Office of the Washington State Auditor

Pat McCarthy

Financial Statements Audit Report

Mason County Public Hospital District No. 1

(Mason General Hospital and Family of Clinics)

For the period January 1, 2015 through December 31, 2016

Published May 30, 2017

Report No. 1019207

Office of the Washington State Auditor
Pat McCarthy

May 30, 2017

Board of Commissioners
Mason General Hospital and Family of Clinics
Shelton, Washington

Report on Financial Statements

Please find attached our report on the Mason General Hospital and Family of Clinics'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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Mason General Hospital and Family of Clinics
Mason County
January 1, 2015 through December 31, 2016

Board of Commissioners
Mason General Hospital and Family of Clinics
Shelton, Washington

We have audited, in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, the financial statements of the Mason General Hospital and Family of Clinics, Mason County, Washington, as of and for the years ended December 31, 2016 and 2015, and the related notes to the financial statements, which collectively comprise the District's basic financial statements, and have issued our report thereon dated May 23, 2017.

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

May 23, 2017

INDEPENDENT AUDITOR'S REPORT ON FINANCIAL STATEMENTS

Mason General Hospital and Family of Clinics
Mason County
January 1, 2015 through December 31, 2016

Board of Commissioners
Mason General Hospital and Family of Clinics
Shelton, Washington

REPORT ON THE FINANCIAL STATEMENTS

We have audited the accompanying financial statements of the Mason General Hospital and Family of Clinics, Mason County, Washington, as of and for the years ended December 31, 2016 and 2015, and the related notes to the financial statements, which collectively comprise the District's basic financial statements as listed 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 opinions on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Mason General Hospital and Family of Clinics, as of December 31, 2016 and 2015, 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 13 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

OTHER REPORTING REQUIRED BY GOVERNMENT AUDITING STANDARDS

In accordance with *Government Auditing Standards*, we have also issued our report dated May 23, 2017 on our consideration of the District's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. 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.

Pat McCarthy

State Auditor

Olympia, WA

May 23, 2017

FINANCIAL SECTION

Mason General Hospital and Family of Clinics
Mason County
January 1, 2015 through December 31, 2016

REQUIRED SUPPLEMENTARY INFORMATION

Management's Discussion and Analysis – 2016 and 2015

BASIC FINANCIAL STATEMENTS

Statement of Net Position – 2016 and 2015
Statement of Revenues, Expenses and Changes in Net Position – 2016 and 2015
Statement of Cash Flows – 2016 and 2015
Notes to Financial Statements – 2016 and 2015

Public Hospital District No. 1 of Mason County, WA d/b/a Mason General Hospital and Family of Clinics

Management's Discussion and Analysis

December 31, 2016 and 2015

Our discussion and analysis of Public Hospital District No. 1 of Mason County, WA, d/b/a Mason General Hospital and Family of Clinics' (the "District"), financial performance provides an overview of the District Hospital's financial activities for the fiscal year ended on December 31, 2016. Please read it in conjunction with the Hospital's financial statements that follow this analysis.

The District Hospital is a governmental entity and a political subdivision of the State of Washington. It was created by the Washington legislature to provide hospital services and other health care services for the residents of the District. The District was created by public vote in 1965 and the current Hospital facility opened its doors in October 1968. The District operates a 25-bed critical access hospital (CAH) (licensed for 68 beds), physician clinics, and buildings to support those operations. The District's services include the acute care hospital, emergency room, and related ancillary services (lab, x-ray, etc.) associated with these services.

A three-member Board of Commissioners governs the District. The members of the Board are elected commissioners for a term of six years. Elections are staggered so no more than one-third of the Board is up for election at one time. The Board is required to elect a president and secretary. One of their duties is to appoint a superintendent. The Board delegates the day-to-day operations of the District to the superintendent.

The District is a municipal government entity. As such, the District levies, and the county collects, property taxes from property owners within the Hospital District. This tax revenue is used to support the purpose of the District, which is to provide health care to the members of the district. However, tax support is minimal, representing less than five percent of the Hospital's receipts.

The Governmental Accounting Standards Board (GASB) prescribes the financial reporting of the Hospital. This is the format followed by the District. The financial statements are audited by the State of Washington's Auditors Office.

Financial Highlights

The overall financial position of the District remains strong in 2016, with an increase in net position of $2.4 million over 2015 because of solid revenue growth and controlled expenditures. The financial position of the District in 2015 was also strong with an increase in net position of $3.9 million over 2014 also due to solid revenue growth and controlled expenditures.

The District's overall business continues to grow, with net patient revenue increasing $5.9 million, or 7.2%. The increase in net revenue is attributable to hospital outpatient and clinic volume growth and annual rate increase recorded in 2016.

Financial Highlights (Continued)

Non patient revenue decreased $76,819, or (-1.22%). In 2015, the District's overall business also grew with net patient revenue increasing $7.2 million or 9.63% primarily due to outpatient and clinic volume growth and annual rate increases recorded in the year. Non patient revenue increased $1,046,877 or 20.02% in 2015.

The District's operating expenses increased by $7.3 million or 8.44% during 2016. Salary and benefits increased $5.3 million, or 9.95%, primarily due to additional FTE positions, annual wage rates, and health insurance costs. Other operating expenses increased by $1,033,150 or 6.28% due to primarily to higher purchased service costs. In 2015, the District's operating expenses increased by $6.5 million or 8.15%. Salary and benefits in 2015 increased $3.5 million, or 7.05% primarily because of additional FTE positions, annual wage rates and health insurance costs. Other operating expenses increased by $1,881,211 or 12.91% in 2015 due primarily again to higher purchased services costs.

The Hospital District had a change in net position of $2,438,328 in 2016 and $3,925,243 in 2015.

During 2016, net accounts receivable increased by $640,027, ending the year at 46.1 days in net accounts receivable. In 2015, net accounts receivable decreased by $1.9 million, with 46.7 days in net accounts receivable. The improvement in 2015 was due to improved billing and collection workflows.

The District's net capital assets decreased by $3.5 million (-6.63%) in 2016, compared to a net decrease of $3.8 million (-6.74%) in 2015. Capital additions of equipment, IT, and facilities totaled $3.1 million dollars during 2016. The additions were partially offset by annual depreciation. Capital asset retirements were approximately $.2 million (see Note 7).

Long-term debt decreased $925,000, $905,000, and $867,353 in 2016, 2015, and 2014, respectively. The decrease is due to principal payments on existing long-term debt as there has been no new long-term debt entered into during these periods. The current portion of long-term debt is $925,000 (see Note 8).

Financial Highlights (Continued)

Condensed financial information for the years ended December 31, 2016, 2015, and 2014, is as follows:

Table 1: Assets and Deferred Outflows of Resources, Liabilities, and Net Position

				2016-2015		2015-2014	
	2016	2015	2014	$ Change	% Change	$ Change	% Change
Assets:							
Current assets	$ 64,199,124	$ 61,170,083	$ 50,728,385	$ 3,029,041	4.95%	$ 10,441,698	20.58%
Net capital assets	49,163,194	52,652,523	56,454,974	(3,489,329)	-6.63%	(3,802,451)	-6.74%
Total assets	$ 113,362,318	$ 113,822,606	$ 107,183,359	$ (460,288)	-0.40%	$ 6,639,247	6.19%
Deferred outflows of resources	$ 348,748	$ 523,132	$ 697,516	$ (174,384)	-33.33%	$ (174,384)	-25.00%
Liabilities:							
Current liabilities	$ 14,581,887	$ 15,335,954	$ 15,972,500	$ (754,067)	-4.92%	$ (636,546)	-3.99%
Long-term debt outstanding - Less current maturities	23,215,000	24,140,000	25,045,000	(925,000)	-3.83%	(905,000)	-3.61%
Long-term unearned revenue - Less current portion	1,336,715	2,749,233	90,304	(1,412,518)	-51.38%	2,658,929	2944.42%
Long-term compensated absences - Less current portion	1,440,822	1,422,237		18,585	1.31%		
Total liabilities	$ 40,574,424	$ 43,647,424	$ 41,107,804	$ (3,073,000)	-7.04%	$ 2,539,620	6.18%
Net position:							
Net investment in capital assets	$ 25,023,194	$ 27,607,523	$ 30,524,974	$ (2,584,329)	-9.36%	$ (2,917,451)	-9.56%
Restricted	155,042	154,905	155,792	137	0.09%	(887)	-0.57%
Unrestricted	47,958,406	42,935,886	36,092,305	5,022,520	11.70%	6,843,581	18.96%
Total net position	$ 73,136,642	$ 70,698,314	$ 66,773,071	$ 2,438,329	3.45%	$ 3,925,243	5.88%

Financial Highlights (Continued)

Table 2: Operating Results and Changes in Net Position

				2016-2015		2015-2014	
	2016	2015	2014	$ Change	% Change	$ Change	% Change
Operating revenue:							
Net patient service revenue	$ 87,707,743	$ 81,836,231	$ 74,649,557	$ 5,871,512	7.17%	$ 7,186,674	9.63%
Other operating revenue	6,198,042	6,274,861	5,227,984	(76,819)	-1.22%	1,046,877	20.02%
Total operating revenue	93,905,785	88,111,092	79,877,541	5,794,693	6.58%	8,233,551	10.31%
Operating expenses:							
Salaries and benefits	58,555,491	53,255,688	49,747,876	5,299,803	9.95%	3,507,812	7.05%
Supplies	10,382,413	9,682,765	8,636,421	699,648	7.23%	1,046,344	12.12%
Other operating expenses	17,486,235	16,453,085	14,571,874	1,033,150	6.28%	1,881,211	12.91%
Depreciation and amortization	6,825,437	6,597,856	6,552,112	227,581	3.45%	45,744	0.70%
Total operating expenses	93,249,576	85,989,394	79,508,283	7,260,182	8.44%	6,481,111	8.15%
Operating income	656,209	2,121,698	369,258	(1,465,489)	-69.07%	1,752,440	474.58%
Nonoperating revenue (expenses):							
Property taxes for operations and debt service	2,313,812	2,399,375	2,240,769	(85,563)	-3.57%	158,606	7.08%
Interest earnings	214,265	139,870	101,162	74,395	53.19%	38,708	38.26%
Interest expense	(961,682)	(982,695)	(993,786)	21,013	-2.14%	11,091	-1.12%
Grants and donations	219,484	301,603	327,090	(82,119)	-27.23%	(25,487)	-7.79%
Gain (loss) on disposal of assets	(3,760)	(54,608)	40,948	50,848	-93.11%	(95,556)	-233.36%
Total nonoperating revenue (exepense) - Net	1,782,119	1,803,545	1,716,183	(21,426)	-1.19%	87,362	5.09%
Change in net position	2,438,328	3,925,243	2,085,441	(1,486,915)	-37.88%	1,839,802	88.22%
Net position - Beginning of year	70,698,314	66,773,071	64,687,630	3,925,243	5.88%	2,085,441	3.22%
Net position - End of year	$ 73,136,642	$ 70,698,314	$ 66,773,071	$ 2,438,328	3.45%	$ 3,925,243	5.88%

Public Hospital District No. 1 of Mason County, WA d/b/a Mason General Hospital and Family of Clinics

Statements of Net Position

As of December 31, 2016 and 2015

Assets and Deferred Outflows of Resources	2016	2015
Currents assets:		
Cash and cash equivalents		
Cash	$ 49,991,742	$ 47,979,738
Restricted	155,961	155,294
Receivables:		
Patient accounts receivable - Net	10,997,740	10,357,713
Taxes receivable	114,736	112,298
Restricted	37,954	38,321
Third-party settlements	242,645	-
Other	553,041	495,419
Inventories	1,504,470	1,316,976
Prepaid expenses	600,835	714,324
Total current assets	64,199,124	61,170,083
Capital assets:		
Nondepreciable capital assets	2,419,398	2,536,805
Depreciable capital assets - Net	46,743,796	50,115,718
Total capital assets - Net	49,163,194	52,652,523
Deferred outflows of resources -		
Excess consideration provided for acquisition	348,748	523,132
TOTAL ASSETS AND DEFERRED OUTFLOWS OF RESOURCES	$ 113,711,066	$ 114,345,738

See accompanying notes to financial statements

Public Hospital District No. 1 of Mason County, WA d/b/a Mason General Hospital and Family of Clinics

Statements of Net Position (Continued)

As of December 31, 2016 and 2015

Liabilities and Net Position	2016	2015
Currents liabilities:		
Accounts payable	$ 1,491,163	$ 2,270,253
Third-party settlements	-	1,111,108
Payroll and related expenses	9,193,806	8,607,268
Accrued interest payable	116,477	119,106
Current maturities of long-term debt	925,000	905,000
Current portion of unearned revenue	1,412,518	1,441,292
Current portion of compensated absences	1,432,166	869,657
Other	10,757	12,270
Total current liabilities	14,581,887	15,335,954
Noncurrent liabilities:		
Long-term debt - Less current maturities	23,215,000	24,140,000
Long-term unearned revenue - Less current portion	1,336,715	2,749,233
Long-term compensated absences - Less current portion	1,440,822	1,422,237
Total noncurrent liabilities	25,992,537	28,311,470
Total liabilities	40,574,424	43,647,424
Net position:		
Net investment in capital assets	25,023,194	27,607,523
Restricted for debt service	155,042	154,905
Unrestricted	47,958,406	42,935,886
Total net position	73,136,642	70,698,314
TOTAL LIABILITIES AND NET POSITION	$ 113,711,066	$ 114,345,738

See accompanying notes to financial statements.

Public Hospital District No. 1 of Mason County, WA d/b/a Mason General Hospital and Family of Clinics

Statements of Revenue, Expenses, and Changes in Net Position

Years Ended December 31, 2016 and 2015

	2016	2015
Operating revenue:		
Net patient service revenue	$ 87,707,743	$ 81,836,231
Other operating revenue	6,198,042	6,274,861
Total operating revenue	93,905,785	88,111,092
Operating expenses:		
Salaries and wages	43,087,624	38,466,981
Employee benefits	15,467,867	14,788,707
Professional fees	4,579,270	4,498,180
Supplies	10,382,413	9,682,765
Purchased services - Utilities	898,242	878,658
Purchased services - Other	8,992,075	8,170,113
Insurance	556,729	601,087
Other	1,959,024	1,798,321
Rent and leases	500,895	506,726
Depreciation and amortization	6,825,437	6,597,856
Total operating expenses	93,249,576	85,989,394
Operating income	656,209	2,121,698
Nonoperating revenue (expenses):		
Property taxes for operations and debt service	2,313,812	2,399,375
Interest earnings	214,265	139,870
Interest expense	(961,682)	(982,695)
Grants and donations	219,484	301,603
Loss on disposal of assets	(3,760)	(54,608)
Total nonoperating revenue - Net	1,782,119	1,803,545
Change in net position	2,438,328	3,925,243
Net position - Beginning of year	70,698,314	66,773,071
Net position - End of year	$ 73,136,642	$ 70,698,314

See accompanying notes to financial statements.

Public Hospital District No. 1 of Mason County, WA d/b/a Mason General Hospital and Family of Clinics

Statements of Cash Flows

Years Ended December 31, 2016 and 2015

	2016	2015
Increase (decrease) in cash and cash equivalents:		
Cash flows from operating activities:		
Cash received from patient services	$ 85,713,963	$ 82,045,756
Cash received from other operating revenue	4,756,750	10,284,758
Cash paid for salaries and benefits	(57,387,859)	(52,167,772)
Cash paid for supplies, professional fees, and other operating expenses	(28,779,365)	(26,546,559)
Net cash provided by operating activities	4,303,489	13,616,183
Cash flows from noncapital financing activities:		
Cash received from property tax for operations	2,311,375	2,406,715
Cash received from donations and grants	219,484	301,603
Payments to memorial fund	(1,513)	(2,207)
Net cash provided by noncapital financing activities	2,529,346	2,706,111
Cash flows from capital and related financing activities:		
Principal payments on long-term debt obligations	(905,000)	(885,000)
Interest paid	(1,429,922)	(1,460,541)
Excess consideration provided for acquisition	(77,585)	-
Interest subsidy	465,978	476,631
Proceeds from the sale of assets	-	5,892
Payments for purchase of property, buildings, and equipment	(3,087,900)	(2,681,521)
Net cash used in capital and related financing activities	(5,034,429)	(4,544,539)
Cash flows from investing activities -		
Interest received	214,265	139,870
Net increase in cash and cash equivalents	2,012,671	11,917,625
Cash and cash equivalents - Beginning of year	48,135,032	36,217,407
Cash and cash equivalents - End of year	$ 50,147,703	$ 48,135,032
Cash and cash equivalents	$ 49,991,742	$ 47,979,738
Cash and cash equivalents - Restricted	155,961	155,294
Cash and cash equivalents - End of year	$ 50,147,703	$ 48,135,032

See accompanying notes to financial statements

Public Hospital District No. 1 of Mason County, WA d/b/a Mason General Hospital and Family of Clinics

Statements of Cash Flows (Continued)

Years Ended December 31, 2016 and 2015

	2016	2015
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	$ 656,209	$ 2,121,698
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation and amortization	6,825,437	6,597,856
Provision for bad debts	3,358,006	2,853,960
Amortization of unearned revenue	(1,441,292)	(1,518,202)
Changes in operating assets and liabilities:		
Patient accounts receivable - Net	(3,998,033)	(933,090)
Other	(57,622)	(288,753)
Inventories	(187,494)	(118,199)
Prepaid expenses	113,489	(46,393)
Accounts payable	(779,090)	42,636
Third-party settlements	(1,353,753)	(1,711,345)
Payroll and related expenses	586,538	1,285,785
Compensated absences	581,094	(197,869)
Unearned revenue	-	5,528,099
Total adjustments	3,647,280	11,494,485
Net cash provided by operating activities	$ 4,303,489	$ 13,616,183

See accompanying notes to financial statements.

Note 1: Summary of Significant Accounting Policies

The Entity

Public Hospital District No. 1 of Mason County, WA d/b/a Mason General Hospital and Family of Clinics (the "District"), is a municipal corporation governed by an elected three-member board. The District does not have component units. The District owns and operates a 25-bed critical access hospital (licensed for 68 beds), eight certified rural health clinics, an eye clinic, and a surgery clinic. The District provides health care services to patients in the Mason County, Washington, market. The services include an acute care hospital, an emergency room, clinics, and related ancillary procedures (lab, x-ray, etc.) associated with these services.

Associate

The Mason General Hospital Foundation (the "Foundation"), formed in 1991, is a separate legal entity, with a separate governing body and budget. The District is not financially accountable for the Foundation; therefore, its financial statements are not included in this report. The Foundation was organized to solicit and accept charitable contributions in order to provide support to the District. The Foundation provided contributions to the District of $58,152 for 2016 and $166,189 for 2015.

The Foundation's financial position at the balance sheet dates September 30, 2016 and 2015, is summarized as follows:

	2016	2015
Assets	$ 1,966,262	$ 1,891,420
Liabilities	$ 27,003	$ 82,145
Fund balance	1,939,259	1,809,275
Total liabilities and fund balance	$ 1,966,262	$ 1,891,420

Note 1: Summary of Significant Accounting Policies (Continued)

Basis of Accounting and Financial Statement Presentation

The accounting policies of the District conform to generally accepted accounting principles (GAAP) as applicable to proprietary funds of governments. GASB is the accepted standard-setting body in the United States for establishing governmental accounting and financial reporting principles.

The accounting records of the District are maintained in accordance with methods prescribed by the State Auditor under 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 measurements focus and full-accrual basis of accounting. Revenue is recorded when earned and expenses are recorded when the 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. Unbilled hospital service receivables are recorded at year-end.

Use of Estimates in Preparation of Financial Statements

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that may affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

Cash and Cash Equivalents

All cash receipts are deposited directly in the District's depository account. Periodically such cash is transferred to the Mason County Treasurer, who acts as the District Treasurer. Warrants are issued by the District against the cash placed with the County Treasurer. For purposes of the statement of cash flows, the District considers all cash and cash investments with maturity dates of less than one year as cash and cash equivalents.

Note 1: Summary of Significant Accounting Policies (Continued)

Investments

The County Treasurer invests cash in interest-bearing investments at the direction of the District. All investments are in the Washington State Local Government Investment Pool (WSLGIP), which is a safe short-term liquidity vehicle. Investments for the government are reported at fair value. The State Treasurer's Investment Pool operates in accordance with appropriate state laws and regulations. The reported value of the pool is the same value as the fair value of the pool shares. The WSLGIP operates in a manner consistent with Section 2a-7 of the Securities and Exchange Commission's Investment Act of 1940 and is unrated. Investments with the WSLGIP are considered cash and 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 copay and deductible amounts that are the patients' responsibility. Payments on patient accounts receivable are applied to the specific claim identified on the remittance advice or statement.

Patient accounts receivable are recorded in the accompanying statement of net position net of contractual adjustments and allowances for doubtful accounts, which reflect management's best estimate of the amounts that won't 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 for uninsured patients and amounts patients are personally responsible for, through a reduction of gross revenue and a credit to a valuation allowance.

Note 1: Summary of Significant Accounting Policies (Continued)

Patient Accounts Receivable and Credit Policy (Continued)

In evaluating the collectibility 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 contractual adjustments and provision for doubtful accounts. Management regularly reviews data about these major payor sources of revenue in evaluating the sufficiency of the allowance for contractual adjustments and provision for doubtful 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 these amounts and a provision for doubtful accounts 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 doubtful accounts 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 provision for bad debts.

Taxes Receivable

Taxes receivable are amounts due from Mason County. The Mason County Treasurer acts as an agent to collect property taxes levied in the county for all taxing authorities. Collections are distributed monthly to the District by the County Treasurer. Property taxes are recorded as receivables when levied. Since state law allows for the sale of property for failure to pay taxes, no estimate of uncollectible taxes is made.

Inventories

Inventories are stated at cost on the first-in, first-out method. Inventories consist of pharmaceutical, medical-surgical, and other supplies used in the operation of the District.

Restricted Assets

Restricted assets include certain cash and cash equivalents whose use is restricted under debt indentures and trust agreements and those set aside by the Board of Commissioners for future bond principal and interest payments, future acquisitions, and replacement of property, buildings, equipment, and other purposes.

Note 1: Summary of Significant Accounting Policies (Continued)

Capital Assets

Capital acquisitions are recorded at cost or, if donated, at fair value at the date of donation and are subsequently considered as being on the basis of cost. The District capitalizes all assets with an initial, individual cost of $5,000 or greater and an estimated useful life of three years or more. Major expenses for capital assets, including capital leases and major repairs that increase useful lives, are capitalized. Maintenance, repairs, and minor renewals are accounted for as expenses when incurred. Depreciation is provided over the estimated useful life of each class of depreciable asset and is computed using the straight-line method. Equipment under capital lease obligations is amortized on the straight-line method over the shorter period of the lease term or the estimated useful life of the equipment. Such amortization is included with depreciation expense in the accompanying financial statements.

Land improvements	15 to 20 years
Buildings and building improvements	5 to 40 years
Major movable equipment	3 to 20 years

Asset Impairment

Capital assets are reviewed for impairment when events or changes in circumstances suggest that the service utility of the capital asset might 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 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 statement of revenue, expenses, and changes in net position. No impairment losses were recorded in 2016 and 2015.

Deferred Outflows of Resources

In addition to assets, the statement of net position will sometimes report a separate section of deferred outflows of resources. This separate financial statement element, deferred outflows of resources, represents a consumption of net position that applies to future periods and so will not be recognized as an outflow of resources until then. The District has only one item that qualifies for reporting in this category. The District purchased a medical clinic and the deferred outflow is the consideration given in excess of the net position acquired. The remaining life of the deferred outflow is estimated at three years. The estimated life will be periodically reviewed and revised as necessary in subsequent reporting periods.

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 earned.

Paid time-off may be accumulated up to a maximum of 320 hours, is payable upon resignation, retirement, or death.

Unearned Revenue

The District has unearned revenue related to the Medicare Electronic Health Record (EHR) incentive payments. These incentive payments are being recognized over the average useful life of the underlying assets.

Net Position

Net position is classified and displayed in three components: (1) Net investment in capital assets consists of capital assets net of accumulated depreciation and reduced by outstanding balances of any outstanding borrowings used to finance the purchase or construction of those assets, (2) Restricted resources are a component of net position with constraints placed on their use either by creditors, grantors, donors, etc. or by law through constitutional provision or enabling legislation, and (3) Unrestricted resources are all other assets that do not meet the definition of restricted resources or net investment in capital assets. When the District has both restricted and unrestricted resources available to finance particular program/activities, it is the District's policy to use restricted resources before unrestricted resources.

Operating Revenue and Expenses

The District's statement of revenue, expenses, and changes in net position distinguish between operating and nonoperating revenue and expenses. Operating revenue results from exchange transactions associated with providing health care services. It also includes payments from the federal government for health care services rendered to eligible individuals. Other operating revenue includes retail revenue from the District's cafeteria, pharmacy, class registration fees, and health information and laboratory services. Nonexchange revenue, including taxes, interest income, grants, and contributions, is reported as nonoperating revenue. Operating expenses are all expenses incurred to provide health care services.

Note 1: Summary of Significant Accounting Policies (Continued)

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. 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 who do not qualify for charity care, the District recognizes revenue on the basis of its standard rates for services provided (or on the basis of discounted rates if negotiated or provided by policy). On the basis of historical experience, a significant portion of the District's uninsured patients will be unable or unwilling to pay for the services provided. Thus, the District records a significant provision for bad debts related to uninsured patients in the period the services are provided.

Charity Care

The District provides care to patients who meet certain criteria under its charity care policy without charge or at amount less than established rates. The District maintains records to identify and monitor the level of charity care provided. These records include the amount of charges foregone for services and supplies furnished under its charity care policy.

Advertising Cost

Advertising costs are expensed as incurred.

Property Tax Revenue

Taxes are due in two equal installments on April 30 and October 31. Collections are distributed monthly to the District by the County Treasurer. Taxes are levied annually on January 1 on property values listed as of the prior May 31. Assessed values are established by the County Assessor at 100 percent of fair market value. A revaluation of all property is required every four years. The amount of property tax received is dependent on the assessed real property valuations as determined by the County Assessor.

Note 1: Summary of Significant Accounting Policies (Continued)

Grants and Contributions

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

Tax Status

The District operates under the laws of the state of Washington for Washington municipal corporations. As organized, the District is exempt from payment of federal income tax on operations or activities under Section 115 of the Internal Revenue Code. All District assets, liabilities, and financial transactions are included in these financial statements.

EHR 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 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)

EHR 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. These incentive payments are amortized over the average useful life of the underlying assets.

Subsequent Events

Subsequent events have been evaluated through the date the financial statements were available to be issued.

Note 2: Cash and Cash Equivalents

Deposits

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

The District's deposits are entirely covered by the Federal Deposit Insurance Corporation or by collateral held in a multiple financial institution collateral pool administered by the Washington Public Deposit Protection Commission.

Investments

The Revised Code of Washington (RCW), Chapter 39, authorizes municipal governments to invest their funds in a variety of investments including federal, state, and local government certificates, notes, or bonds; the Washington State Local Government Investment Pool; savings accounts in qualified public depositories; and certain other investments.

The District's investment policy specifies that investments will be limited to collateralized certificates of deposit, collateralized repurchase options, passbook savings, money market checking, U.S. Government Treasury securities, or the Washington State Local Government Investment Pool. Investments with the WSLGIP are considered cash and cash equivalents.

Note 2: Cash and Cash Equivalents (Continued)

The carrying amount of cash, cash equivalents, and investments was as follows at December 31:

	2016	2015
Cash on deposit	$ 41,826,641	$ 39,209,753
Board-designated cash - Capital fund	2,201,741	3,355,875
Board designated (WSLGIP) - Capital fund	5,963,360	5,414,110
Totals	$ 49,991,742	$ 47,979,738

The District's investments generally are reported at fair value. The carrying amount of cash, cash equivalents, and investments included in the District's restricted assets was as follows at December 31:

	2016	2015
Restricted (WSLGIP)	$ 117,088	$ 116,584

Note 3: Restricted Assets

Restricted assets consisted of the following at December 31:

	2016	2015
Debt service (WSGLIP)	$ 117,088	$ 116,584
Debt service (interest subsidy receivable)	37,954	38,321
Total restricted for debt service	$ 155,042	$ 154,905

Note 4: Patient Accounts Receivable

Patient accounts receivable consisted of the following at December 31:

	2016	2015
Patient accounts receivable	$ 28,557,042	$ 26,113,886
Less:		
Contractual adjustments	14,153,081	12,192,780
Allowance for doubtful accounts	3,406,221	3,563,393
Patient accounts receivable - Net	$ 10,997,740	$ 10,357,713

Note 5: Reimbursement Arrangements With Third-Party Payors

The District has agreements with third-party payors that provide for reimbursement to the District at amounts that vary from its established rates. Gross hospital revenue billed under the Medicare and Medicaid programs totaled approximately $142,787,000 and $135,625,000 in 2016 and 2015, respectively. A summary of the basis of reimbursement with major third-party payors follows:

Medicare

The District is designated as a CAH. As a CAH, the District's inpatient and outpatient services provided to Medicare program beneficiaries are paid for based on a cost-reimbursement methodology. Professional services provided by physicians and other clinicians are reimbursed on prospectively determined fee schedules or a cost-reimbursement methodology depending on the type of professional services provided. The District has five clinics designated as rural health clinics and they are paid on a cost-per-visit basis. The District is reimbursed for cost at a tentative rate, with final settlement determined after submission of annual cost reports by the District and audits thereof by the Medicare fiscal intermediary.

The Medicare program's administrative procedures preclude final determination of amounts due to the District for such services until three years after the District's cost reports are audited or otherwise reviewed and settled on by the Medicare fiscal intermediary. Medicare has audited and settled cost reports for the years through 2014.

Note 5: Reimbursement Arrangements With Third-Party Payors (Continued)

Medicaid

Medicaid reimbursement for inpatient and outpatient hospital services is paid based on cost as defined and limited by the Washington State Health Care Authority. The District is reimbursed at a tentative rate, with final settlement determined after submission of annual cost reports by the District and audits thereof by the Medicaid fiscal intermediary. Medicaid pays rural health clinic services on a prospectively set rate. Medicaid hospital cost reports have been audited and tentatively settled for the years through 2014.

Accountable Care Organizations

The District, along with other parties, formed an accountable care organization (ACO) to participate in the Medicare shared Savings Program (MSSP) effective January 1, 2016. The original term of the MSSP is three years. The ACO participants coordinate care for assigned Medicare fee-for-service members. Based on terms of the agreement with CMS, the ACO has the potential to receive a portion of the cost savings for services provided to assigned members.

Other Payors

The District also has entered into payment agreements with certain commercial insurance carriers, health maintenance organizations, and preferred provider organizations. Payment to the District under these agreements includes prospectively determined rates per discharge, reimbursed costs, discounted charges, and per diem payments. Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors.

Medicare EHR Incentive Funding

The District amortized $1,441,292 and $1,518,202 of unearned revenue from the Medicare EHR incentive program for 2016 and 2015, respectively. These amounts are included in other operating revenue in the accompanying statement of revenue, expenses, and changes in net position. Unamortized unearned revenue from the Medicare EHR incentive payments totaled $2,749,233 and $4,190,525 at December 31, 2016 and 2015, respectively.

Note 5: Reimbursement Arrangements With Third-Party Payors (Continued)

Compliance

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

CMS has implemented a new project using recovery audit contractors (RAC) as part of its efforts to ensure accurate payments under the Medicare program. The project uses RACs to search for potentially inaccurate Medicare payments that might have been made to health care providers and 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 organization may either accept or appeal the RAC's findings. The District's policy is to adjust revenue for decreases in reimbursement from the RAC reviews when these amounts are estimable and to adjust revenue for increases in reimbursement from the RAC reviews when the increase in reimbursement is agreed upon. The District was not subject to a RAC audit during 2016 or 2015.

Note 6: Property Taxes

The District received approximately 1.17% and 1.30% of its financial support from property taxes for the years ended December 31 2016 and 2015, respectively. The funds were used as follows:

	2016	2015
Property taxes for operations and debt service	$ 2,313,812	$ 2,399,375

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

For 2016, the District's regular tax levy was $0.39 per $1,000 on the total assessed valuation of $5,395,098,136 for a total regular levy of $2,121,266. There were no additional levies for debt service in 2016.

For 2015, the District's regular tax levy was $0.39 per $1,000 on the total assessed valuation of $5,310,141,002 for a total regular levy of $2,083,720. There were no additional levies for debt service in 2015.

Note 7: Capital Assets

Capital asset activity for the year ended December 31, 2016, was as follows:

	Beginning Balance 1/1/16	Increase	Decrease	Ending Balance 12/31/16
Capital assets not being depreciated:				
Land	$ 2,015,497	$ -	$ -	$ 2,015,497
Construction in progress	521,308	2,150,681	2,268,089	403,900
Total capital assets not being depreciated	2,536,805	2,150,681	2,268,089	2,419,397
Capital assets being depreciated:				
Land improvements	2,664,469	20,450	-	2,684,919
Leasehold improvements	42,847	-	-	42,847
Buildings	35,773,423	314,159	-	36,087,582
Equipment	52,179,263	2,880,965	231,504	54,828,724
Total capital assets being depreciated	90,660,002	3,215,574	231,504	93,644,072
Less accumulated depreciation for:				
Land improvements	1,168,743	195,320	-	1,364,063
Leasehold improvements	28,208	4,285	-	32,493
Buildings	13,219,576	1,562,781	-	14,782,357
Equipment	26,127,757	4,811,082	217,477	30,721,362
Total accumulated depreciation	40,544,284	6,573,468	217,477	46,900,275
Total capital assets, depreciable - Net	50,115,718	(3,357,894)	14,027	46,743,797
Total capital assets - Net	$ 52,652,523	$ (1,207,213)	$ 2,282,116	$ 49,163,194

Note 7: Capital Assets (Continued)

Capital asset activity for the year ended December 31, 2015, was as follows:

	Beginning Balance 1/1/15	Increase	Decrease	Ending Balance 12/31/15
Capital assets not being depreciated:				
Land	$ 2,015,497	$ -	$ -	$ 2,015,497
Construction in progress	97,257	1,675,921	1,251,870	521,308
Total capital assets not being depreciated	2,112,754	1,675,921	1,251,870	2,536,805
Capital assets being depreciated:				
Land improvements	2,483,391	181,078	-	2,664,469
Leasehold improvements	42,847	-	-	42,847
Buildings	35,564,501	208,922	-	35,773,423
Equipment	50,696,153	1,844,063	360,953	52,179,263
Total capital assets being depreciated	88,786,892	2,234,063	360,953	90,660,002
Less accumulated depreciation for:				
Land improvements	990,902	177,841	-	1,168,743
Leasehold improvements	23,923	4,285	-	28,208
Buildings	11,679,320	1,540,256	-	13,219,576
Equipment	21,750,527	4,701,090	323,860	26,127,757
Total accumulated depreciation	34,444,672	6,423,472	323,860	40,544,284
Total capital assets, depreciable - Net	54,342,220	(4,189,409)	37,093	50,115,718
Total capital assets - Net	$ 56,454,974	$ (2,513,488)	$ 1,288,963	$ 52,652,523

Note 8: Long-Term Debt and other Noncurrent Liabilities

A schedule of changes in noncurrent liabilities for the year ended December 31, 2016, was as follows:

	Beginning Balance 1/1/16	Additions	Reductions	Ending Balance 12/31/16	Amount Due Within One Year
Long-term debt					
Bonds & notes payable					
2010B LTGO Bonds	$ 25,045,000	$ -	$ 905,000	$ 24,140,000	$ 925,000
Long-term unearned revenue	$ 4,190,525	$ -	$ 1,441,292	$ 2,749,233	$ 1,412,518
Long-term compensated absences	$ 2,291,894	$ 581,094	$ -	$ 2,872,988	$ 1,432,166

A schedule of changes in noncurrent liabilities for the year ended December 31, 2015, was as follows:

	Beginning Balance 1/1/15	Additions	Reductions	Ending Balance 12/31/15	Amount Due Within One Year
Bonds and notes payable -					
2010B LTGO Bonds	$ 25,930,000	$ -	$ 885,000	$ 25,045,000	$ 905,000
Long-term unearned revenue	$ 180,628	$ 5,528,099	$ 1,518,202	$ 4,190,525	$ 1,441,292
Long-term compensated absences	$ 2,489,763	$ -	$ 197,869	$ 2,291,894	$ 869,657

Note 8: Long-Term Debt and other Noncurrent Liabilities (Continued)

The terms and due dates of the District's noncurrent liabilities, including long-term debt, long-term unearned revenue and long-term uncompensated absences at December 31, 2016, is as follows:

Long-Term Debt

Limited Tax General Obligation Bonds 2010B (the "2010B Bonds"), dated October 14, 2010, in the amount of $25,930,000, due in varying annual principal installments of $905,000 in 2016 to $1,760,000 in 2035, plus interest at varying interest rates from 3.088% to 6.397% per bond schedule, payable in June and December each year. The 2010B Bonds maturing on or before December 1, 2020, are not subject to optional redemption prior to their stated maturities. The Bonds maturing on or after December 1, 2025, are subject to redemption on any date on or after December 1, 2020. The 2010B Bonds are designated as "Build America Bonds" and will be allowed a credit payable by the United States Treasury in an amount equal to 35% (less sequestration) of the interest payable on each interest payment date. The District issued general obligation bonds to finance the campus renewal project and construction of a new surgical wing.

Principal maturities of long-term debt for succeeding years are as follows for the years ending December 31:

	Principal	Interest	Totals
2017	925,000	1,397,725	2,322,725
2018	945,000	1,363,167	2,308,167
2019	975,000	1,323,222	2,298,222
2020	1,000,000	1,280,546	2,280,546
2021	1,030,000	1,235,276	2,265,276
2022-2025	4,495,000	4,367,379	8,862,379
2026-2030	6,640,000	3,887,802	10,527,802
2031-2035	8,130,000	1,602,449	9,732,449
Totals	$ 24,140,000	$ 16,457,566	$ 40,597,566

Note 8: Long-Term Debt and other Noncurrent Liabilities (Continued)

Long-Term Unearned Revenue

All unearned revenue relates to the EHR incentive payment program and will be fully recognized by 2029.

Long-Term Compensated Absences

All compensated absences with accumulations greater than the minimum annual benefit is considered long-term.

Note 9: Operating Leases

The District is committed under various leases for various equipment and building spaces. These leases are considered operating leases for accounting purposes. Lease expense for the year ended December 31, 2016, amounted to $374,155. Future minimum rental commitments for these leases for the years ending December 31 are as follows:

2017		342,849
2018		209,259
2019		146,833
2020		20,932
Total	$	719,873

Note 10: Net Patient Service Revenue

Net patient service revenue consisted of the following for the years ended December 31:

	2016	2015
Gross patient service revenue:		
Inpatient services	$ 47,409,212	$ 48,263,796
Outpatient services	123,690,000	112,767,036
Physician clinics	23,810,889	20,092,732
Totals	194,910,101	181,123,564
Less:		
Contractual adjustments	103,844,352	96,433,373
Provision for bad debts	3,358,006	2,853,960
Net patient service revenue	$ 87,707,743	$ 81,836,231

Note 11: 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, 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 $2,575,976 and $2,209,561 for the years ended December 31, 2016 and 2015, respectively.

The estimated cost of providing care to patients under the District's charity care policy aggregated approximately $1,139,300 and $1,059,900 in 2016 and 2015, respectively. The cost was calculated by multiplying the ratio of cost to gross charges for the District by the gross uncompensated charges associated with providing charity care.

Note 12: Pension

Defined Contribution Plan

The District sponsors and contributes to the Public Hospital District No. 1 of Mason County Pension Plan Number 001, a defined contribution pension plan, for its employees. The Plan covers its employees who have attained the age of 18 years and worked at least 1,000 hours in the first year.

Benefit terms, including contribution requirements, for the Plan are established and may be amended by the District board of directors. Employees are eligible to participate if they agree to contribute 3% of their earnings up to $650 a month and 6% of earnings over $650 per month to the deferred compensation plan. The District contributes 4% of earnings of up to $650 per month and 8% of earnings over $650 per month. For the years ended December 31, 2016 and 2015, the District recognized pension expense of $1,595,795 and $1,894,779, respectively. Forfeitures reflected in the pension expense totaled $462,000 and $0 for the years ended December 31, 2016 and 2015, respectively. The District's pension expense liability totaled $178,530 and 169,327 for the years ended December 31, 2016 and 2015, respectively.

Each participant shall have a nonforfeitable and vested right to his or her account for each year of service completed while an employee of the employer, in accordance with the following schedule:

Years	Nonforfeitable percentage
0-2	0%
3	30%
4	40%
5	60%
6	80%
7 or more	100%

Deferred Compensation Plan

In addition to the defined contribution plan above, the District provides a deferred compensation plan to eligible employees under section 457(b) and 403(b) of the Internal Revenue Code. The plan is funded solely from employee contributions, which are deposited with insurance companies. The plan is administered by VALIC. Funds on deposit with the insurance company were $31,783,270 and $27,476,716 as of December 31, 2016 and 2015, respectively. Employee contributions to the plan were $2,990,678 and $2,763,754 as of December 31, 2016 and 2015, respectively.

Note 13: Risk Management

Professional Liability Insurance

The District is one of a number of Washington hospitals that are members of the Washington Hospital Casualty Company (WCC), a nonprofit mutual insurance corporation used for payment of liability claims. The WCC 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 that 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 "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 aggregate limit of $5,000,000, plus $11,000,000 annual excess coverage per claim with an annual aggregate of $11,000,000. There are no significant deductible or coinsurance clauses. No liability has been accrued for future coverage of 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 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.

Self-Insurance

The District self-insures for health care benefits provided to its employees. Employee medical claims are paid by the District through a plan administrator, HMA. Employees file their claims with the administrator. The administrator pays the claim and invoices the amount paid back to the District. The District pays the claims out of unrestricted funds. The District also has major medical coverage with an insurance company that provides coverage for employee claims in excess of $150,000.

Expenses for health insurance coverage totaled $11,131,757 and $10,326,448 in 2016 and 2015, respectively.

NOTE 13: RISK MANAGEMENT (CONTINUED)

Self-Insurance (Continued)

The District has estimated the incurred, but not reported liability as of December 31, 2016 using actuarial methods. These methods include the use of average lag claims multiplied by a stabilization reserve factor. The following represents changes to those liabilities during the past two years:

	Beginning Liability	Current Year Claims and Changes in Estimates	Claim Payments and Fees	Ending Liability
2016	$ 4,724,266	$ 11,131,757	$ 10,794,661	$ 5,061,362
2015	$ 3,808,630	$ 10,326,448	$ 9,410,812	$ 4,724,266

Workers' Compensation and Unemployment Insurance

The District has a self-insured workers' compensation plan for its employees. The District participates in the Public Hospital District Workers' Compensation Trust, which is administered by the Washington State Hospital Association. The District pays its share of actual injury claims, maintenance of reserves, administrative expenses, and reinsurance premiums. The District recognized workers' compensation expense of $556,855 and $569,052 in 2016 and 2015, respectively.

The District has a self-insured unemployment plan for its employees. The District participates in the Public Hospital District Unemployment Compensation Fund, which is administered by the Washington State Hospital Association. The District pays its share of actual unemployment claims, maintenance of reserves, and administrative expenses. The District recognized unemployment expense of $144,220 and $133,243 in 2016 and 2015, respectively.

Property

The District is insured for earthquake, flood, theft, and fire for $92,689,609.

Note 14: Concentration of Credit Risk

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

The mix of patient revenue at December 31 is as follows:

	2016	2015
Medicare	43%	45%
Medicaid	30%	30%
Self-pay	4%	3%
Other	23%	22%
Totals	100%	100%

Note 15: Functional Expenses

The District provides general health care services to residents within its geographic location. Expenses related to providing these services consisted of the following for the year ended December 31:

	2016	2015
Health care services	$ 75,107,762	$ 68,072,133
General and administrative	19,103,496	18,899,956
Total operating expenses and interest	$ 94,211,258	$ 86,972,089

Note 16: Reclassifications

In order to conform to the 2016 presentation, the following reclassifications were made to the 2015 balances:

Originally classified as compensated absences	$	2,291,894
Reclassified:		
Current portion of compensated absences	$	869,657
Long-term compensated absences - Less current portion		1,422,237
Total	$	2,291,894

ABOUT THE STATE AUDITOR'S OFFICE

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

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

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

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

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

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

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

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