-2 wages | 100% of employee deferrals up to 2.5% of the employees prior year Box 1 W-2 wages |
| 10+ Years | 100% of employee deferrals up to 4.5% of the employees prior year Box 1 W-2 wages | 100% of employee deferrals up to 3.0% of the employees prior year Box 1 W-2 wages |

The District accrued employer matching contributions to the iSERP Plan of \$28,964 and \$27,387 for the year ended December 31, 2015 and 2014, respectively. These contributions are paid annually by June 30, based on the prior year's employee contributions and compensation.

Grays Harbor County Public Hospital District No. 1

Notes to Financial Statements

Note 10 Concentration of Risk

Receivables

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 Eastern Grays Harbor County.

The mixes of receivables from patients at the years ending were as follows:

| | 2015 | 2014 |
|--------------------------|-------------|-------------|
| Medicare | 21% | 29% |
| Medicaid | 28% | 28% |
| Other third-party payors | 26% | 24% |
| Self-pay patients | 25% | 19% |
| Total | 100% | 100% |

Physicians

The District is dependent on local physicians, nurse practitioners, and physician assistants practicing in its service area to provide healthcare and utilize hospital services. A decrease in the number of physicians providing these services or change in their utilization patterns may have an adverse effect on hospital operations.

Note 11 Non Operating Revenues (Expenses)-Net

Total non-operating revenues (expenses) for the years ended 2015 and 2014 were as follows:

| | 2015 | 2014 |
|--|------------------|--------------------|
| Property and other tax revenues | \$ 549,379 | \$530,253 |
| Interest income revenues | 48,119 | 12,769 |
| Interest Expense | (755,369) | (776,049) |
| Rental income revenues | 15,310 | 14,864 |
| Noncapital grants and contributions revenues | 75,863 | 16,622 |
| Miscellaneous net revenues | 77,078 | 7,150 |
| Total non operating revenues (expenses) - net | \$ 10,380 | \$(194,391) |

Grays Harbor County Public Hospital District No. 1

Notes to Financial Statements

Note 12 Risk Management and Contingent Liability

Medical Malpractice Claims

On September 1, 2014, the District changed insurance brokers to Parker, Smith and Feek, Inc. who brokered a new insurance policy through Physicians Insurance a Mutual Company for the District. Through August 30, 2014, the District carried a policy with Washington Casualty Company (WCC). WCC is a wholly owned subsidiary of FinCor Holdings, Inc.

The District's policies provide 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 an annual aggregate limit of \$ 5,000,000. There are no significant deductible 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 risk of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions, injuries to employees; and natural disasters. The District carries commercial insurance for these risks of loss. Settled claims resulting from these risks have not exceeded the commercial insurance coverage in any of the past three years

Grays Harbor County Public Hospital District No. 1

Notes to Financial Statements

Note 12 Risk Management and Contingent Liability (Continued)

Industry 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, accreditations, government health care 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 health care providers. 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 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 known or unasserted at this time.

Health Care Reform

As a result of recently enacted federal health care reform legislation, substantial changes are anticipated in the United States of America's health care system. Such legislation includes numerous provisions affecting the delivery of health care services, the financing of health care costs, reimbursement of health care providers, and the legal obligations of health insurers, providers, and employers. These provisions are currently slated to take effect at specified times over approximately the next decade. The federal health care reform legislation does not affect the 2014 or 2015 financial statements.

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.

Grays Harbor County Public Hospital District No. 1

Notes to Financial Statements

Note 12 Risk Management and Contingent Liability (Continued)

Medicaid

As a result of the Washington State budget situation, Medicaid reimbursement for the District may be significantly reduced in the future. The potential Medicaid reductions do not affect the 2015 or 2014 financial statements.

Workers Compensation

The District has a self-insured workers' compensation plan through 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. Total payments, reduced by any related distributions of dividends, made by the District charged to workers' compensation expense were approximately \$216,000 and \$112,000 in 2015 and 2014, respectively.

Unemployment Insurance

The District has a self-insured unemployment plan through the Public Hospital District Unemployment Compensation Trust (Trust) which is a risk transfer pool administered by the Washington State Hospital Association. The District pays its share of actual unemployment claims, maintenance of reserves, and administrative expenses. Net distribution of dividends from the Trust to the District were approximately \$1,100 and \$19,000 in 2015 and 2014, respectively, due to the Trust being over funded.

Related Party Transactions

The District leases medical office space for one of the rural health clinics from Blue Lady, LLC. Blue Lady, LLC is 50% owned by one of the District's providers. The initial lease agreement for this space expired on February 28, 2014; however a new lease agreement was entered to, which commenced on March 1, 2014 through February 28, 2017. The lease agreement requires monthly payments in the amount of approximately \$5,000. A total of approximately \$60,000 was paid to Blue Lady, LLC during the years ending 2015 and 2014.

Grays Harbor County Public Hospital District No. 1

Notes to Financial Statements

Note 12 Risk Management and Contingent Liability (Continued)

Emergency and Medical Unit Registered Nurse Employment Contract

As of December 31, 2015 and 2014, approximately 14% and 20%, respectively, of the District's employees were covered under a collective bargaining agreement with the Association of Emergency Department and Medical Unit Registered Nurses. As of the date of the December 31, 2014, the parties were engaged in bargaining. A Last, Best and Final Offer was implemented on August 10, 2015, which shall remain in full force and effective for the three years, ending August 10, 2018.

Wellness Facility

The District is developing an application for funding to submit to the United States Department of Agriculture Rural Development office (USDA RD) for construction of a new Wellness Center. The estimated construction budget for this project is between \$22,000,000 and \$24,000,000, with the District being responsible for the first 10%. The loan from the USDA RD will be approximately \$20,000,000.

The project scope includes a new multi-story 60,000 Square Foot building to be located in Elma, WA, NE of the current hospital, Summit Pacific Medical Center. Key building features include space for primary care, education, rehabilitation services, conferences, community, hospital support and a café. The building will accommodate twenty providers specializing in behavioral health and primary care. The overall goal of the project is to provide health services that encourage wellness, increase employment opportunities and improve access to healthcare countywide. Positioning primary care in the new building will vacate SPMC space for ambulatory procedures and infusion therapy. The community in Eastern Grays Harbor County will be directly served.

This loan will be backed by the District's operating revenues. We are seeking a loan with a term of 25 to 30 years with level payments and a competitive interest rate. A loan through the USDA will provide funding at lower interest rates which in turn reduce overall project costs.

ABOUT THE STATE AUDITOR'S OFFICE

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

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

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

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

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

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| Contact information for the State Auditor's Office | |
|---|--|
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