



Office of the Washington State Auditor
Pat McCarthy

Financial Statements Audit Report

**Adams County Public Hospital District
No. 3**

(Othello Community Hospital)

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

Published April 12, 2018

Report No. 1021136





Office of the Washington State Auditor

Pat McCarthy

April 12, 2018

Board of Directors
Othello Community Hospital
Othello, Washington

Report on Financial Statements

Please find attached our report on Othello Community Hospital's financial statements.

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

Sincerely,

A handwritten signature in cursive script that reads "Pat McCarthy".

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**

**Othello Community Hospital
Adams County
January 1, 2015 through December 31, 2016**

Board of Directors
Othello Community Hospital
Othello, 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 Othello Community Hospital, Adams County, Washington, as of and for the year 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 April 5, 2018.

INTERNAL CONTROL OVER FINANCIAL REPORTING

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

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

deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

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

In addition, we noted certain matters that we have reported to the management of the District in a separate letter dated April 5, 2018.

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*. However, we noted certain matters that we have reported to the management of the District in a separate letter dated April 5, 2018.

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.

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

April 5, 2018

INDEPENDENT AUDITOR'S REPORT ON FINANCIAL STATEMENTS

Othello Community Hospital Adams County January 1, 2015 through December 31, 2016

Board of Directors
Othello Community Hospital
Othello, Washington

REPORT ON THE FINANCIAL STATEMENTS

We have audited the accompanying financial statements of Othello Community Hospital, Adams County, Washington, as of and for the year 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 10.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether

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

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

Opinion

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

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis 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 April 5, 2018 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

April 5, 2018

FINANCIAL SECTION

**Othello Community Hospital
Adams 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

Adams County Public Hospital District No. 3 d/b/a Othello Community Hospital

Management's Discussion and Analysis

Year Ended December 31, 2016 and 2015

Our discussion and analysis of the Adams County Public Hospital District No. 3's (District or Hospital) financial performance provides an overview of the District's financial activities for the fiscal years ended on December 31, 2016 and December 31, 2015. Please read it in conjunction with the District's financial statements that follow this analysis.

The District is a governmental entity and a political subdivision of the State of Washington. The District was created to provide hospital services and other health care services for the residents of Adams County. The Hospital facility opened its doors in January 1958. The District is licensed for 49 beds but operates a 16-bed acute care hospital and the facilities to support those operations. District services include the acute care hospital, an emergency room, and the related ancillary services (lab, x-ray, etc.) associated with these services.

A five member board of commissioners governs the District. The members of the board are elected commissioners for terms of six years. The District is not geographically subdivided, so all commissioner positions are "at large". Elections are staggered so no more than one third of the board is up for election at one time in a typical election year. One board position expired at the end of 2015 (position 1), and the sitting commissioner was returned to her seat in the November 5, 2015 elections; no commissioner positions were up for election in 2016.

The District board is required to elect a president and secretary. One of the primary duties of the board is to appoint a superintendent of the District. The board delegates the day to day operations of the District to the appointed 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. These tax revenues are used to support the purpose of the District Hospital, which is to provide health care to the members of the District. However, this tax support is minimal representing about three percent of gross revenue.

The Government Accounting Standards Board prescribes the financial reporting of government entities. This is the format followed by the District. The accounting records and financial statements are audited by the Office of the Auditor of the State of Washington.

Adams County Public Hospital District No. 3 d/b/a Othello Community Hospital

Management's Discussion and Analysis

Year Ended December 31, 2016 and 2015

Issues Facing the Hospital District

There are issues facing the District that could result in material changes in its financial position in the long term. Among those issues are:

- Risks related to Medicare and Medicaid reimbursement
- Risks related to possible budget cuts in other state-funded healthcare programs
- High liability and malpractice insurance premiums
- Rising health insurance deductibles and copays, complicating collection efforts
- Declining service volumes as patients defer care for economic reasons
- Competition in the local health care market
- The threat of specialty physicians leaving the area
- Nursing and other healthcare-related labor shortages
- Increasing employee benefit costs, especially health insurance
- High costs related to IT infrastructure in an increasingly electronic environment

The Hospital is certified as a provider under both the Medicare program, which provides certain healthcare benefits to beneficiaries who are over 65 years of age or disabled, and the Medicaid program, funded jointly by the federal government and the states, which provides medical assistance to certain needy individuals and families. Nearly three quarters of gross patient revenue for 2015 and 2016 was derived from the Medicare and Medicaid programs.

The Hospital became a Critical Access Hospital on July 1, 2002. As a Critical Access Hospital, the District is reimbursed at cost for the majority of services provided under the Medicare and Medicaid programs. While the Critical Access Hospital program provides a measure of relief to qualifying hospitals, the program is subject to the financial constraints faced by the federal and state governments, and may be curtailed or eliminated at some point in the future.

Under Medicaid, the federal government provides grants to states that have programs meeting certain federal guidelines. The Hospital has benefited from such grants. These funds are sometimes reduced as federal or state governments try to balance their budgets.

In recent years, both the state and federal governments have increased enforcement of laws designed to combat health care fraud, and additional anti-fraud legislation has been adopted at both the federal and state levels. The fees (including legal fees) and fines to a hospital caught in violation of these laws can be substantial. Furthermore, failure of the District to meet these laws can result in the exclusion of Medicare and Medicaid funds.

Adams County Public Hospital District No. 3 d/b/a Othello Community Hospital

Management's Discussion and Analysis

Year Ended December 31, 2016 and 2015

Risks Related to HIPAA

Under the Health Insurance Portability and Accountability Act (HIPAA), health plans, healthcare clearinghouses, and healthcare providers including hospitals and their business partners must maintain reasonable and appropriate administrative, technical, and physical safeguards to ensure the integrity and confidentiality of electronic healthcare information. The hospital must also protect against reasonable foreseeable threats to the security or integrity of the information and protect against unauthorized use or disclosure. Again, penalties are high with the loss of Medicare and Medicaid funds, fines and criminal sanctions for violations of HIPAA.

General Risks Affecting Healthcare Facilities

Technology and Services

Scientific and technological advances, new procedures, drugs and appliances, preventive medicine, occupational health and safety programs and outpatient healthcare delivery may reduce utilization and revenues for the Hospital in the future. Medical technological advances maintain a trend toward the use of expensive, sophisticated equipment on the one hand, while advances in digital communication (the widespread availability of "smart phones," for example) have resulted in potential alternative routes for accessing medical care. In addition, the progression toward electronic medical record-keeping has added greatly to the cost of implementing and maintaining an adequate IT infrastructure.

Employment and Labor Issues

The Hospital is a major employer with a complex mix of professional, technical, clerical, maintenance, dietary, housekeeping, and other workers. Risks include discrimination claims, retirement plan compliance issues, personal tort actions, work-related injuries and exposure to hazardous materials. A nursing shortage, as well as shortages in other medical professional or technical positions, is an issue creating pressure toward higher salaries, and, at times, requiring the use of temporary staff at premium wage rates.

Competition

Competition from other hospitals and healthcare providers are a risk to the Hospital's revenue. New or existing organizations may try to carve out profitable segments of the Hospital's business leaving the Hospital with product lines that are losing money.

Adams County Public Hospital District No. 3 d/b/a Othello Community Hospital

Management's Discussion and Analysis

Year Ended December 31, 2016 and 2015

General Risks Affecting Healthcare Facilities (Continued)

Insurance

In Washington State, with no cap on malpractice damages, the exposure is high for healthcare providers resulting in relatively higher premiums for liability insurance compared with other parts of the nation. Although the hospital's malpractice costs have remained stable over the last several years, historically malpractice rates have seen a cyclical rise and fall: Malpractice insurance costs remain an area of concern.

Financial Highlights

The accompanying financial statements are an inter-related group of reports designed to enable the reader to have a general understanding of the District's financial position on December 31, 2015 and December 31, 2016, and the results of its financial operations during the 2015 and 2016 years. The Statement of Net Position presents the broad categories of assets owned by the District on December 31 of each year along with the related liabilities owed by the District on that date. The difference between the assets and the liabilities, designated as Net Assets, is effectively the District's unencumbered ownership share of the assets.

The Statements of Revenue, and Expenses, and Changes in Net Position describes the District's financial operations for the 2015 and 2016 years in broad terms. This statement identifies the general sources of its revenue for the year and the major categories of expenses incurred in generating the revenue. The District had a decrease in net position for 2015 and 2016. The deficit in 2015 and 2016 decreased the District's net position; this statement reconciles the net position at the beginning of each year with the net position at the end of each year. The ending net position at year end on this statement is the same amount as the net position reported on the Statement of Net Position at year end.

The Statements of Cash Flows reconciles the cash and cash equivalents at the beginning of the year with the cash and equivalents at the end of the year by identifying the major categories of cash received and cash expended during the year. The ending cash and equivalents at the end of each year is the same amount as reported in the Statement of Net Position at each year end. This report also reconciles the income from operations, as reported on Statements of Revenue and Expenses and Changes in Net Position, to the net cash provided by operating activities as identified within the statement. The concept of this section of the Statements of Cash Flows is to identify the items in the Statements of Net Position and the Statements of Revenues and Expenses which reconcile those accrual basis statements to cash generated each year.

Adams County Public Hospital District No. 3 d/b/a Othello Community Hospital

Management's Discussion and Analysis

Year Ended December 31, 2016 and 2015

Financial highlights of 2016:

Gross patient revenues decreased from 2015 to 2016. Gross revenue from inpatient services decreased approximately \$.04 million while outpatient revenue decreased about \$1.40 million, for a total decrease of about \$1.44 million in gross patient revenues. The decrease in inpatient revenue came primarily in inpatient surgical services and anesthesiology. The decrease in outpatient revenue is largely attributable to substantial decreases in outpatient surgical services and anesthesiology. There was also a notable decreases in outpatient pharmacy revenue. There were few areas of operation that saw an increase in revenue, including inpatient obstetrics, inpatient laboratory, outpatient radiology, and outpatient emergency room services.

There was also a decrease in revenue deductions from 2015 to 2016. Medicaid deductions decreased 23.33% and Medicare deductions decreased 25.56% for a combined decrease of \$2.35 million, but this was partially balanced out by increase in other contractual and charity deductions, leaving an overall decrease in contractual adjustments of \$2.29 million. Bad debt also decrease by \$.42 million, making a combined decrease of \$2.71 million in contractual adjustments and bad debt. The \$1.44 million decrease in gross patient revenues was offset by the \$2.71 million decrease in revenue deductions, resulting in an increase in net patient service revenue of \$1.26 million.

There was an increase of \$.15 million in non-patient operating revenues from 2015 to 2016, attributable to a \$.21 million energy efficiency construction grant paid by the Washington Department of Enterprise Services for HVAC improvements in the patient care areas and surgeries.

The District's operating expenses increased overall by 0.08% from 2015 to 2016, in the amount of \$12,830. Employee salaries increased \$.17 million or about 2.15% and depreciation increased \$.12 million or about 16.23%. Offsetting these increases was a decrease in professional fees of \$.09 million and a decrease in purchased services of \$.12 million.

The District incurred an excess of revenues over expenses of \$.55 million in 2016. This was a 160% increase compared to the \$.90 million deficit of revenues over expenses in 2015. While net patient revenues increased encouragingly in 2016, that increase was partially offset by increased operating expenses.

Adams County Public Hospital District No. 3 d/b/a Othello Community Hospital

Management's Discussion and Analysis

Year Ended December 31, 2016 and 2015

Financial highlights of 2016 (Continued):

Gross patient accounts receivable increased from \$6.48 million on December 31, 2015 to \$7.00 million on December 31, 2016. Gross receivables increased \$.52 million while estimated revenue deductions decreased \$.04 million, for an overall increase in net patient account collectibles of \$.56 million.

Capital expenditures for 2016 totaled \$.80 million, somewhat less than the 2015 total of \$.85 million. Most significant among the 2016 expenditures were \$.42 million for a 3D mammography unit, \$.24 million for Spacelabs central monitor system, and \$.19 million for a Northstar E450 Ambulance.

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

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

| | 2016 | 2015 | 2014 |
|---|----------------------|----------------------|----------------------|
| ASSETS | | | |
| Current assets | \$ 14,364,236 | \$ 19,075,714 | \$ 22,512,654 |
| Capital assets, net | 8,514,064 | 8,590,324 | 8,494,274 |
| Other noncurrent assets | 15,353,350 | 9,916,473 | 7,350,320 |
| Total Assets, and Deferred Outflows of Resources | <u>\$ 38,231,650</u> | <u>\$ 37,582,511</u> | <u>\$ 38,357,248</u> |
| LIABILITIES, DEFERRED INFLOWS OF RESOURCES, AND NET POSITION | | | |
| Current liabilities | \$ 860,322 | \$ 756,434 | \$ 628,743 |
| Total Liabilities | <u>860,322</u> | <u>756,434</u> | <u>628,743</u> |
| NET ASSETS | | | |
| Unrestricted | 28,857,264 | 28,235,753 | 29,234,231 |
| Invested in capital assets | 8,514,064 | 8,590,324 | 8,494,274 |
| Total Net Position | <u>37,371,328</u> | <u>36,826,077</u> | <u>37,728,505</u> |
| Total Liabilities, Deferred Inflows of Resources, and Net Position | <u>\$ 38,231,650</u> | <u>\$ 37,582,511</u> | <u>\$ 38,357,248</u> |

Adams County Public Hospital District No. 3 d/b/a Othello Community Hospital

Management's Discussion and Analysis

Year Ended December 31, 2016 and 2015

| Table 2: Operating Results and Changes in Net Assets | 2016 | 2015 | 2014 |
|---|---------------|---------------|---------------|
| Operating Revenues | | | |
| Net patient service revenue | \$ 15,491,466 | \$ 14,227,012 | \$ 14,820,796 |
| Other | 480,228 | 331,482 | 1,055,132 |
| Total Operating Revenue | 15,971,694 | 14,558,494 | 15,875,928 |
| Operating Expenses | | | |
| Salaries, wages and benefits | 9,997,182 | 9,857,881 | 9,441,960 |
| Supplies | 1,191,500 | 1,214,309 | 1,091,334 |
| Other operating expenses | 4,861,812 | 5,087,833 | 4,792,844 |
| Depreciation | 876,245 | 753,886 | 655,021 |
| Total Operating Expenses | 16,926,739 | 16,913,909 | 15,981,159 |
| Operating Loss | (955,045) | (2,355,415) | (105,231) |
| Total Nonoperating Revenue - Net | 1,500,296 | 1,452,987 | 1,463,318 |
| Excess (Deficiency) of Revenues over Expenses | 545,251 | (902,428) | 1,358,087 |
| Net position, beginning of year | 36,826,077 | 37,728,505 | 36,370,418 |
| Net Position, End of Year | \$ 37,371,328 | \$ 36,826,077 | \$ 37,728,505 |

Contacting the District's Financial Management:

The financial report is designed to provide readers with a general overview of the District's finances and to show the District's accountability for the money it receives. If you have questions about this report or need additional financial information contact the Administration office at Othello Community Hospital, 315 N. 14th Avenue, Othello, WA 99344 or call 509.488.2636.

Adams County Public Hospital District No. 3 d/b/a Othello Community Hospital

Statements of Net Position

December 31, 2016 and 2015

| <i>Assets and Deferred Outflows of Resources</i> | 2016 | 2015 |
|--|----------------------|----------------------|
| Current assets: | | |
| Cash and cash equivalents | \$ 7,838,276 | \$ 13,996,139 |
| Current investments | 2,564,748 | 2,064,822 |
| Receivables: | | |
| Patient - Net | 2,989,920 | 2,431,487 |
| Taxes | 60,715 | 54,485 |
| Estimated third-party payor settlements | 229,965 | 176,535 |
| Interest receivable | 116,782 | 96,448 |
| Other | 325,689 | 40,866 |
| Inventories | 171,213 | 151,596 |
| Prepaid expenses | 66,928 | 63,336 |
| Total current assets | 14,364,236 | 19,075,714 |
| Noncurrent asses: | | |
| Noncurrent investments | 15,353,350 | 9,916,473 |
| Nondepreciable capital assets | 20,000 | 217,817 |
| Depreciable capital assets - Net of accumulated depreciation | 8,494,064 | 8,372,507 |
| Total noncurrent assets | 23,867,414 | 18,506,797 |
| TOTAL ASSETS AND DEFERRED OUTFLOWS OF RESOURCES | \$ 38,231,650 | \$ 37,582,511 |

See accompanying notes to financial statements.

Adams County Public Hospital District No. 3 d/b/a Othello Community Hospital

Statements of Net Position (Continued)

December 31, 2016 and 2015

| <i>Liabilities, Deferred Inflows of Resources, and Net Position</i> | 2016 | 2015 |
|---|----------------------|----------------------|
| Current liabilities: | | |
| Accounts payable | \$ 67,348 | \$ 40,940 |
| Employee compensation and related liabilities | 189,570 | 162,968 |
| Accrued compensated absences - Current portion | 36,235 | 26,524 |
| Total current liabilities | 293,153 | 230,432 |
| Noncurrent accrued compensated absences | 567,169 | 526,002 |
| Total liabilities | 860,322 | 756,434 |
| Net position: | | |
| Net investment in capital assets | 8,514,064 | 8,590,324 |
| Unrestricted | 28,857,264 | 28,235,753 |
| Total net position | 37,371,328 | 36,826,077 |
| TOTAL LIABILITIES, DEFERRED INFLOWS OF RESOURCES, AND NET POSITION | \$ 38,231,650 | \$ 37,582,511 |

See accompanying notes to financial statements.

Adams County Public Hospital District No. 3 d/b/a Othello Community Hospital

Statements of Revenue, Expenses, and Changes in Net Position

Years Ended December 31, 2016 and 2015

| | 2016 | 2015 |
|-------------------------------------|---------------|---------------|
| Operating revenue: | | |
| Net patient service revenue | \$ 15,491,466 | \$ 14,227,012 |
| Other operating revenue | 480,228 | 331,482 |
| Total operating revenue | 15,971,694 | 14,558,494 |
| Operating expenses: | | |
| Salaries and wages | 8,030,898 | 7,862,108 |
| Employee benefits | 1,966,284 | 1,995,773 |
| Professional fees | 184,172 | 273,711 |
| Supplies | 1,191,500 | 1,214,309 |
| Purchased services - Other | 3,666,394 | 3,788,325 |
| Purchased services - Utilities | 358,957 | 371,706 |
| Insurance | 182,029 | 184,418 |
| Other | 360,838 | 366,254 |
| Rent | 109,422 | 103,419 |
| Depreciation | 876,245 | 753,886 |
| Total operating expenses | 16,926,739 | 16,913,909 |
| Loss from operations | (955,045) | (2,355,415) |
| Nonoperating revenues (expenses): | | |
| Property taxes | 1,110,438 | 1,081,533 |
| Interest earnings | 389,858 | 371,454 |
| Total nonoperating revenues | 1,500,296 | 1,452,987 |
| Increase (Decrease) in net position | 545,251 | (902,428) |
| Net position at beginning | 36,826,077 | 37,728,505 |
| Net position at end | \$ 37,371,328 | \$ 36,826,077 |

See accompanying notes to financial statements.

Adams County Public Hospital District No. 3 d/b/a Othello Community Hospital

Statements of Cash Flows

Years Ended December 31, 2016 and 2015

| | 2016 | 2015 |
|---|---------------|---------------|
| Cash flows from operating activities: | | |
| Receipts from and on behalf of patients | \$ 14,879,603 | \$ 13,681,581 |
| Receipts from other operating revenue | 195,405 | 1,296,356 |
| Payments to employees | (9,919,702) | (9,709,847) |
| Payments to suppliers, contractors, and others | (6,050,113) | (6,316,141) |
| Net cash used in operating activities | (894,807) | (1,048,051) |
| Cash flows from noncapital financing activities: | | |
| Property taxes for operations | 1,104,208 | 1,086,985 |
| Net cash provided by noncapital financing activities | 1,104,208 | 1,086,985 |
| Cash flows from capital and related financing activities: | | |
| Purchase of capital assets | (799,985) | (849,936) |
| Net cash used in capital and related financing activities | (799,985) | (849,936) |
| Cash flows from investing activities: | | |
| Net sales (purchase) of investments | (5,936,803) | 1,342,199 |
| Interest received | 369,524 | 397,778 |
| Net cash (used in) provided by investing activities | (5,567,279) | 1,739,977 |
| Net increase (decrease) in cash and cash equivalents | (6,157,863) | 928,975 |
| Cash and cash equivalents - at beginning | 13,996,139 | 13,067,164 |
| Cash and cash equivalents - at end | \$ 7,838,276 | \$ 13,996,139 |

See accompanying notes to financial statements.

Adams County Public Hospital District No. 3 d/b/a Othello Community Hospital

Statements of Cash Flows (Continued)

Years Ended December 31, 2016 and 2015

| | 2016 | 2015 |
|---|--------------|----------------|
| Reconciliation of loss from operations to net cash used in operating activities: | | |
| Loss from operations | \$ (955,045) | \$ (2,355,415) |
| Adjustments to reconcile loss from operations to net cash used in operating activities: | | |
| Depreciation | 876,245 | 753,886 |
| Provision for bad debts | 987,392 | 1,404,571 |
| Change in operating assets and liabilities: | | |
| Receivables: | | |
| Patient accounts | (1,545,825) | (1,792,588) |
| Other | (284,823) | 964,874 |
| Inventories | (19,617) | (509) |
| Prepaid expenses | (3,592) | 6,853 |
| Accounts payable | 26,408 | (20,343) |
| Employee compensation and related liabilities | 26,602 | 109,277 |
| Accrued compensated absences | 50,878 | 38,757 |
| Estimated third-party payor settlements | (53,430) | (157,414) |
| Total adjustments | 60,238 | 1,307,364 |
| Net cash used in operating activities | \$ (894,807) | \$ (1,048,051) |

See accompanying notes to financial statements.

Adams County Public Hospital District No. 3 d/b/a Othello Community Hospital

Notes to Financial Statements

Note 1 - Summary of Significant Accounting Policies

The Entity

Adams County Public Hospital District No. 3 (the "District") owns and operates Othello Community Hospital, a 16-bed acute care hospital in Othello, Washington. The District considers the southwestern portion of Adams County, Washington to be its primary service market and provides acute care services to patients in that area. The services provided include an acute care hospital, inpatient and outpatient surgery, emergency room, obstetrics, and the related ancillary procedures (lab, anesthesia, x-ray, therapy, etc.) associated with those services.

Financial Statement Presentation

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

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

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

Tax Status

The District operates under the laws of the state of Washington for Washington municipal corporations. As organized, the District is exempt from payment of federal income tax. All District assets, liabilities, and financial transactions are included in these financial statements.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures 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.

Adams County Public Hospital District No. 3 d/b/a Othello Community Hospital

Notes to Financial Statements

Note 1 - Summary of Significant Accounting Policies (Continued)

Cash and Cash Equivalents and Investments

All cash receipts are deposited directly to the District's depository bank account. Periodically, such cash is transferred to the Adams County Treasurer who acts as the Hospital District Treasurer. Warrants are issued by the District against the cash deposited with the County Treasurer and the warrants are paid by the County Treasurer from these funds. For purposes of the statements of cash flows, the District considers all cash and cash investments with maturity dates of less than ninety days as cash and cash equivalents.

At the direction of the District, the County Treasurer invests cash in certificates of deposit, money market funds, the State of Washington local government pool (WSLGIP), which is a safe short-term liquidity vehicle, and other short-term investments. The County Treasurer invests cash in interest-bearing investments at the direction of the District. 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 co-pay and deductible amounts that are the patients' responsibility. Payments on patient accounts receivables are applied to the specific claim identified on the remittance advice or statement. The District does not have a policy to charge interest on past due accounts.

Patient accounts receivable are recorded in the accompanying statements of net position net of contractual adjustments and allowance for uncollectable accounts which reflect management's best estimate of the amounts that will not be collected. The carrying amounts of patient accounts receivables are reduced by allowances that reflect management's best estimate of the amounts that will not be collected.

Management provides for contractual adjustments under terms of third-party reimbursement agreements through a reduction of gross revenue and a credit to patient accounts receivable. In addition, management provides for probable uncollectible amounts, primarily from uninsured patients and amounts patients are personally responsible for, through a reduction of gross revenue and a credit to the allowance for uncollectable accounts.

Adams County Public Hospital District No. 3 d/b/a Othello Community Hospital

Notes to Financial Statements

Note 1 - Summary of Significant Accounting Policies (Continued)

Patient Accounts Receivable and Credit Policy (Continued)

In evaluating the collectability of patient accounts receivable, the District analyzes past results and identifies trends for each of its major payor sources of revenue to estimate the appropriate allowance for uncollectable accounts and provision for bad debts. Management regularly reviews data from the major payor sources revenue in evaluating the sufficiency of the allowance for uncollectable accounts. Specifically, for receivables associated with services provided to patients who have third-party coverage, the District analyzes contractually due amounts and provides an allowance for uncollectable accounts and a provisions for bad debts for expected uncollectible deductibles and copayments on accounts for which the third-party payor has not yet paid, or for payors who are known to be having financial difficulties that make the realization of amounts due unlikely.

For receivables associated with self-pay patients (which includes both patients without insurance and patients with deductible and copayment balances due for which third-party coverage exists for part of the bill), the District records a significant provision for bad debts in the period of service on the basis of its past experience, which indicates that many patients are unable or unwilling to pay the portion of their bill for which they are financially responsible. The difference between the standard rates (or discounted rates if negotiated) and the amounts actually collected after all reasonable collection efforts have been exhausted is charged off against the allowance for uncollectable accounts.

Fair Value Measurement

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. A three-tier hierarchy prioritizes the inputs used in measuring fair value. These tiers include Level 1, defined as quoted market prices in active markets for identical assets or liabilities; Level 2, defined as inputs other than quoted market prices in active markets that are either directly or indirectly observable; and Level 3, defined as unobservable inputs therefore, requiring an entity to develop its own assumptions. The asset's or liability's fair value measurement within the hierarchy is based on techniques that maximize the use of relevant observable inputs and minimizes the use of unobservable inputs.

Property Taxes

The District has the authority to impose taxes on property within the boundaries of the District. Taxes are received from Adams County (the "County"). Ad Valorem taxes and per parcel assessments are levied by the County on the District's behalf on February 15 and are intended to finance the District's activities of the same year. Taxes are payable in two equal installments on April 30 and October 31.

Adams County Public Hospital District No. 3 d/b/a Othello Community Hospital

Notes to Financial Statements

Note 1 - Summary of Significant Accounting Policies (Continued)

Inventories

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

Capital Assets (Continued)

The District's policy is to capitalize all capital asset expenditures exceeding \$5,000. Expenditures for maintenance and repairs are charged to operations as incurred; betterments and major renewals are capitalized. When these assets are disposed of, the related cost and accumulated depreciation and amortization are removed from the accounts and the resulting gain or loss is classified in nonoperating gains and losses. Donated items are recorded at fair market value at the date of contribution and are subsequently considered as being on the basis of cost. Depreciation and amortization have been computed on the straight-line method over the estimated useful service lives of the assets.

| | |
|-------------------------------------|------------|
| Land improvements | 3-25 years |
| Buildings and building improvements | 2-40 years |
| Major movable equipment | 3-15 years |
| Software | 3-5 years |

Asset Impairment

Capital assets are reviewed for impairment when events or changes in circumstances suggest that the service utility of the capital asset may have significantly and unexpectedly declined. Capital assets are considered impaired if both the decline in service utility of the capital asset is large in magnitude and the event or change in circumstances that may be indicative of impairment include evidence of physical damage, enactment or approval of laws or regulations or other changes in environmental factors, technological changes or evidence of obsolescence, changes in the manner or duration of use of a capital asset, and construction stoppage. The determination of the impairment loss is independent of the event or circumstance in which the impairment occurred. Impairment losses, if any, are recorded in the statements of revenues and expenses and changes in net position. No impairment losses were recorded in 2016 and 2015.

Compensated Absences

The District maintains a paid time off (PTO) program to provide eligible personnel with compensation during holidays, for vacations, and for other absences from work. The District accrues PTO for compensated absences as an expense and liability when earned based on the employee's status. The employee may not accumulate more than four hundred hours on their anniversary date before they are paid for their excess accumulation.

Adams County Public Hospital District No. 3 d/b/a Othello Community Hospital

Notes to Financial Statements

Note 1 - Summary of Significant Accounting Policies (Continued)

Compensated Absences (Continued)

Employees terminating after six months of employment are paid for accrued unused PTO in their final pay check. Employees terminating with less than six months of employment lose any accrued unused PTO. The District maintains an extended illness benefit (EIB) program to provide eligible personnel with compensation during extended illnesses of themselves or eligible family members. The maximum allowable balance of EIB hours is 720 and employees are not paid for accumulated EIB hours upon separation of employment. The District does not accrue a liability for EIB hours.

Net Position

Net position of the District is classified and displayed in two components. Net investment in capital assets consist of capital assets net of accumulated depreciation and reduced by the current balances of any outstanding borrowings used to finance the purchase or construction of those assets. Unrestricted net position is remaining net position that does not meet the definition of 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 statements of revenue, expenses, and changes in net position distinguish between operating and nonoperating revenues and expenses. Operating revenue results from exchange transactions associated with providing health care services, the District's principal activity. Operating expenses are all expenses incurred to provide health care services, other than financing costs. All other revenue and expenses not meeting these definitions, including property tax revenue and interest income, are reported as nonoperating revenue and expenses.

Net Patient Service Revenue

Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and are adjusted in future periods as final settlements are determined.

For uninsured patients who do not qualify for charity care, the District recognizes revenue 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.

Adams County Public Hospital District No. 3 d/b/a Othello Community Hospital

Notes to Financial Statements

Note 1 - Summary of Significant Accounting Policies (Continued)

Charity Care

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

Contributions and Grants

Contributions and grants that are not restricted by the donor are included in non-operating gains in the statements of revenues and expenses. Contributions and grants restricted by donors for specific purposes are recorded in the restricted fund and transferred to the general fund when restricted amounts are expended for their restricted purpose. When restricted funds are used for operations, these amounts are reflected in the statements of revenue and expenses as other operating revenue. When restricted funds are used for capital acquisitions, replacements, and renewals, these funds are reflected as an increase in net position and a reduction in the restricted assets.

Disproportionate Share Funds

The District received funds from the Washington State Department of Social and Health Services to maintain and or expand access to services for low-income and Medicaid-eligible patients. The District reported revenues of \$276,221 and \$366,939 in 2016 and 2015, respectively.

Electronic Health Record Incentive Funding

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

The District recognizes revenue for EHR incentive payments when there is reasonable assurance that the District will meet the conditions of the program. For Medicaid purposes, the District may request and received the first incentive payments as they adopt, implement, upgrade, and demonstrate meaningful use of certified EHR technology. In order to claim the first Medicare payment, the District must actually demonstrate meaningful use of certified EHR technology for the applicable period. The demonstration of meaningful use is based on meeting a series of objectives.

Adams County Public Hospital District No. 3 d/b/a Othello Community Hospital

Notes to Financial Statements

Note 1 - Summary of Significant Accounting Policies (Continued)

Electronic Health Record Incentive Funding (Continued)

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.

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.

Advertising Cost

Advertising cost are expenses as incurred, and were \$6,106 and \$7,961 for the years ended December 31, in 2016 and 2015, respectively.

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.

Subsequent Events

Subsequent events have been evaluated through the date the financial statements were available to be issued. See note 14 for additional information on a subsequent event.

New Accounting Pronouncements

Management adopted new accounting guidance GASB Statement No. 72, *Fair Value Measurement and Application*. This statement provides guidance for determining a fair value measurement for financial reporting purposes and for applying fair value to certain investments and disclosures related to all fair value measurements.

Adams County Public Hospital District No. 3 d/b/a Othello Community Hospital

Notes to Financial Statements

Note 2 - Cash and Cash Equivalents and Investments

The *Revised Code of Washington*, Chapter 39, authorizes municipal governments to invest their funds in a variety of investments including federal, state, and local government certificates, notes, or bonds; the WSLGIP; savings accounts in qualified public depositories; and certain other investments. The District's certificates of deposit are through the Adams County Treasurer and do not have credit ratings. Cash on deposit with the WSLGIP and with qualified public depositories is protected against loss by the State of Washington Public Deposit Protection Commission (PDPC), as provided for by RCW 39.58, subject to certain limitations. The District's deposits and investments are entirely covered by FDIC or by collateral held in a multiple financial institution collateral pool administered by the PDPC.

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

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

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

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

Adams County Public Hospital District No. 3 d/b/a Othello Community Hospital

Notes to Financial Statements

Note 2 – Cash and Cash Equivalents and Investments (Continued)

The District's investments generally are reported at fair value. Funds held with the WSLGIP are considered cash for purposes of presenting cash flows. The carrying amounts of deposits and investments are included in the District's statements of net position as follows at December 31:

| | 2016 | 2015 |
|--|----------------------|----------------------|
| Cash and cash equivalents | \$ 7,838,276 | \$ 13,996,139 |
| Investments: | | |
| Current investment | 2,564,748 | 2,064,822 |
| Long term investments - Federal bonds | 15,353,350 | 9,916,473 |
| Total investments | 17,918,098 | 11,981,295 |
| Total cash and cash equivalents and investments | \$ 25,756,374 | \$ 25,977,434 |

Note 3 – Fair Value Measurements

The following is a description of the valuation methodologies used for assets measured at fair value.

Fixed-income securities are valued at cost, which approximates fair value.

The methods described above may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, while the District believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different fair value measurement at the reporting date.

The District's investments by level within the fair value hierarchy were as follows at December 31, 2016:

| Type | Fair Value Measurement Using | | | Total Assets at Fair Value |
|--------------------|------------------------------|---------------|-----------|-------------------------------|
| | Level I | Level II | Level III | |
| Assets | | | | |
| Total Fixed income | \$ - | \$ 17,918,098 | \$ - | \$ 17,918,098 |

Adams County Public Hospital District No. 3 d/b/a Othello Community Hospital

Notes to Financial Statements

Note 4 - Patient Accounts Receivable -Net

The District grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payor agreements. The majority of these patients are geographically concentrated in and around Adams County. No single patient comprises more than five percent of the total receivable at year-end. The mix of patient receivables is as follows at December 31:

| | 2016 | 2015 |
|---|--------------|--------------|
| Receivable from patients and their insurance carriers | \$ 4,964,525 | \$ 4,131,050 |
| Receivable from Medicare | 718,349 | 833,395 |
| Receivable from Medicaid | 1,315,046 | 1,513,041 |
| Patient accounts receivable | 6,997,920 | 6,477,486 |
| Less: | | |
| Contractual adjustments | 2,633,000 | 2,744,999 |
| Allowance for uncollectible accounts | 1,375,000 | 1,301,000 |
| Patient accounts receivable - Net | \$ 2,989,920 | \$ 2,431,487 |

The District's allowance for uncollectable accounts for self-pay patients decreased from 62% of self-pay accounts receivable at December 31, 2015, to 60% at December 31, 2016. In addition, the District's self-pay write-offs decreased \$417,179 from \$1,404,570 for year 2015 to \$987,392 for year 2016. The District has not changed its charity care or uninsured discount policies during years 2015 or 2016. The District does not maintain a material allowance for uncollectable accounts from third-party payors, nor did the District have significant write-offs from third-party payors.

Note 5 - Property Taxes

The District received approximately 3.09% and 2.92% 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 |
|------------------------------|--------------|--------------|
| Levied to support operations | \$ 1,110,438 | \$ 1,081,533 |

Adams County Public Hospital District No. 3 d/b/a Othello Community Hospital

Notes to Financial Statements

Note 5 - Property Taxes (Continued)

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.

For 2016, the District's general tax levy was \$.500407 per \$1,000 on a total assessed valuation of \$1,230,133,916 for a total general levy of \$616,059. Additionally, the District's EMS tax levy was \$.400000 per \$1,000 on a total assessed valuation of \$1,230,133,916 for a total EMS levy of \$492,053.

For 2015, the District's general tax levy was \$.507390 per \$1,000 on a total assessed valuation of \$1,196,079,989 for a total general levy of \$606,879. Additionally, the District's EMS tax levy was \$.398957 per \$1,000 on a total assessed valuation of \$1,196,079,989 for a total EMS levy of \$477,185.

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.

Note 6 - Reimbursement Arrangements With Third-Party Payors

The District provides services to patients under contractual agreements with the Medicare and Medicaid programs. Differences between gross revenue charged and reimbursement under each of the various programs are included in contractual adjustments. A summary of the basis of reimbursement with major third-party payors is as follows: Gross revenue billed under the programs totaled approximately \$25,064,000 and \$26,891,000 for the years ended December 31, 2016 and 2015, respectively.

Medicare and Medicaid – The District's hospital is designated as a Critical Access Hospital. As such, all inpatient, swing bed, and outpatient hospital services are paid based on a cost reimbursement method, with the exception of certain types of laboratory and therapy services, which are reimbursed on a prospectively determined fee schedule.

Professional services provided by physicians and other clinicians continue to be reimbursed on prospectively determined fee schedules.

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

Accounting for Medicare and Medicaid Contractual Arrangements – The District is reimbursed for cost-reimbursable items at interim rates, with final settlements determined after audit of the related annual cost reports by the respective Medicare and Medicaid fiscal intermediaries. Estimated provisions to approximate the final expected settlement after review by the intermediaries are included in the accompanying financial statements.

Adams County Public Hospital District No. 3 d/b/a Othello Community Hospital

Notes to Financial Statements

Note 6 - Reimbursement Arrangements With Third-Party Payors (Continued)

The District's Medicare and Medicaid cost reports have been audited and tentatively settled through 2015 and 2014, respectively.

Electronic Health Record Incentive Funding

As of December 31, 2016 and 2015, the District recognized Medicaid EHR incentive payments totaling \$0 and \$1,518, respectively. The Medicaid EHR incentive payment is recognized as other operating revenue.

Laws and Regulations

The health care industry is subject to numerous laws and regulations of federal, state, and local governments. These laws and regulations include, but are not necessarily limited to, matters such as licensure, accreditation, government health care program participation requirements, reimbursement for patient services, and billing regulations. Government activity with respect to investigations and allegations concerning possible violations of such regulations by health care providers has increased. Violations of these laws and regulations could result in expulsion from government health care programs together with the imposition of significant fines and penalties, as well as significant repayment for patient services previously billed. Management believes that the District is in substantial compliance with applicable current laws and regulations. Compliance with such laws and regulations can be subject to future government review and interpretation, as well as regulatory actions unknown or un-asserted at this time.

The Centers for Medicare and Medicaid Services (CMS) uses recovery audit contractors (RACs) to search for potentially inaccurate Medicare payments that may 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. Certain states have also hired Medicaid Integrity Contractors (MICs) to perform audits similar to RACs. The District will have the ability to appeal adjustments before final settlement of the claim is made. As of December 31, 2016, the District has not been notified by the RAC or MIC of any potential significant reimbursement adjustments.

Adams County Public Hospital District No. 3 d/b/a Othello Community Hospital

Notes to Financial Statements

Note 7 - Capital Assets

Capital asset additions, retirements, and balances for the following for the year ended December 31, 2016:

| | Balance January 1 | Transfers/ Additions | Retirements | Balance December 31 |
|---------------------------------------|----------------------|-------------------------|-------------|------------------------|
| Capital assets not being depreciated: | | | | |
| Land | \$ 20,000 | \$ - | \$ - | \$ 20,000 |
| Construction in Progress | 197,817 | (197,817) | - | - |
| Capital assets being depreciated: | | | | |
| Land and improvements | 138,627 | - | - | 138,627 |
| Buildings and fixed equipment | 15,897,847 | 669,143 | 8,313 | 16,558,677 |
| Equipment | 7,380,897 | 328,659 | 645,365 | 7,064,191 |
| Software | 77,120 | - | - | 77,120 |
| Total depreciable assets | 23,494,491 | 997,802 | 653,678 | 23,838,615 |
| Total assets before depreciation | 23,712,308 | 799,985 | 653,678 | 23,858,615 |
| Less accumulated depreciation for: | | | | |
| Land and improvements | 116,261 | 6,399 | - | 122,660 |
| Buildings and fixed equipment | 8,237,804 | 621,381 | 8,313 | 8,850,872 |
| Equipment | 6,733,097 | 248,465 | 645,365 | 6,336,197 |
| Software | 34,822 | - | - | 34,822 |
| Total accumulated depreciation | 15,121,984 | 876,245 | 653,678 | 15,344,551 |
| Capital assets - Net | \$ 8,590,324 | \$ (76,260) | \$ - | \$ 8,514,064 |

Adams County Public Hospital District No. 3 d/b/a Othello Community Hospital

Notes to Financial Statements

Note 7 - Capital Assets (Continued)

Capital asset additions, retirements, and balances for the following for the year ended December 31, 2015:

| | Balance January 1 | Transfers/ Additions | Retirements | Balance December 31 |
|---------------------------------------|----------------------|-------------------------|-------------|------------------------|
| Capital assets not being depreciated: | | | | |
| Land | \$ 20,000 | \$ - | \$ - | \$ 20,000 |
| Construction in Progress | 694,998 | (497,181) | - | 197,817 |
| Capital assets being depreciated: | | | | |
| Land and improvements | 114,928 | 23,699 | - | 138,627 |
| Buildings and fixed equipment | 15,039,829 | 952,042 | 94,024 | 15,897,847 |
| Equipment | 7,253,271 | 371,376 | 243,750 | 7,380,897 |
| Software | 77,120 | - | - | 77,120 |
| Total depreciable assets | 22,485,148 | 1,347,117 | 337,774 | 23,494,491 |
| Total assets before depreciation | 23,200,146 | 849,936 | 337,774 | 23,712,308 |
| Less accumulated depreciation for: | | | | |
| Land and improvements | 114,927 | 1,334 | - | 116,261 |
| Buildings and fixed equipment | 7,779,715 | 552,113 | 94,024 | 8,237,804 |
| Equipment | 6,776,408 | 200,439 | 243,750 | 6,733,097 |
| Software | 34,822 | - | - | 34,822 |
| Total accumulated depreciation | 14,705,872 | 753,886 | 337,774 | 15,121,984 |
| Capital assets - Net | \$ 8,494,274 | \$ 96,050 | \$ - | \$ 8,590,324 |

Adams County Public Hospital District No. 3 d/b/a Othello Community Hospital

Notes to Financial Statements

Note 8 - Risk Management

The District is one of a number of Washington hospitals who are members of the Washington Casualty Company (WCC). WCC is a wholly owned subsidiary of Coverys, 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 policy. Although there exists the possibility of claims arising from services provided to patients through December 31, 2016, which have not yet been asserted, the District is unable to determine the ultimate cost if any, of such possible claims and, accordingly, no provision has been made. 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 policy’s limits provide \$1,000,000 per claim of primary coverage with a \$5,000,000 annual aggregate limit. WCC also provides excess coverage of \$4,000,000 per claim with \$4,000,000 annual aggregate. There are no significant deductible or coinsurance clauses for this policy.

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 unemployment insurance through the Public Hospital District Unemployment Compensation Fund and for workers’ compensation benefits through the Public Hospital District Workers’ Compensation Trust. Both are risk transfer pools administered by the Washington State Hospital Association. Premiums are based upon prior claims history and are charged to operations as they are paid. Total unemployment insurance expense was \$16,187 and \$14,936 in 2016 and 2015, respectively, and the workers’ compensation benefits expense was \$26,440 and \$35,506 in 2016 and 2015, respectively.

Adams County Public Hospital District No. 3 d/b/a Othello Community Hospital

Notes to Financial Statements

Note 9 - Charity Care

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 \$688,830 and \$676,813 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 \$358,099 and \$338,862 in 2016 and 2015, respectively. The cost was calculated by multiplying the ratio of cost to gross charges for the District times the gross uncompensated charges associated with providing the charity care.

Note 10 - Retirement Plan

The District sponsors and administers the Section 403(b) Retirement Plan for Othello Community Hospital, a retirement plan under Section 403(b) of the Internal Revenue Code. The plan is a defined contribution plan for all employees who have completed one year of service including 1,000 hours of service. Participants are subject to a five-year graded vesting schedule at the rate of 20% annually. Forfeitures are applied to fixed matching contribution of the next plan year. The amount of forfeitures were \$167 and \$3,447, for the years ended December 31, 2016 and 2015, respectively. The District contributes 7% of each covered employee's compensation. The employees must contribute at least 3% of their wages to the plan for matching contribution. Total employer contributions to the plan were \$381,605 and \$364,770 for the years ended December 31, 2016 and 2015, respectively.

Adams County Public Hospital District No. 3 d/b/a Othello Community Hospital

Notes to Financial Statements

Note 11 - Net Patient Service Revenue

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

| | 2016 | 2015 |
|---|---------------|---------------|
| Gross patient service revenue | \$ 33,832,884 | \$ 35,275,361 |
| Less - Adjustment to gross patient service revenue: | | |
| Contractual adjustments | 17,354,026 | 19,643,778 |
| Provision for bad debts | 987,392 | 1,404,571 |
| Total adjustments | 18,341,418 | 21,048,349 |
| Net patient service revenue | \$ 15,491,466 | \$ 14,227,012 |

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

| | 2016 | 2015 |
|-------------------|------|------|
| Medicare | 14% | 14% |
| Medicaid | 60% | 61% |
| Other | 26% | 25% |
| Total adjustments | 100% | 100% |

Adams County Public Hospital District No. 3 d/b/a Othello Community Hospital

Notes to Financial Statements

Note 12 - 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 years ended December 31:

| | 2016 | 2015 |
|-------------------------------|---------------|---------------|
| Health care services | \$ 14,357,986 | \$ 14,272,156 |
| Management and administration | 2,568,753 | 2,641,753 |
| Total expenses | \$ 16,926,739 | \$ 16,913,909 |

Note 13 - Commitments

The District entered into an annual computer software agreement with Engage to provide maintenance and support services on the District's information system in the annual amount of approximately \$424,000 made in monthly payments.

Note 14 – Subsequent Event

As part of the American Recovery and Reinvestment Act of 2009, Congress authorized funds for medical providers participating in Medicare/Medicaid, to encourage investment in implementing and upgrading electronic health records (EHR) systems. The Medicaid portion of those funds were made available to individual states to administer and distribute to participating providers within their purview. The District applied for a share of the Washington State Medicaid funds according to instructions provided by the Washington State Health Care Authority (HCA), on the basis of which the District was awarded incentive payments over a 4 year period between 2011 and 2014. Subsequent review of the Washington State program by Medicare's Office of the Inspector General (OIG) indicated overpayment of funds to a number of hospitals in Washington State, including the District. In response to the OIG finding, the HCA initially sent requests to the hospitals for repayment of those amounts, but later rescinded those requests and commissioned an independent audit of the participating hospitals. The results of the audit are still pending, and the HCA's intentions following the audit remain unclear.

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

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