Office of the Washington State Auditor
Pat McCarthy

Financial Statements and Federal Single Audit Report

King County Public Hospital District No. 1

(Valley Medical Center)

For the period July 1, 2016 through June 30, 2018

Published March 29, 2019

Report No. 1023530

Office of the Washington State Auditor
Pat McCarthy

March 29, 2019

Board of Commissioners and Board of Trustees
Valley Medical Center
Renton, Washington

Report on Financial Statements and Federal Single Audit

Please find attached our report on Valley Medical Center's financial statements and compliance with federal laws and regulations.

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

Sincerely,

Pat McCarthy

State Auditor

Olympia, WA

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SCHEDULE OF FINDINGS AND QUESTIONED COSTS

Valley Medical Center
July 1, 2017 through June 30, 2018

SECTION I – SUMMARY OF AUDITOR'S RESULTS

The results of our audit of Valley Medical Center are summarized below in accordance with Title 2 *U.S. Code of Federal Regulations* (CFR) Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance).

Financial Statements

We issued an unmodified opinion on the fair presentation of the financial statements of the business-type activities and the aggregate discretely presented component unit in accordance with accounting principles generally accepted in the United States of America (GAAP).

Internal Control over Financial Reporting:

- *Significant Deficiencies:* We reported no deficiencies in the design or operation of internal control over financial reporting that we consider to be significant deficiencies.
- *Material Weaknesses:* We identified no deficiencies that we consider to be material weaknesses.

We noted no instances of noncompliance that were material to the financial statements of the Medical Center.

Federal Awards

Internal Control over Major Programs:

- *Significant Deficiencies:* We reported no deficiencies in the design or operation of internal control over major federal programs that we consider to be significant deficiencies.
- *Material Weaknesses:* We identified no deficiencies that we consider to be material weaknesses.

We issued an unmodified opinion on the Medical Center's compliance with requirements applicable to its major federal program.

We reported no findings that are required to be disclosed in accordance with 2 CFR 200.516(a).

Identification of Major Federal Programs:

The following program was selected as a major program in our audit of compliance in accordance with the Uniform Guidance.

CFDA No.	Program or Cluster Title
93.268	Immunization Cooperative Agreements

The dollar threshold used to distinguish between Type A and Type B programs, as prescribed by the Uniform Guidance, was $750,000.

The Medical Center qualified as a low-risk auditee under the Uniform Guidance.

SECTION II – FINANCIAL STATEMENT FINDINGS

None reported.

SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

None reported.

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*

Valley Medical Center
July 1, 2016 through June 30, 2018

Board of Commissioners and Board of Trustees
Valley Medical Center
Renton, 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 business-type activities and the aggregate discretely presented component unit of Valley Medical Center, a component unit of the University of Washington, as of and for the years ended June 30, 2018 and 2017, and the related notes to the financial statements, which collectively comprise the Medical Center's basic financial statements, and have issued our report thereon dated March 22, 2019.

INTERNAL CONTROL OVER FINANCIAL REPORTING

In planning and performing our audits of the financial statements, we considered the Medical Center'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 opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Medical Center's internal control. Accordingly, we do not express an opinion on the effectiveness of the Medical Center'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 Medical Center'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 Medical Center's financial statements are free from material misstatement, we performed tests of the Medical Center'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 Medical Center'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 Medical Center'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

March 22, 2019

INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE FOR EACH MAJOR FEDERAL PROGRAM AND REPORT ON INTERNAL CONTROL OVER COMPLIANCE IN ACCORDANCE WITH THE UNIFORM GUIDANCE

Valley Medical Center
July 1, 2017 through June 30, 2018

Board of Commissioners and Board of Trustees
Valley Medical Center
Renton, Washington

REPORT ON COMPLIANCE FOR EACH MAJOR FEDERAL PROGRAM

We have audited the compliance of Valley Medical Center, with the types of compliance requirements described in the U.S. *Office of Management and Budget (OMB) Compliance Supplement* that could have a direct and material effect on each of the Medical Center's major federal programs for the year ended June 30, 2018. The Medical Center's major federal programs are identified in the accompanying Schedule of Findings and Questioned Costs.

Management's Responsibility

Management is responsible for compliance with federal statutes, regulations, and the terms and conditions of its federal awards applicable to its federal programs.

Auditor's Responsibility

Our responsibility is to express an opinion on compliance for each of the Medical Center's major federal programs based on our audit of the types of compliance requirements referred to above. We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and the audit requirements of Title 2 *U.S. Code of Federal Regulations* Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance). Those standards and the Uniform Guidance require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements

referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the Medical Center's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances.

We believe that our audit provides a reasonable basis for our opinion on compliance for each major federal program. Our audit does not provide a legal determination on the Medical Center's compliance.

Opinion on Each Major Federal Program

In our opinion, the Medical Center complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended June 30, 2018.

REPORT ON INTERNAL CONTROL OVER COMPLIANCE

Management of the Medical Center is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered the Medical Center's internal control over compliance with the types of requirements that could have a direct and material effect on each major federal program in order to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for each major federal program and to test and report on internal control over compliance in accordance with the Uniform Guidance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the Medical Center's internal control over compliance.

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

Our consideration of internal control over compliance 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. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Purpose of this Report

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of the Uniform Guidance. Accordingly, this report 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

March 22, 2019

INDEPENDENT AUDITOR'S REPORT ON FINANCIAL STATEMENTS

Valley Medical Center
July 1, 2016 through June 30, 2018

Board of Commissioners and Board of Trustees
Valley Medical Center
Renton, Washington

REPORT ON THE FINANCIAL STATEMENTS

We have audited the accompanying financial statements of the business-type activities and the aggregate discretely presented component unit of Valley Medical Center, a component unit of the University of Washington, as of and for the years ended June 30, 2018 and 2017, and the related notes to the financial statements, which collectively comprise the Medical Center's basic financial statements as listed on page 14.

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 Medical Center'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 Medical Center'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 respective financial position of the business-type activities and the aggregate discretely presented component unit of Valley Medical Center, as of June 30, 2018 and 2017, and the respective changes in financial position and, where applicable, 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 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.

Supplementary and Other Information

Our audits were conducted for the purpose of forming opinions on the financial statements that collectively comprise the Medical Center's basic financial statements. The accompanying Schedule of Expenditures of Federal Awards is presented for purposes of additional analysis as required by Title 2 *U.S. Code of Federal Regulations* (CFR) Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance). This schedule is not a required part of the basic financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements. The information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

OTHER REPORTING REQUIRED BY GOVERNMENT AUDITING STANDARDS

In accordance with *Government Auditing Standards*, we have also issued our report dated March 22, 2019 on our consideration of the Medical Center'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 Medical Center's internal control over financial reporting and compliance.

Pat McCarthy

State Auditor

Olympia, WA

March 22, 2019

FINANCIAL SECTION

Valley Medical Center
July 1, 2016 through June 30, 2018

REQUIRED SUPPLEMENTARY INFORMATION

BASIC FINANCIAL STATEMENTS

SUPPLEMENTARY AND OTHER INFORMATION

PUBLIC HOSPITAL DISTRICT NO. 1 OF KING COUNTY, WASHINGTON, DBA VALLEY MEDICAL CENTER
(A Component Unit of the University of Washington)

Management's Discussion and Analysis

June 30, 2018 and 2017

The following discussion and analysis provides an overview of the financial position and activities of Public Hospital District No. 1 of King County, Washington, dba Valley Medical Center (VMC), for the years ended June 30, 2018, 2017 and 2016. This discussion has been prepared by management and is designed to focus on current activities, resulting changes, and current known facts and should be read in conjunction with the financial statements and accompanying notes that follow this section.

VMC is a discretely presented component unit of the University of Washington and part of UW Medicine which includes: UW Medical Center, Harborview Medical Center (Harborview), Northwest Hospital & Medical Center (Northwest Hospital), UW Physicians Network dba UW Neighborhood Clinics (UWNC), UW Physicians (UWP), the UW School of Medicine (the School) and Airlift Northwest (Airlift).

Using the Financial Statements

This annual report consists of two parts – management's discussion and analysis and the basic financial statements. VMC's basic financial statements consist of three statements: statements of net position; statements of revenues, expenses, and changes in net position; and statements of cash flows. These financial statements and related notes provide information about the activities of VMC, including resources held by VMC but restricted for specific purposes by contributors, grantors, or enabling legislation.

The statements of net position includes all of VMC's assets and liabilities, using the accrual basis of accounting, as well as an indication about which assets can be used for general purposes and which are designated for a specific purpose. The statements of net position also include deferred inflows and outflows of resources as well as information to help compute the rate of return on investments, evaluate the capital structure of VMC, and assess the liquidity and financial flexibility of VMC.

The statements of revenues, expenses, and changes in net position report all of the revenues and expenses during the time period indicated. Net position, the difference between the sum of assets and the sum of liabilities and deferred inflows and outflows – is one way to measure the financial health of VMC and whether the organization has been able to recover all its costs through net patient service revenues and other revenue sources.

The statements of cash flows report the cash provided by VMC's operating activities, as well as other cash sources and uses, such as investment income and cash payments for capital additions and improvements. These statements provide meaningful information on how VMC's cash was generated and what it was used for.

As defined by generally accepted accounting principles (GAAP), VMC presents financial statements for its primary government as well as for its discretely presented component unit, Imaging Partners at Valley (IPV), which is a legally separate organization for which VMC is financially accountable. The analysis presented below excludes the financial position and results of operations of IPV, unless otherwise noted.

Results of Operations for Fiscal Year 2018

VMC recorded $11.8 million in net operating income for fiscal year 2018; this is a change of $39.6 million from the net operating loss of $27.8 million in 2017. In 2018, VMC's net position increased by $40.2 million to $257.6 million from $217.4 million. The net operating income in 2018 primarily resulted from cost savings from the implementation of voluntary early retirement and early separation programs in June 2017; cost control initiatives across the board; and growth in both inpatient and outpatient volumes, including ambulatory outpatient hospital visits, and primary, and specialty care visits.

	2018	2017	2016
		(In thousands)	
Total operating revenues	$ 643,835	582,978	556,819
Total operating expenses	632,006	610,809	551,065
Operating income (loss)	11,829	(27,831)	5,754
Property tax revenue	22,722	21,490	19,902
Interest income	4,277	4,417	4,290
Interest and amortization expense	(14,253)	(17,696)	(17,698)
Investment income (loss)	(1,809)	(2,868)	377
Other, net	17,414	290	(1,134)
Nonoperating income	28,351	5,633	5,737
Change in net position	40,180	(22,198)	11,491
Net position, beginning of year	217,400	239,598	228,107
Net position, end of year	$ 257,580	217,400	239,598

- Inpatient days increased 1% from 2017 to 2018 and 3% from 2016 to 2017.
- VMC experienced significant growth in outpatient volumes, particularly in the primary and specialty care clinics with the expansion of the multi-specialty clinics in October 2017.
- VMC experienced significant growth in the contract pharmacies program. Revenue increased 90% over prior year by $6.8 million to $14.4 million.
- VMC management implemented significant cost saving initiatives in the second half of the fiscal year 2017 and continued into fiscal year 2018, focusing on labor productivity, detailed revenue cycle process improvement initiatives, continued standardization of high dollar medical supplies and equipment, and reductions in purchased services.
- VMC continued to invest in information technology.
- VMC recognized $16.5 million gain in fiscal year 2018 from the sale of a joint venture lab.

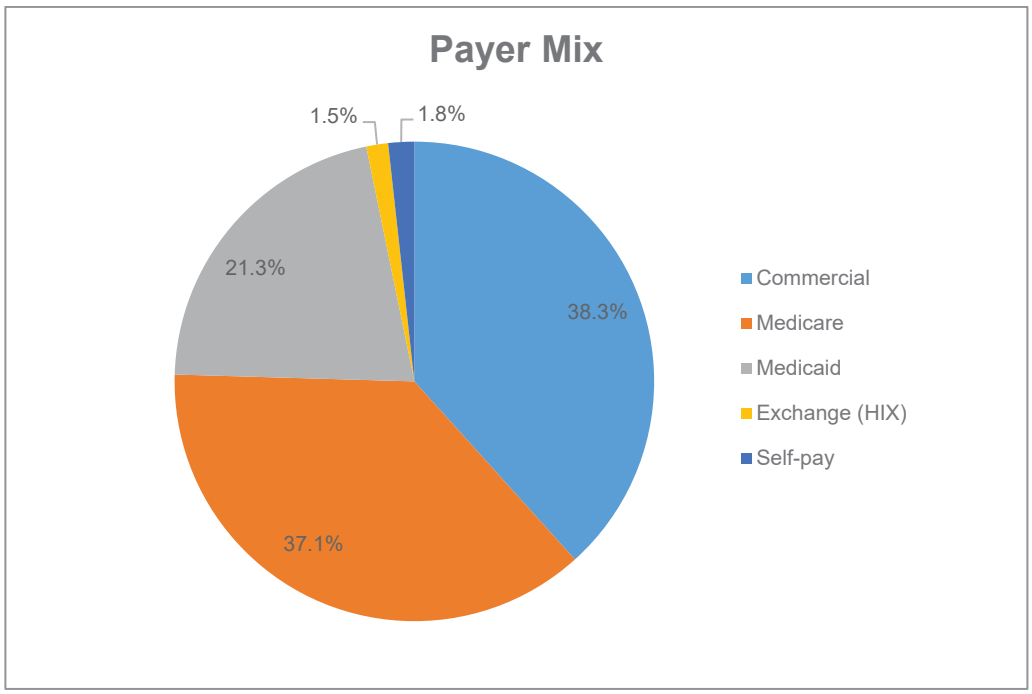
The chart below represents the key performance statistics for the last three years.

	2018	2017	2016
Available beds	311	295	283
Discharges	18,409	18,153	17,518
Patient days	73,102	72,541	70,148
Average length of stay	3.97	4.00	4.00
Occupancy	64 %	67 %	68 %
Case mix index (CMI)	1.54	1.55	1.48
Surgery cases	12,767	12,617	12,665
Emergency room visits	85,098	83,871	83,067
Primary care clinic visits	216,522	193,596	185,154
Specialty/urgent care clinic visits	408,280	333,904	314,660
Full time equivalents (FTEs)	3,134	3,051	2,813
Births	3,536	3,742	3,809

Total Operating Revenues

Total operating revenues consist primarily of net patient service revenue and other operating revenues. Net patient service revenues are recorded based on standard billing rates less contractual adjustments, financial assistance, and an allowance for uncollectible accounts. VMC has agreements with federal and state agencies, and commercial insurers that provide for payments at amounts different from gross charges. The differences between gross charges and contracted payments are identified as contractual adjustments. VMC, as well as its component unit, provide care at no charge or reduced charges to patients who qualify under VMC's financial assistance policy. VMC also estimates the amount of patient responsibility accounts receivable that will become uncollectible which is reported as a reduction of operating revenues. The difference between gross charges and the estimated net realizable amounts from payers and patients is recorded as a contractual allowance or bad debt adjustment to charges. The resulting net patient service revenue is shown in the statements of revenues, expenses, and changes in net position.

Net patient service revenue comprises inpatient and outpatient revenue. Outpatient revenue consists of both hospital-based and clinic network revenue. Other operating revenue comprises hospital-related revenues such as the pharmacies and the cafeteria, as well as meaningful use incentives.



VMC's payer mix is a key factor in the overall financial operating results. The chart above illustrates gross payer mix for 2018. For the years ended June 30, 2018, 2017, and 2016, Medicaid revenue represented 21%, 23%, and 24%, respectively. This high percentage in Medicaid revenue in 2017 and 2016 was a direct result of the expansion of the Medicaid program in Washington State as part of the Affordable Care Act. There was a decrease in Medicaid revenue in 2018 that shifted to Medicare and self-pay. For the years ended June 30, 2018, 2017, and 2016, Medicare revenue represented 37%, 36%, and 34%, respectively. The shift in payer mix was from Medicaid to Medicare and primarily due to the aging population within the district, as well as likely migration into the district.

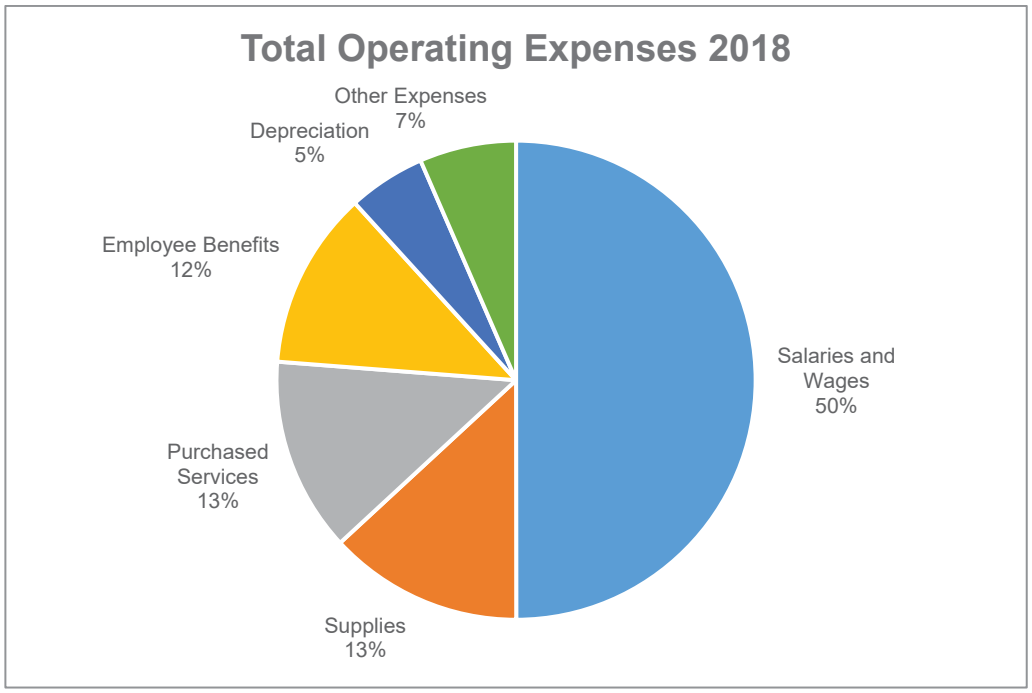
Reimbursement from governmental payers is generally below commercial rates and reimbursement rules are complex and subject to both interpretation and settlements. With the expansion of Medicaid, VMC will have higher government revenues which are subject to settlements in future years.

For the years ended June 30, 2018, 2017, and 2016, VMC's total operating revenues were $643.8 million, $583.0 million, and $556.8 million composed of $598.6 million, $544.7 million, and $519.8 million in net patient service revenues and $45.2 million, $38.3 million, and $37.0 million in other operating revenue, respectively.

In 2018 and 2017, the increase in operating revenue is due to growth in inpatient volumes, growth in outpatient volumes across the clinic network (primary and specialty, and urgent care), and continued increases in outpatient surgical procedures. The increase in other operating revenue is attributed to increases in the radiology imaging service line, and in outpatient and contract pharmaceutical volumes.

Total Operating Expenses

Total operating expenses were $632.0 million for the year ended June 30, 2018 compared to $610.8 million for the year ended June 30, 2017. The composition of fiscal year 2018 operating expenses is illustrated in the pie chart below.



Salaries and wages increased $21.4 million from $294.5 million in fiscal year 2017 to $315.9 million in fiscal year 2018. The increase was primarily related to contractually agreed upon wage increases; continued addition of providers in the clinic network's services in primary, urgent and specialty care – specifically the multi-specialty expansion project in October 2017 that opened six specialty clinics, and growth in certain hospital inpatient and outpatient departments.

Salaries and wages increased $34.4 million from $260.1 million in fiscal year 2016 to $294.5 million in fiscal year 2017. The increase was primarily related to contractually agreed upon wage increases; continued addition of providers in the clinic network's services in primary, urgent and specialty care, growth in certain hospital inpatient and outpatient departments, and the voluntary one-time early retirement and early separation programs.

Employee benefits decreased $3.8 million from $79.7 million in fiscal year 2017 to $75.9 million in fiscal year 2018 and increased $12.8 million from $66.9 million in fiscal year 2016 to $79.7 million in fiscal year 2017. Employee benefit costs are a function of employment. In fiscal year 2018, benefits decreased by 5%, while salaries and wages increased by 7%. The lower benefit cost in fiscal year 2018 was a result of the voluntary one-time early retirement and early separation programs implemented in June 2017 when $4.1 million COBRA benefits were expensed in fiscal year 2017 and much lower medical & pharmaceutical claims in fiscal year 2018 after the retirees left VMC's self-insured program. The increase in fiscal year 2017 was the result of the early retirement and early separation programs and the higher medical claims.

Purchased services expense, which consists of professional and consulting fees, decreased $9.9 million from $92.8 million in fiscal year 2017 to $82.9 million in fiscal year 2018 and increased $8.1 million from $84.7 million in fiscal year 2016 to $92.8 million in fiscal year 2017. The decrease between fiscal year 2017 and 2018 is attributed to lower physician fees as VMC continues to employ more specialty physicians – specifically VMC opened six specialty clinics in October 2017, and cost savings initiatives implemented in fiscal year 2018. The increase between fiscal year 2016 and 2017 is attributed to additional physician fees and contracted services agreements from growth in volumes.

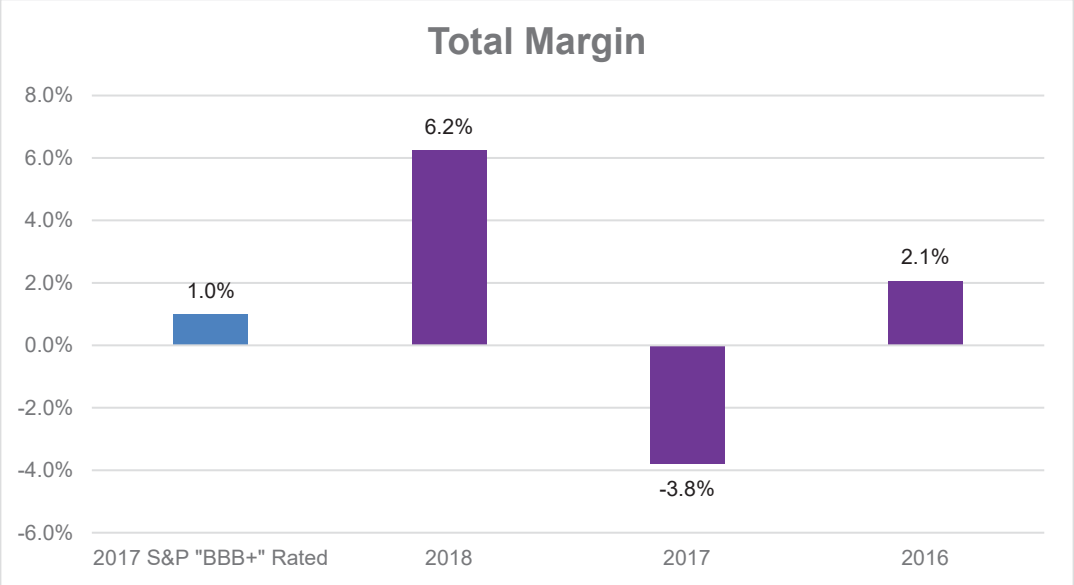
Supplies and other expense include medical and surgical supplies, pharmaceutical supplies, insurance, taxes, and other expenses. In total, these expenses increased $11.9 million from $112.4 million in fiscal year 2017 to $124.3 million in fiscal year 2018. The increase is primarily due to increased volume in both inpatient and outpatient areas, particularly in ambulatory outpatient surgery volumes, and price increases with pharmaceutical supplies. Supplies and other expense increased $2.1 million from $110.3 million in fiscal year 2016 to $112.4 million in fiscal year 2017. The slight increase is primarily as a result of price inflation with medical and pharmaceutical supplies.

Depreciation expense increased $1.6 million from $31.4 million in fiscal year 2017 to $33.0 million in fiscal year 2018 and increased $2.3 million from $29.0 million in fiscal year 2016 to $31.4 million in fiscal year 2017. The increases in both years were due to the capitalization of various projects into fixed assets.

Nonoperating revenue consists of revenue from property taxes, interest and investment income offset by interest and amortization expense and other activities not directly related to patient care. Net nonoperating revenue increased $22.7 million between fiscal years 2018 and 2017, primarily due to the increase in revenue from taxation, an decrease in interest expenses and investment losses, and a $16.5 million gain recognized from the sale of a joint venture lab in 2018. Net nonoperating revenue increased $0.1 million between fiscal years 2017 and 2016, primarily due to the increase in revenue from taxation, an increase in interest income and investment losses in 2017.

Total Margin

Total margin or excess margin is a ratio that defines the percentage of total revenue that has been realized in the form of change in net position and is a common measure of total hospital profitability. Total margin for the fiscal years 2018, 2017 and 2016 compared to the industry median for Standard & Poor's (S&P's) BBB+ rated stand-alone hospitals is illustrated in the bar chart below.



Financial Health

Statements of Net Position

The table below is a presentation of certain condensed financial information derived from VMC's statements of net position as of June 30, 2018, 2017 and 2016.

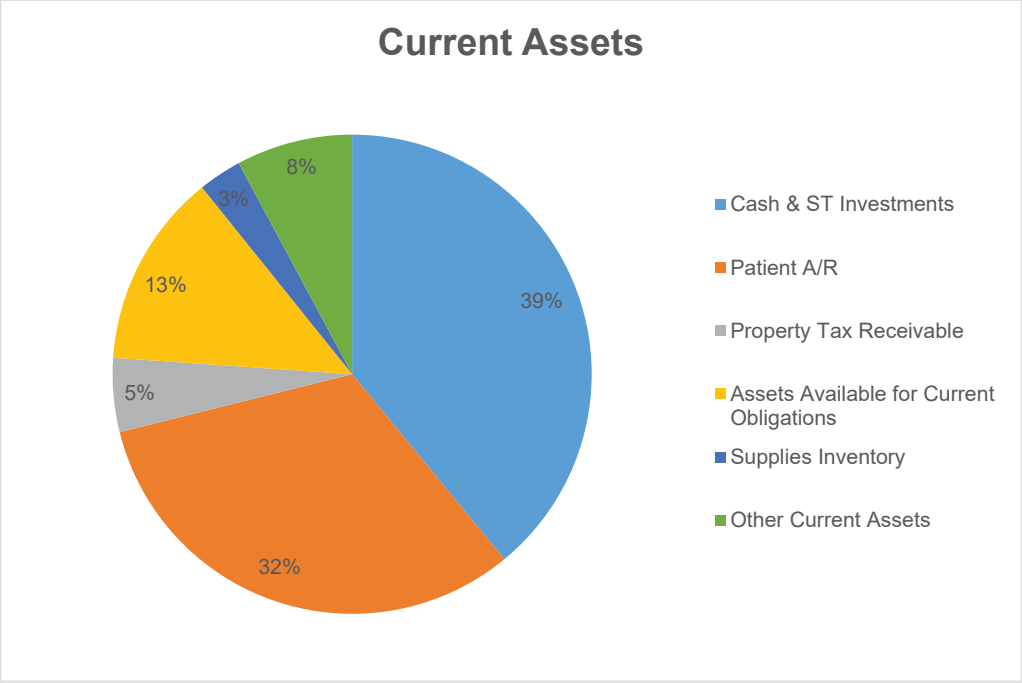
	2018	2017	2016
		(In thousands)	
Current assets	$ 226,526	219,753	187,957
Noncurrent assets:			
Capital assets, net	379,540	362,569	348,083
Other noncurrent assets	78,603	93,658	117,904
Long-term investments	1,378	2,053	12,596
Goodwill, intangible assets and other	2,796	3,163	3,531
Total assets	688,843	681,196	670,071
Deferred outflow of resources	12,491	13,242	—
Total assets and deferred outflows	701,334	694,438	670,071
Current liabilities	119,460	124,067	100,842
Noncurrent liabilities	299,263	310,254	302,887
Total liabilities	418,723	434,321	403,729
Total deferred inflows of resources	25,031	42,717	26,744
Net position	$ 257,580	217,400	239,598

Total assets were $688.8 million at June 30, 2018 compared to $681.2 million at June 30, 2017, an increase of $7.6 million, and $670.1 million at June 30, 2016, an increase of $11.1 million between 2016 and 2017. The majority of the change between 2017 and 2018 is attributed to an increase in capital assets.

Current Assets

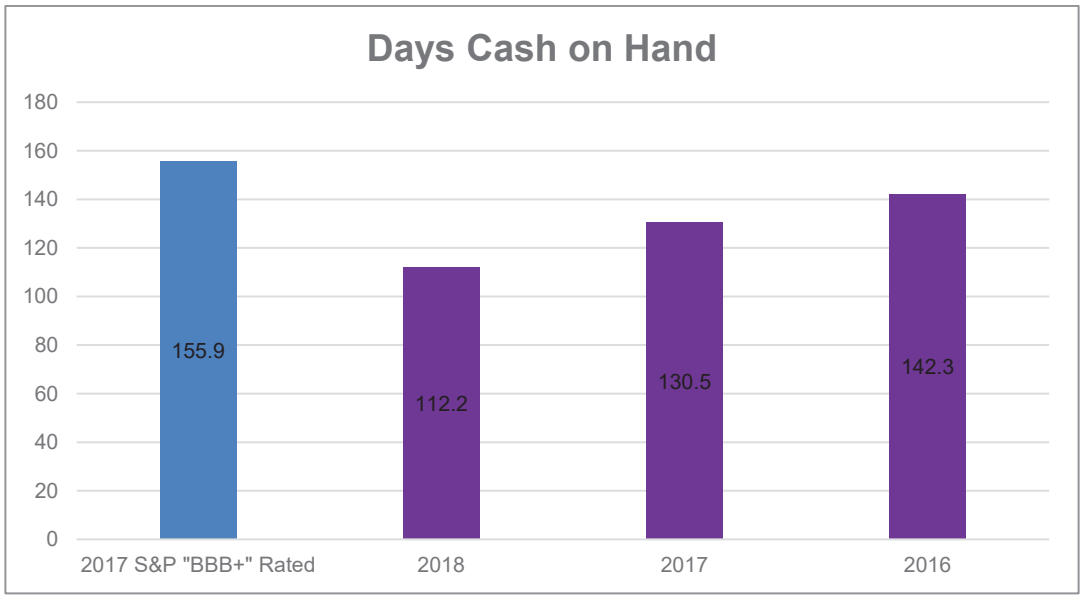
Current assets consist of cash and cash equivalents, and other current assets that are expected to be converted to cash within a year. Current assets also include net patient accounts receivable valued at the estimated net realizable amount due from patients and insurers. Total current assets were $226.5 million at

fiscal year-end 2018, compared to $219.8 million at year-end 2017. Fiscal year 2018 composition of current assets is illustrated in the pie chart below.



Cash and short-term investments held by VMC consist of cash, cash equivalents and investments expected to mature in 12 months or less. Cash and short-term investments decreased $7.2 million in 2018 from $95.6 million at June 30, 2017 to $88.4 million at June 30, 2018. The decrease in 2018 was attributed to capital costs of building a garage funded by operations. Cash and short-term investments increased $35.1 million in 2017 from $60.4 million at June 30, 2016 to $95.6 million at June 30, 2017. The increase in 2017 was attributed to keeping tax collections invested in short term investment options and $16.5 million received as a deposit for the expected sale of VMC's interest in Paclab. Days cash on hand is utilized to evaluate an organization's continuing ability to meet its short-term operating needs. Days cash on hand, including short and long-term

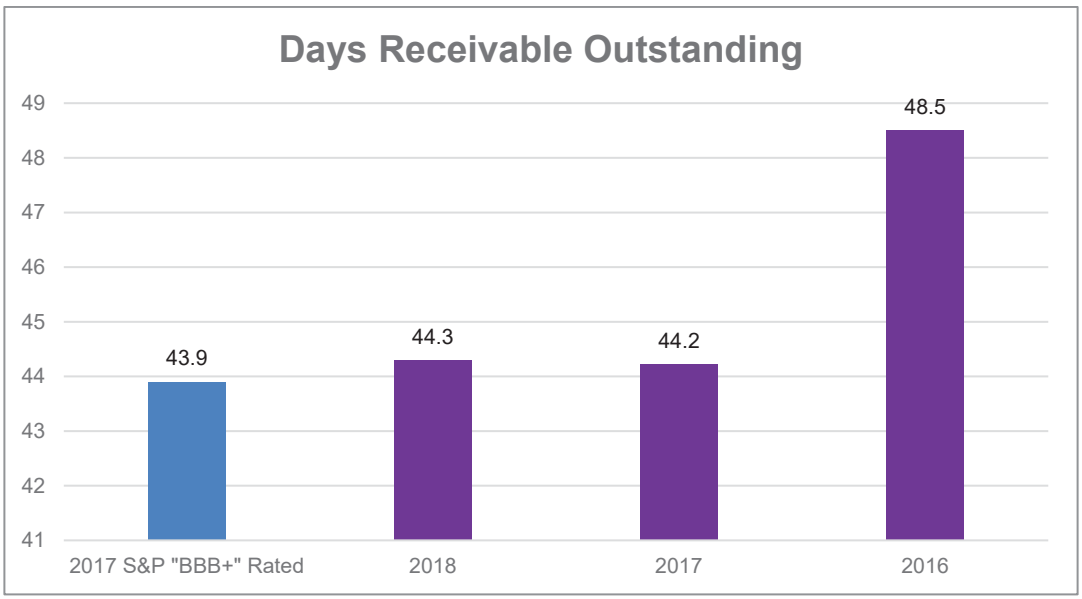
investments and noncurrent assets unrestricted for general capital improvements and operations, as of June 30 for fiscal years 2018, 2017 and 2016 are illustrated in the graph below.



VMC's total days cash on hand, including short and long-term investments and board designated assets for general capital improvements and operations, decreased 18.3 days from 130.5 days at June 30, 2017 to 112.2 days at June 30, 2018 and decreased 11.8 days from 142.3 days at June 30, 2016 to 130.5 days at June 30, 2017. The decrease between 2017 and 2018 was primarily due to capital spending. The decrease between 2016 and 2017 was primarily due to more capital spending and weaker financial performance.

Net patient accounts receivable was $72.7 million as of June 30, 2018, compared to $66.0 million at June 30, 2017. The increase of $6.7 million was driven by growth in revenue and industry trends regarding payer strategy for cost containment and contract management. Net patient accounts receivable at June 30, 2017 and 2016 were $66.0 million and $68.9 million, respectively. The decrease of $2.9 million was primarily due to process improvement initiatives within revenue cycles processes.

Days receivable outstanding illustrates an organization's ability to convert patient service revenue to cash. Days receivable outstanding as of June 30 for fiscal years 2018, 2017 and 2016 are illustrated in the graph below.



VMC's total net days receivable outstanding increased 0.1 days from 44.2 days at June 30, 2017 to 44.3 days at June 30, 2018, and decreased 4.3 days from 48.5 days at June 30, 2016 to 44.2 days at June 30, 2017. Net A/R days were essentially even between 2017 and 2018, representing continued strong revenue cycle management. The decrease from 2016 to 2017 was primarily due to a focus on revenue cycle management.

As of June 30, 2018 and 2017, 40% of the patient accounts receivable balance is due from commercial payers, 54% is due from governmental payers Medicare and Medicaid, 5% from self-pay patients, and 1% is due from health exchange insured patients. As of June 30, 2016, 41% of patient accounts receivable balance is due from commercial payers, 53% is due from governmental payers Medicare and Medicaid, 4% from self-pay patients and 2% from health exchange insured patients.

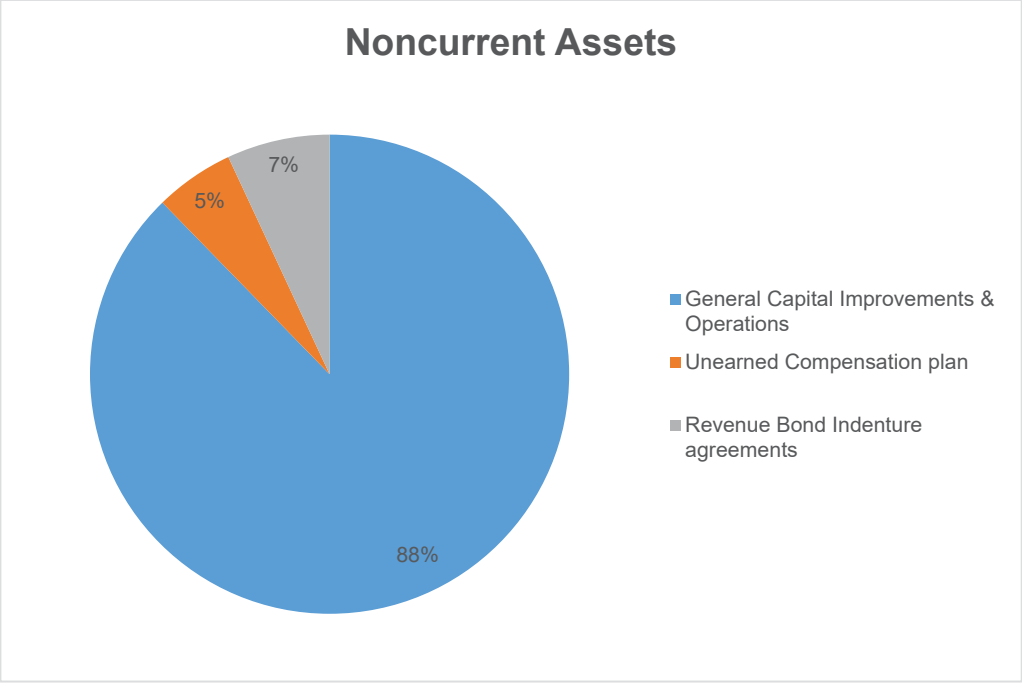
Property tax receivable increased $0.3 million from $11.0 million at June 30, 2017 to $11.3 million at June 30, 2018 and is primarily reflective of increased property values. In 2017, property tax receivable increased $0.8 million for the same reasons.

Noncurrent assets available for current obligations represents board designated and externally restricted funds expected to be used within one year for debt and interest obligations. Assets available for current obligations increased from $29.2 million at June 30, 2017 to $29.7 million at June 30, 2018. The $0.5 million increase in 2018 was due to current portion of bond payments. The $0.2 million increase in 2017 is due to higher construction-in-progress liabilities.

Noncurrent Assets

Long-term investments represent unrestricted and undesignated investments with greater than one year to maturity. Long-term investments decreased $0.7 million from $2.1 million at June 30, 2017 to $1.4 million at June 30, 2018 and decreased $10.5 million from $12.6 million at June 30, 2016 to $2.1 million at June 30, 2017. The changes between years are primarily classification shifts between short and long-term investments based on investment maturities.

Noncurrent assets consist of board-designated assets held by VMC for general capital improvements and other operations, unearned compensation plan arrangements, and various revenue obligation bond agreements.



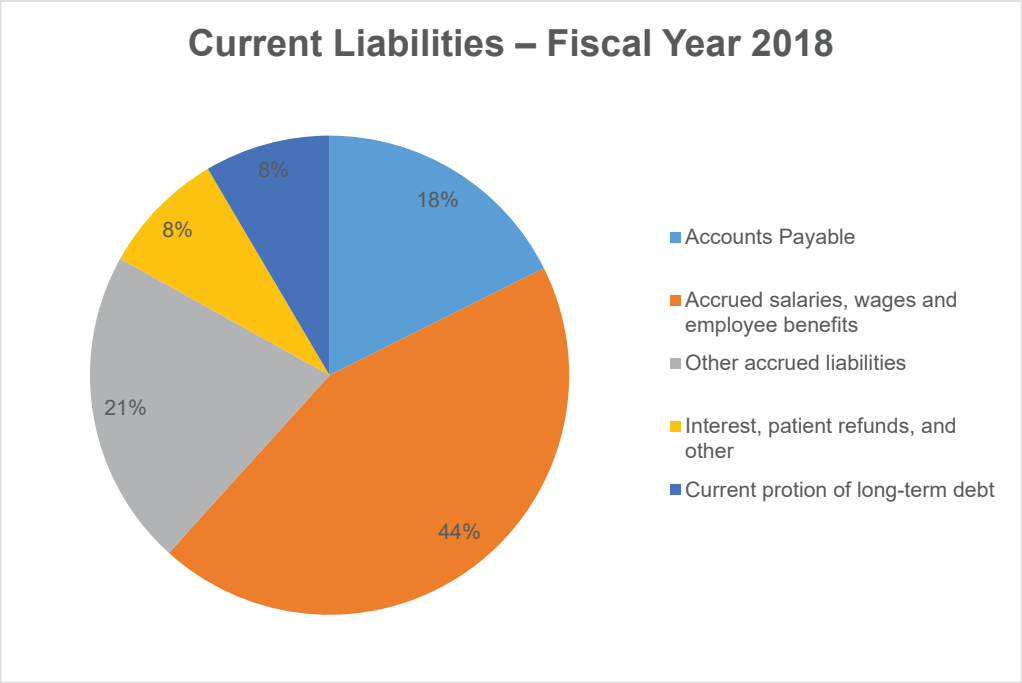
Total other noncurrent assets decreased from $93.7 million at June 30, 2017 to $78.6 million at June 30, 2018. The decrease in 2018 is related to capital spending. Total other noncurrent assets decreased $24.2 million between fiscal years 2017 and 2016 from $117.9 million to $93.7 million. The decrease in 2017 was related to using unrestricted investments to fund general capital improvements and operations.

Capital assets increased $17.0 million during fiscal year 2018 from $362.6 million at June 30, 2017 to $379.5 million at June 30, 2018, and increased $14.5 million during fiscal year 2017 from $348.1 million at June 30, 2016 to $362.6 million at June 30, 2017. The increase in 2018 was the primarily due to the

construction of the garage. The increase in 2017 was primarily due to the expansion of the clinic network and improvements done in the second floor of the hospital.

Current Liabilities

Current liabilities consist of accounts payable and other accrued liabilities that are expected to be paid within one year. Total current liabilities were $119.5 million at June 30, 2018, compared to $124.1 million at June 30, 2017. Fiscal year 2018 composition of current liabilities is illustrated in the pie chart below.



Accounts payable decreased $0.2 million between June 30, 2017 and June 30, 2018 from $20.0 million to $19.8 million and increased $2.0 million between June 30, 2016 and June 30, 2017 from $18.1 million to $20.0 million. Changes in accounts payable are primarily driven by timing of payments to vendors, as well as overall volume growth. Included in accounts payable as of June 30, 2018 and 2017 were amounts accrued for capital related expenditures of $4.5 million and $5.0 million, respectively.

Accrued salaries, wages and employee benefits decreased $6.5 million from $59.1 million at June 30, 2017 to $52.6 million at June 30, 2018 and increased $15.9 million from $43.2 million at June 30, 2016 to $59.1 million at June 30, 2017. Changes in accrued salaries, wages and employee benefits are also related to timing of payments to employees, as well as the overall growth in FTEs due to volume growth and expansion. The primary factor that caused the 2017 increase was a $12.6 million accrual for the voluntary early retirement and early separation programs. There were no such programs in 2018.

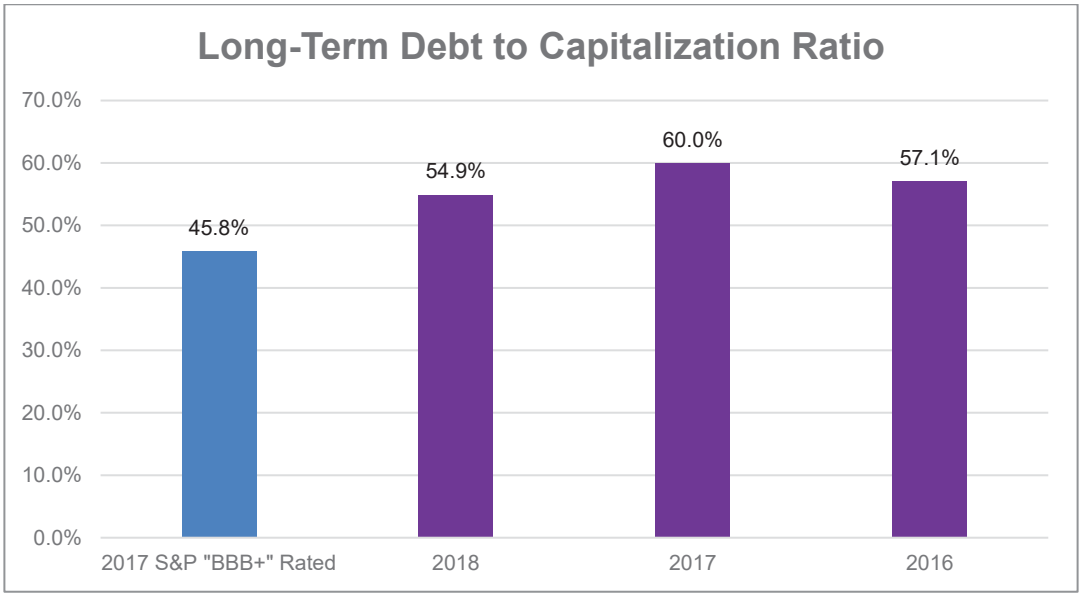
Other accrued liabilities, including estimated third-party payer settlements increased $0.7 million from $24.8 million at June 30, 2017 to $25.5 million at June 30, 2018 and increased $2.4 million from $22.4 million at June 30, 2016 to $24.8 million at June 30, 2017. The increases in both years were primarily due to estimated final Certified Public Expenditure cost settlements for fiscal years 2010-2018, as well as a payable to the University of Washington.

Noncurrent Liabilities

Noncurrent liabilities consist of long-term debt and other noncurrent liabilities. Total noncurrent liabilities were $299.3 million at June 30, 2018, compared to $310.3 million at June 30, 2017.

Long-term debt decreased from $305.0 million at June 30, 2017 to $293.5 million at June 30, 2018 and increased from $299.4 million at June 30, 2016 to $305.0 million at June 30, 2017. The decrease in 2018 was a result of payments made in accordance with debt repayment schedules. The increase in 2017 was due to a bond issuance made to refinance older bonds. Management is not aware of any violations with its debt covenants for the years ended June 30, 2018 and 2017.

Long-term debt to capitalization is a ratio used to evaluate the capital structure of healthcare organizations. The graph below shows the long-term debt to capitalization ratio as of June 30 for 2018, 2017 and 2016 and comparison to the stand-alone hospital for S&P BBB+ rated hospitals has been included in the bar chart below.



VMC's long-term debt to capitalization ratio is higher than the stand-alone hospital median due to debt issues to fund several significant construction and information technology initiatives, including the sixth and seventh floor Emergency Services Tower expansion, the Covington Ambulatory Clinic, and the implementation of an electronic medical record system.

Net Position

Invested in capital assets net of related debts increased by $25.7 million from $61.3 million at June 30, 2017 to $87.0 million at June 30, 2018 and increased by $21.2 million from $40.1 million at June 30, 2016 to $61.3 million at June 30, 2017. The increase in 2018 was due to capital additions and repayment of related debt. The increase in 2017 was due to capital additions.

Unrestricted increased by $14.3 million from $148.1 million at June 30, 2017 to $162.4 million at June 30, 2018 and decreased by $43.4 million from $191.5 million at June 30, 2016 to $148.1 million at June 30, 2017. The increase in 2018 was due to the increases in both net position in the statement of revenues, expenses, changes in net position and net investment in capital. The decrease in 2017 was due to the decrease in net position in the statement of revenues, expenses, changes in net position and the increase in net investment in capital.

Deferred Outflows and Inflows of Resources

Deferred outflows of resources decreased by $0.7 million from $13.2 million at June 30, 2017 to $12.5 million at June 30, 2018. The decrease was due to amortization of the deferred amount from the debt refinancing in fiscal year 2017.

Deferred inflows of resources decreased $17.7 million from $42.7 million at June 30, 2017 to $25.0 million at June 30, 2018. The decrease between June 30, 2017 and June 30, 2018 was due to the $16.5 million deposit received in May 2017 related to the expected sale of the joint venture lab that was recognized as gain in 2018 when the transaction closed. Deferred inflows of resources increased $16.0 million from $26.7 million at June 30, 2016 to $42.7 million at June 30, 2017. The increase between June 30, 2016 and June 30, 2017 was due to a $16.5 million deposit received in May 2017 related to the expected sale of the joint venture lab.

Factors Affecting the Future

UW Medicine Accountable Care Network

In 2014, UW Medicine formed an Accountable Care Network (ACN) with other selected healthcare organizations and healthcare professionals in Western Washington to form a care delivery network to assume responsibility for the healthcare of contracted populations of patients to achieve the Triple Aim: improved healthcare experience for the individual, improved health of the population, and more affordable care.

- The ACN has contracted with the Washington Health Care Authority (HCA) to participate in its new Puget Sound Accountable Care Program (ACP) as a healthcare benefit option for Public Employees Benefits Board (PEBB) members. The ACP is offered to all PEBB members who reside in Snohomish, King, Kitsap, Pierce, and Thurston Counties, with possible expansion into a number of additional counties planned in 2018. This contract with HCA to cover PEBB members began January 1, 2016.
- A subset of the network members have also agreed to participate with the ACN in a contract with Premera as part of its new Accountable Health System (AHS) product. As an AHS, the UW Medicine ACN will share in accountability for the quality and cost of healthcare for Premera members who select this plan. This product was sold both on and off the Washington Health Exchange in select counties with coverage that

began January 1, 2016 and must have 5,000 planwide members per product, per region to share in financial savings and risk.

- The UW Medicine ACN also entered into an agreement to provide health care services to nonunion employees of a large local employer with coverage that began January 1, 2015.

These arrangements provide an opportunity for shared savings between the ACN and the contracted entity based on achieving quality and financial benchmarks. If certain financial benchmarks are not attained, UW Medicine, along with its network members, are at risk for reductions in payment levels from the contracted entity based on the agreement.

UW Medicine/MultiCare Alliance

In July 2017, UW Medicine and MultiCare Health System (MultiCare) announced that they have formed a new alliance that will expand access to high-quality healthcare and allow the two organizations to engage in joint activities to further the mission of each organization. Through the alliance, UW Medicine and MultiCare will provide cost-effective and clinically integrated healthcare in communities throughout the Puget Sound region while supporting the education of the next generation of clinicians and advancing research. The parties joint activities will be guided by four core principles: the provision of high-quality, patient-centered care; a commitment to teaching and research; ensuring strong financial stewardship to deliver value to the payers of healthcare services; and a focus on improving the health of populations served by the alliance.

Regulatory, Legislative, and Accounting Changes

The following regulatory and legislative activity will impact all entities in UW Medicine during fiscal year 2018 and beyond:

- **Medicare Sequestration** – On April 1, 2013, a provision of the Budget Control Act of 2011 requiring mandatory across-the-board reductions in Federal spending commenced (commonly referred to as sequestration). The provision included a 2% reduction to Medicare payments made to healthcare providers, including payments made under the meaningful use incentive program. The payment reduction is effective until 2023.
- **Medicaid Expansion** – On January 1, 2014, the Washington state Medicaid program was expanded to significantly increase the number of Medicaid enrollees receiving benefits. Due to the increased access to Medicaid coverage, VMC has experienced a reduction in uninsured and underinsured patients and an increase in patients who qualify for Medicaid. The reduction of uninsured and underinsured patients is expected to have an impact on Medicare and Medicaid Disproportionate Share (DSH) reimbursement methodologies in the future. VMC has experienced a change to their payer mix, which is anticipated to continue.
- **Pay for Performance** – The Affordable Care Act mandated programs that affect reimbursement through evaluation of the quality of care and cost of care provided to patients at the federal level, however, there are an increasing number of programs arising from state and private interests. These programs provide incentives (and/or penalties) for reporting performance data and those that provide incentives (and/or penalties) based on benchmarking performance data against other providers regionally and nationally. The

pay for performance programs will continue into the future and UW Medicine is examining performance to attain incentive dollars.

- **Economic Uncertainty Facing the Healthcare Industry** – The healthcare industry, in general, and the acute care hospital business, in particular, are experiencing significant regulatory uncertainty based, in large part, on legislative efforts to significantly modify or repeal and potentially replace the Patient Protection and Affordable Care Act, as amended by the Health Care and Education Reconciliation Act of 2010 (Affordable Care Act or ACA). It is difficult to predict the full impact of these actions on our future revenues and operations. However, we believe that our ultimate success in increasing our profitability depends in part on our success in executing our strategies. In general, these strategies are intended to improve our financial performance through the reduction of costs and the streamlining of how we provide clinical care, as well as mitigate the recent negative reimbursement trends being experienced within our market with a continued focus on patient volumes that are shifting from inpatient to outpatient settings due to technological advancements and demand for care that is more convenient, affordable and accessible, and the industry is migrating to value-based payment models with government and private payers shifting risk to providers.

Contacting VMC's Financial Management

This financial report is intended to provide our taxpayers, patients, and creditors with a general overview of VMC's finances and operations and to demonstrate VMC's accountability for those finances and the tax funding it receives. You may access VMC's annual and monthly financial information via our website, valleymed.org. VMC also files quarterly financial and statistical reports, as well as other required disclosures with the Municipal Securities Rulemaking Board's Electronic Municipal Market Access at emma.msrb.org.

If you have questions about this report or need additional financial information, please contact VMC's Finance Department via phone at 425.228.3450 or at Attn: Chief Financial Officer, PO Box 50010, Renton, Washington 98058.

PUBLIC HOSPITAL DISTRICT NO. 1 OF KING COUNTY,
WASHINGTON, DBA VALLEY MEDICAL CENTER
(A Component Unit of the University of Washington)

Statements of Net Position

June 30, 2018 and 2017

Assets	VMC 2018	VMC 2017	Component unit – IPV 2018	Component unit – IPV 2017
Current assets:				
Cash and cash equivalents	$ 46,997,037	73,647,468	1,189,381	1,178,983
Short-term investments	41,430,627	21,919,763	—	—
Accounts receivable, less allowance for uncollectible accounts of $18,514,319 in 2018 and $16,225,082 in 2017	72,651,206	65,997,321	—	—
Property tax receivable	11,298,408	10,950,936	—	—
Due from:				
Primary government	—	—	1,275,927	1,076,366
Component unit	909,458	685,359	—	—
Noncurrent assets, required for current obligations	29,744,687	29,188,098	—	—
Supplies inventory	6,626,816	5,457,376	—	—
Prepaid expenses and other assets	16,867,992	11,906,673	73,921	61,168
Total current assets	226,526,231	219,752,994	2,539,229	2,316,517
Long-term investments	1,378,162	2,052,571	—	—
Other noncurrent assets:				
Unrestricted for general capital improvements and operations	95,029,508	110,187,226	—	—
Restricted under unearned compensation plan arrangements	5,793,939	5,233,273	—	—
Restricted under revenue bond indenture agreements	7,524,065	7,425,645	—	—
	108,347,512	122,846,144	—	—
Less amounts required for current obligations	(29,744,687)	(29,188,098)	—	—
Total other noncurrent assets	78,602,825	93,658,046	—	—
Capital assets:				
Land	13,413,733	13,413,733	—	—
Construction in progress	44,591,910	29,776,963	—	—
Depreciable capital assets, net of accumulated depreciation	321,534,060	319,378,730	905,628	1,040,684
Total capital assets	379,539,703	362,569,426	905,628	1,040,684
Goodwill, intangible assets and other	2,795,535	3,163,252	—	—
Total assets	688,842,456	681,196,289	3,444,857	3,357,201
Deferred outflow of resources	12,491,284	13,242,056	—	—
Total assets and deferred outflows	$ 701,333,740	694,438,345	3,444,857	3,357,201

PUBLIC HOSPITAL DISTRICT NO. 1 OF KING COUNTY,
WASHINGTON, DBA VALLEY MEDICAL CENTER
(A Component Unit of the University of Washington)

Statements of Net Position

June 30, 2018 and 2017

Liabilities and Net Position	VMC 2018	VMC 2017	Component unit – IPV 2018	Component unit – IPV 2017
Current liabilities:				
Accounts payable	$ 19,816,107	20,016,539	241,973	187,777
Accrued salaries, wages and benefits	52,634,976	59,093,014	—	—
Due to:				
Primary government	—	—	909,458	685,359
Component unit	1,275,927	1,076,366	—	—
Other accrued liabilities, including estimated third-party payor settlements	25,533,650	24,789,495	—	—
Interest, patient refunds and other	10,069,964	10,281,182	—	—
Current portion of long-term debt and capital lease obligations	10,129,509	8,810,000	78,075	244,258
Total current liabilities	119,460,133	124,066,596	1,229,506	1,117,394
Unearned compensation plan	5,793,939	5,233,273	—	—
Long-term debt and capital lease obligations, net of current portion	293,468,348	305,021,605	—	78,076
Total liabilities	418,722,420	434,321,474	1,229,506	1,195,470
Deferred inflows of resources	25,031,251	42,717,299	—	—
Net position:				
Invested in capital assets net of related debt	86,989,664	61,299,666	827,553	718,350
Restricted:				
For debt service	7,524,065	7,425,645	—	—
Expendable for specific operating activities	715,562	615,447	—	—
Unrestricted	162,350,778	148,058,814	1,387,798	1,443,381
Total net position	257,580,069	217,399,572	2,215,351	2,161,731
Total liabilities, deferred inflows, and net position	$ 701,333,740	694,438,345	3,444,857	3,357,201

See accompanying notes to basic financial statements.

PUBLIC HOSPITAL DISTRICT NO. 1 OF KING COUNTY,
WASHINGTON, DBA VALLEY MEDICAL CENTER
(A Component Unit of the University of Washington)

Statements of Revenues, Expenses, and Changes in Net Position

Years ended June 30, 2018 and 2017

	VMC		Component unit – IPV	
	2018	2017	2018	2017
Operating revenues:				
Net patient service revenue (net of VMC's provision for uncollectible accounts of $20,549,829 in 2018 and $13,108,798 in 2017)	$ 598,620,249	544,658,032	12,195	16,139
Other operating revenue	45,215,073	38,319,621	9,693,782	9,695,279
Total operating revenues	643,835,322	582,977,653	9,705,977	9,711,418
Operating expenses:				
Salaries and wages	315,905,760	294,461,660	—	—
Employee benefits	75,912,798	79,722,001	—	—
Purchased services	82,908,600	92,837,144	797,614	762,983
Supplies and other expenses	124,268,032	112,421,456	237,908	217,714
Depreciation	33,011,305	31,366,538	155,789	194,722
Total operating expenses	632,006,495	610,808,799	1,191,311	1,175,419
Operating income (loss)	11,828,827	(27,831,146)	8,514,666	8,535,999
Nonoperating income (expense):				
Property tax revenue	22,722,217	21,490,047	—	—
Interest income	4,277,316	4,416,830	—	—
Interest and amortization expense	(14,252,926)	(17,696,582)	(5,342)	(14,150)
Investment (loss), net	(1,809,288)	(2,867,644)	—	—
Funding from affiliates	3,604,560	—	—	—
Funding to affiliates	(3,276,872)	—	—	—
Gain recognized from sale of joint venture lab	16,522,486	—	—	—
Other, net	564,177	290,185	—	—
Distributions to members	—	—	(8,455,704)	(8,253,460)
Net nonoperating income (expense)	28,351,670	5,632,836	(8,461,046)	(8,267,610)
Increase (decrease) in net position	40,180,497	(22,198,310)	53,620	268,389
Net position, beginning of year	217,399,572	239,597,882	2,161,731	1,893,342
Net position, end of year	$ 257,580,069	217,399,572	2,215,351	2,161,731

See accompanying notes to basic financial statements.

PUBLIC HOSPITAL DISTRICT NO. 1 OF KING COUNTY,
WASHINGTON, DBA VALLEY MEDICAL CENTER
(A Component Unit of the University of Washington)

Statements of Cash Flows

Years ended June 30, 2018 and 2017

	VMC		Component unit – IPV	
	2018	2017	2018	2017
Cash flows from operating activities:				
Receipts from and on behalf of patients	$ 592,710,519	549,932,181	12,195	16,139
Payments to suppliers and contractors	(213,047,536)	(199,956,907)	(1,050,103)	(1,026,075)
Payments to employees	(397,715,930)	(356,566,710)	—	—
Other cash receipts	44,990,974	31,716,855	9,494,221	9,398,232
Net cash provided by operating activities	26,938,027	25,125,419	8,456,313	8,388,296
Cash flows from noncapital financing activities:				
Cash received from tax levy	22,686,525	21,550,408	—	—
Distribution to Valley Medical Center	—	—	(6,540,465)	(6,412,391)
Distribution to noncontrolling member of Imaging Partners at Valley, LLC	—	—	(1,635,116)	(1,603,100)
Other	427,803	(18,351)	—	—
Net cash provided by (used in) noncapital financing activities	23,114,328	21,532,057	(8,175,581)	(8,015,491)
Cash flows from capital and related financing activities:				
Principal payments on long-term debt and capital lease obligations	(8,810,000)	(8,500,000)	(244,259)	(280,845)
Interest paid	(14,582,090)	(15,055,406)	(5,342)	(14,150)
Purchases of capital assets	(50,847,652)	(45,092,722)	(22,213)	(115,847)
Sale of capital assets	—	—	1,480	—
Proceeds from issuance of refunding bonds	—	193,900,000	—	—
Proceeds from premium on refunding bonds	—	21,623,594	—	—
Payment to refunding bond escrow agent	—	(215,425,369)	—	—
Cash paid for bond issuance	—	(1,234,621)	—	—
Other	(593,250)	(763,228)	—	—
Net cash used in capital and related financing activities	(74,832,992)	(70,547,752)	(270,334)	(410,842)
Cash flows from investing activities:				
Sale of investments and noncurrent assets	48,324,952	101,886,788	—	—
Purchases of investments and noncurrent assets	(54,472,062)	(75,755,312)	—	—
Investment and interest income	4,277,316	4,416,830	—	—
Deposit from expected sale of joint venture lab	—	16,522,486	—	—
Other cash receipts	—	6,412,391	—	—
Net cash (used in) provided by investing activities	(1,869,794)	53,483,183	—	—
Net (decrease) increase in cash and cash equivalents	(26,650,431)	29,592,907	10,398	(38,037)
Cash and cash equivalents, beginning of year	73,647,468	44,054,561	1,178,983	1,217,020
Cash and cash equivalents, end of year	$ 46,997,037	73,647,468	1,189,381	1,178,983

PUBLIC HOSPITAL DISTRICT NO. 1 OF KING COUNTY,
WASHINGTON, DBA VALLEY MEDICAL CENTER
(A Component Unit of the University of Washington)

Statements of Cash Flows

Years ended June 30, 2018 and 2017

	VMC		Component unit – IPV	
	2018	2017	2018	2017
Reconciliation of operating income (loss) to net cash provided by operating activities:				
Operating income (loss)	$ 11,828,827	(27,831,146)	8,514,666	8,535,999
Adjustments to reconcile operating income to net cash provided by operating activities:				
Depreciation	33,011,305	31,366,538	155,789	194,722
Provision for uncollectible accounts	20,549,829	13,108,798	—	—
Other income	—	(6,602,766)	—	—
Changes in assets and liabilities:				
Accounts receivable	(27,203,714)	(10,209,776)	—	—
Due from:				
Primary government	—	—	(199,561)	(297,047)
Component unit	(224,099)	—	—	—
Supplies inventory	(1,169,440)	(255,770)	—	—
Prepaid expenses and other assets	(4,961,319)	1,956,030	(12,753)	(29,445)
Accounts payable	247,607	838,610	(1,828)	(15,933)
Accrued salaries, wages, and benefits	(6,458,038)	15,912,578	—	—
Due to:				
Component unit	199,561	297,047	—	—
Other accrued liabilities and estimated third-party payor settlements	744,155	2,375,127	—	—
Other liabilities	(187,313)	2,465,776	—	—
Unearned compensation	560,666	1,704,373	—	—
Net cash provided by operating activities	$ 26,938,027	25,125,419	8,456,313	8,388,296
Supplemental disclosure of noncash investing, capital, and financing activities:				
(Decrease) increase in capital assets included in accounts payable	$ (448,038)	1,119,655	—	—

See accompanying notes to basic financial statements.

(1) Organization

Public Hospital District No. 1 of King County, Washington (the District), is a Washington municipal corporation established under Chapter 70.44 Revised Code of the State of Washington (RCW). The District includes the majority of the cities of Kent, Renton, and Covington, and portions of Bellevue, Newcastle, Maple Valley, Black Diamond, Auburn, SeaTac, Tukwila, and Federal Way. The District is considered a political subdivision of the State of Washington and is allowed, by law, to be its own treasurer.

The District, dba Valley Medical Center (VMC), and the University of Washington (the University) participate in a Strategic Alliance Agreement. Under this agreement, VMC is a discretely presented component unit of the University, subject to the oversight of a Board of Trustees.

The Board of Trustees oversees the healthcare operations of the District, while a publicly elected Board of Commissioners oversees the District's tax levies and certain nonhealthcare-related functions.

The Board of Commissioners comprises five individuals, each elected by district residents to serve a six year term. The District itself is divided into three subdistricts, each represented by one commissioner. The remaining two commissioners serve as at-large members of the Board of Commissioners. Terms of the subdistrict commissioners are staggered.

The Board of Trustees is designed to include all of the then-current Public Hospital District Commissioners, as well as five trustees who reside within the District Service Area, at least three of whom also reside within the boundaries of the District. In addition, two current or former trustees of the UW Medicine board or a Board of another component unit within UW Medicine and the CEO of UW Medicine and dean of the School of Medicine, University of Washington or his designee also serve on the Board of Trustees. The Board of Trustees members, which included the five elected Board of Commissioners, during fiscal year 2018 were:

Donna Russell, Chair
Gary Kohlwes, Vice Chair
Bernie Dochnahl
Lawton Montgomery (President of Board of Commissioners)
Julia Patterson
Lisa Brandenburg
Mike Miller
Barbara Drennen (Commissioner)
Peter Evans
Jim Griggs (Commissioner)
Erin Aboudara (Commissioner)
Vicki Orrico
Tamara Sleeter, M.D. (Commissioner)

VMC is under the direction of the Executive Director, who is accountable to the District Board of Trustees and UW Medicine's Executive Vice-President for Medical Affairs and Dean of the University of Washington School of Medicine for the management of VMC.

The District, dba VMC, is comprised of a 321 licensed bed hospital and a network of primary care, specialty care and behavioral health clinics. The district health system mission statement states that it "is committed to providing access to safe, quality healthcare for the public. The District healthcare system is integrated with UW Medicine and collaborates to ensure comprehensive, high quality, safe, compassionate, and cost-effective healthcare is provided."

VMC is part of UW Medicine which includes UW Medical Center, Harborview Medical Center (Harborview), Northwest Hospital & Medical Center (Northwest Hospital), UW Physicians Network dba UW Neighborhood Clinics (the Clinics), UW Physicians (UWP), the UW School of Medicine (the School) and Airlift Northwest (Airlift).

VMC reported an increase in net position of $40.2 million for fiscal year 2018. This amount includes the $16.5 million gain recognized from a sale of a joint venture lab. The increase is also the result of strong financial performance from operations. Significant cost containment initiatives to address to continued payer shift from commercial to Medicare were deployed in 2017 and continued in 2018. VMC expected to see the return on this initiative within 12-24 months and the results were demonstrated in fiscal year 2018.

Financial Reporting Entity

As defined by generally accepted accounting principles (GAAP), the financial reporting entity consists of VMC as the primary government, and its component unit, which is a legally separate organization for which the primary government is financially accountable. Financial accountability is defined as an appointment of the voting majority of the component unit's board, and either (a) the ability to impose will by the primary government, or (b) the possibility that the component unit will provide a financial benefit to or impose a financial burden on the primary government, or (c) the component unit is financially dependent on the primary government.

Component units are reported as part of the reporting entity under the blended or discrete method of presentation. The discrete method presents the financial statements of the component unit outside of the basis of the financial statement totals of the primary government. The following is a description of the discrete component unit of VMC.

The Imaging Partners at Valley (IPV) is a limited liability company formed under the laws of Washington State. IPV has two members: the District and Mustang Technology Group, LLC. IPV provides inpatient and outpatient magnetic resonance, positron emission tomography, and computed tomography imaging services to patients. IPV is considered a component unit of the District because IPV's operating budget is subject to the overall approval of the District, even though the District does not have a voting majority on IPV's governing board.

The primary government and the discretely presented component unit report their financial information in a form that complies with the "Healthcare Organizations Audit and Accounting Guide" of the American Institute of Certified Public Accountants. The accounting systems of the primary government and the discretely presented component unit have been adapted to also provide the financial information necessary to meet the governmental reporting requirements of the District.

Additionally, VMC is a discretely presented component unit of the University under the Strategic Alliance Agreement between the University of Washington and the District, whereby VMC is managed as a component unit of the UW Medicine, subject to the oversight of the Board of Trustees.

(2) Summary of Significant Accounting Policies

(a) Accounting Standards

The accompanying basic financial statements are prepared in accordance with accounting principles generally accepted in the United States of America for state and local governments as prescribed by the Governmental Accounting Standards Board (GASB) pronouncements and interpretations. VMC uses proprietary fund accounting.

VMC prepares and presents its financial information in accordance with GASB Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments* (GASB 34), known as the "Reporting Model" statement. GASB 34 requires that financial statements be accompanied by a narrative introduction and analytical overview of the reporting entity in the form of "management's discussion and analysis" (MD&A). This reporting model also requires the use of a direct method cash flow statement.

(b) Basis of Accounting

VMC and IPV's financial statements have been prepared using the accrual basis of accounting with the economic resources measurement focus. Under this method of accounting, revenues are recognized when earned and expenses are recorded when liabilities are incurred without regard to receipt or disbursement of cash.

(c) Use of Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles, requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Significant estimates in VMC's financial statements include patient accounts receivable allowances and third-party payer settlements.

(d) General Accounts

VMC is required to maintain its financial records on an accounting basis that segregates assets, liabilities, revenues, and expenses in conformity with The State of Washington municipal corporation laws prescribed by the State Auditor under the authority of Chapter 43.09 RCW and the Department of Health in *Accounting and Reporting Manual for Hospitals*, as well as the Board of Commissioners' or

Board of Trustees' resolutions. Certain accounts maintained separately on the books of VMC have been combined for financial statements presentation.

(i) Operating Account

The operating account is used to track current operating assets, liabilities, revenues, and expenses.

(ii) Plant and Construction Accounts

These account for land, buildings, and equipment; and the proceeds of the 2004, 2008, 2011, and 2016 limited tax general obligation bonds. The District transfers sufficient taxation revenues to the bond redemption fund to make principal payments on the Series 2004, 2008, and 2011 bonds. Interest payments are also made from the bond redemption fund.

(iii) Bond Account

Principal and interest payments on the Series 2004, 2008, 2011, and 2016 bonds are made from this account.

(iv) Revenue Bond Account

This account was established pursuant to Bond Resolution 943 and is used to pay the Series 2010A and 2010B principal and interest payments.

(v) 2010 Refundable Credits Account

Created pursuant to Bond Resolution 943, this account receives all refundable credits (the subsidy), if any, from the U.S. Department of the Treasury in respect to the Series 2010B Build America Bonds (BABs). The District has irrevocably pledged the 2010 Refundable Credits to the payment of principal and interest on the Series 2010B Bonds only, and such funds will not be used for any other purpose until all of the Series 2010 Bonds have been paid in full.

(vi) Restricted Accounts

These accounts are maintained to account for restricted donations, gifts, and bequests received from outside sources for specific purposes.

(e) Cash and Cash Equivalents

Cash and cash equivalents include investments in highly liquid debt instruments with an original maturity of three months or less at the date of purchase, excluding amounts whose use is limited by board designation or by other arrangements under trust agreements.

Custodial credit risk for deposits is the risk that in the event of a financial institution failure, the deposits may not be returned to the depositor. The Federal Deposit Insurance Corporation (FDIC) provides insurance to depositors to guard against custodial credit risk. Under FDIC insurance coverage is provided for account balances up to $250,000 per depositor, per insured bank. As of June 30, 2018 and 2017, VMC had no bank balances subject to custodial credit risk as any deposits in excess of

$250,000 were covered by collateral held in a multi financial institution collateral pool administered by the Washington Public Deposit Protection Commission.

(f) Investments

VMC holds investments, as allowed by State law, in the form of bankers' acceptances, repurchase agreements, obligations secured by the U.S. Treasury, other obligations of the United States or its agencies, and certificates of deposit with financial institutions in accordance with state guidelines. Investments are for the funding of future capital improvements, self-insurance liabilities, and operational cash. In addition, certain funds are restricted by bond indentures to be used solely for debt service. Long-term investments represent unrestricted and undesignated investments with greater than one year to maturity.

VMC accounts for its marketable investments in accordance with GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*, which requires that most investments be reported at fair value. Fair value is determined based on quoted market prices. Investment income, including interest income and realized and unrealized gains or losses, is reported as nonoperating revenue or expense.

(g) Inventories

Inventories consist primarily of surgical, medical, and pharmaceutical supplies in organized stores at various locations across VMC. Inventories are recorded at the lower of cost (first-in, first-out (FIFO) or market. Obsolete and uninsurable items are written off.

(h) Capital Assets

Capital assets, defined as purchases with a per item cost of $5,000 or greater and a useful life of at least three years, are stated at cost at acquisition or if acquired by gift, at fair market value at the date of the gift. Additions, replacements, major repairs, and renovations are capitalized. Maintenance and repairs are expensed. The cost of the capital assets sold or retired and the related accumulated depreciation are removed from the accounts, and any resulting gain or loss is recorded.

The provision for depreciation is determined by the straight-line method, which allocates the cost of tangible property ratably over its estimated useful life. VMC's depreciation and useful life policies utilize several methodologies in assigning depreciable lives to assets. Construction projects under $5 million and equipment and information technology systems' useful lives are typically established by using American Hospital Association guidelines. Projects in excess of $5 million are assigned useful lives using a composite weighted life provided by external consultants or by facility life analyses performed

by external consultants, and reviewed by VMC management. The estimated useful lives used by VMC are as follows:

Land improvements	10 to 20 years
Buildings, renovations and furnishings	5 to 72 years
Fixed equipment	5 to 25 years
Movable equipment	3 to 20 years
Leasehold improvements	The shorter of the lease term or useful life of asset

Qualifying interest is capitalized on construction projects as a cost of the related project beginning with commencement of construction and ceases when the construction period ends and the related asset is placed in service. Interest capitalized during 2018 and 2017 was $1,232,834 and $453,933, respectively.

(i) Goodwill, Intangible Assets, and Other

Intangible assets include items related to the purchase of physician practices. Physician noncompetition agreements are amortized over the terms of the agreements. Goodwill, which represents the excess of the cost of an acquired physician practice over the net amounts assigned to acquired assets and assumed liabilities, is currently amortized over the estimated life of the asset. Goodwill is also reviewed annually for impairment.

VMC has a membership interest, considered an other asset, in First Choice Health Network, a group purchasing cooperative. It is recorded under the equity method.

(j) Compensated Absences

VMC employees earn annual leave at rates based on the employee's level of employment, applicable labor agreements, and length of service and sick leave based on hours worked during a biweekly pay period. Annual leave balances, which are limited to two times the annual accrual rate, can be converted to monetary compensation upon employment termination. Sick leave balances, which are unlimited, may be converted to monetary compensation upon employment termination at a percentage of the employees' normal compensation rate based on continuous years of service depending upon the employee's level of employment and the applicable labor agreement. VMC recognizes annual and sick leave liabilities when earned.

Annual leave accrued at June 30, 2018 and 2017 was $16.1 million and $15.7 million, respectively. Sick leave accrued as of June 30, 2018 and 2017 was $4.8 million and $5.1 million, respectively. The accrued annual and sick leave liabilities are included in accrued salaries, wages and benefits in the accompanying primary government statements of net position.

(k) Third Party Payor Settlements, Net

VMC is reimbursed for Medicare inpatient, outpatient, and rehabilitation services, and for capital and medical education costs during the year either prospectively or at an interim rate. The difference between the interim payments and the reimbursement computed based on the Medicare filed cost report results in an estimated receivable from or payable to Medicare at the end of each year.

The Medicare program's administrative procedures preclude final determination of amounts receivable from or payable to VMC until after the cost reports have been audited or, otherwise reviewed and settled by Medicare. The estimated amounts for unsettled Medicare cost reports are included in other accrued liabilities, including estimated third-party payor settlements in the accompanying primary government statements of net position.

(l) Classification of Revenues and Expenses

VMC's statement of revenues, expenses, and changes in net position distinguishes between operating and nonoperating revenues and expenses. Operating revenues, such as patient service revenue, result from exchange transactions associated with providing healthcare services – VMC's primary business. Exchange transactions are those in which each party to the transaction receives and gives up essentially equal values.

Operating expenses are all expenses, other than financing costs, incurred by the primary government and component unit to provide healthcare services to patients.

Nonoperating revenues and expenses are recorded for certain exchange and nonexchange transactions. These activities include tax levy income and debt service related to bonds and other peripheral or incidental transactions.

(m) Net Patient Service Revenue

VMC has agreements with third-party payers that provide for payments to VMC at amounts different from its established rates. Payment arrangements include prospectively determined rates per discharge, reimbursed costs, discounted charges, and per diem payments. Net patient service revenues are reported at the estimated net realizable amounts from patients, third-party payers, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payers.

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. A summary of the payment arrangements with major third-party payers is as follows:

(i) Medicare

Acute inpatient services rendered to Medicare program beneficiaries are paid at prospectively determined rates per discharge based on Medicare severity diagnosis-related groupings (MS-DRGs), as well as reimbursements related to capital costs. These rates vary according to a patient classification system that is based on clinical, diagnostic, and other factors. Payments for

Medicare outpatient services are provided based upon a prospective payment system known as ambulatory payment classifications (APCs). APC payments are prospectively established and may be greater than or less than the primary government's actual charges for its services. The Medicare program utilizes the prospective payment system known as case mix group (CMGs) for rehabilitation services reimbursement. As with MS-DRGs, CMG payments are prospectively established and may be greater than or less than VMC's actual charges for its services. Third-party settlements are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined.

(ii) Medicaid

Inpatient services rendered to Medicaid program beneficiaries are provided at prospectively determined rates per discharge. Outpatient services rendered are provided based upon the APC prospective payment system.

(iii) Commercial

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

(iv) UW Medicine Accountable Care Network

UW Medicine has formed an accountable care network (ACN) with other health care organizations and healthcare professionals to share financial and clinical responsibility for the healthcare of particular populations of patients. VMC is a network member of the UW Medicine ACN and as such shares in any risk contract surplus or deficits based on agreed upon contractual terms. Since its inception, the ACN has entered into various contracts which include provisions for shared risk as well as shared savings based on achieving certain quality and financial benchmarks. VMC and the other network members share in the financial risk or savings. At June 30, 2018 and 2017, VMC recorded liabilities of $4,299,172 and $5,533,621, respectively for its portion of the estimated liability related to these risk-sharing arrangements. These amounts are reflected in other accrued liabilities, including estimated third-party payor settlements in the accompanying statements of net position.

(n) Financial Assistance

VMC provides care without charge or at amounts less than established rates to patients who meet certain criteria under its financial assistance policy. VMC maintains records to identify and monitor the level of financial assistance it provides. These records include charges foregone for services and supplies furnished under its financial assistance policy to the uninsured and the underinsured. Because VMC does not pursue collection of amounts determined to qualify as financial assistance, they are not reported as net patient service revenue. The charges associated with financial assistance provided by VMC were approximately $25,050,647 and $21,407,021 respectively, for the years ended June 30, 2018 and 2017.

VMC estimates the cost of financial assistance using its cost to charge ratio of 26.0% and 25.8% for the fiscal years ended June 30, 2018 and 2017, respectively. Applying VMC's cost to charge ratio of 26.0% to total financial assistance of $25,050,647 results in a cost of financial assistance of approximately $6,513,168 for the fiscal year ended June 30, 2018. Applying VMC's cost to charge ratio of 25.8% to total financial assistance of $21,407,021 results in a cost of financial assistance of approximately $5,523,011 for the fiscal year ended June 30, 2017.

(o) Federal Income Taxes

The District, as a political subdivision of the state of Washington, is not subject to federal income taxes under Section 115 of the Internal Revenue Code unless unrelated business income is generated during the year. Since 1983, the District has been deemed a 501(c)(3) entity by the Internal Revenue Service (IRS).

VMC's discretely presented component unit is a limited liability company and, therefore, is not a tax-paying entity for federal income tax purposes. Accordingly, no current or deferred income tax expense has been recorded in the component unit's financial statements. Income of the component unit is taxed to the members on their individual tax returns, if applicable. The discretely presented component unit had no uncertain tax positions at June 30, 2018 and 2017.

(p) Deferred Outflows and Inflows of Resources

Deferred outflows of resources consist of the excess of the reacquisition price over the carrying amount of bonds refinanced in fiscal year 2017. This balance is amortized to interest expense through 2038. The balance was $12,491,284 and $13,242,056 at June 30, 2018 and June 30, 2017, respectively.

Deferred inflows of resources consist of property tax revenue, deferred gain from the sale of Valley Professional Center North (VPCN) and at June 30, 2017, a deposit related to the expected sale of a lab joint venture. VMC recognized the gain from the sale of the joint venture lab in fiscal year 2018 when the transaction closed. The following are the components of deferred inflows of resources for the as of June 30, 2018 and 2017:

	VMC	
	2018	**2017**
Property tax revenue	$ 11,539,970	11,228,190
Deferred gain on sale of VPCN	13,491,281	14,966,623
Deposit from sale of lab joint venture	—	16,522,486
Total deferred inflows of resources	$ 25,031,251	42,717,299

(q) Net Position

Net position of the VMC is classified in various components. Net investment in capital assets consist of capital assets net of accumulated depreciation and reduced by outstanding borrowings used to finance the purchase or construction of those assets. Restricted for debt service consists of assets restricted,

by each revenue bonds' official statement, for expenditures of principal and interest. Restricted for expendable for specific operating activities are noncapital net assets that must be used for a particular purpose, as specified by donors external to VMC. Unrestricted net position is remaining net position that does not meet the definition of net investment in capital assets or restricted.

(r) Reclassifications

Certain reclassifications, which have no impact on net position or changes in net position, have been made to prior year amounts to conform to the current year presentation.

(s) Recently Adopted and Upcoming Accounting Pronouncements

In November 2016, the GASB issued Statement No. 83, *Certain Asset Retirement Obligations*, which will be effective for the fiscal year ending June 30, 2019. An asset retirement obligation (ARO) is a legally enforceable liability associated with the retirement of a tangible capital asset. Governments that have legal obligations to perform future tangible asset retirement activities will need to recognize a liability and offsetting deferred outflow of resources when incurred and reasonably estimable. The basis of the estimate is the current value of the future outlays expected to be incurred and adjusted annually for inflation and any changes of relevant factors. The deferral is to be recognized as an expense in a systematic and rational manner over the life of the tangible capital asset. The liability is derecognized as retirement costs are paid. The standard requires disclosure of information about the nature of government's AROs, the methods and assumptions used for the estimates of the liabilities, and the estimated remaining useful life of the associated tangible capital assets. VMC is currently analyzing the impact of this statement.

In June 2017, the GASB issued Statement No. 87, *Leases*, which will be effective for the fiscal year beginning July 1, 2020. This Statement establishes a single model for lease accounting based on the foundational principle that leases are financings of the right to use an underlying asset. Lessees will be required to recognize a lease liability and an intangible right-to-use lease asset, and lessors will be required to recognize a lease receivable and a deferred inflow of resources. Contracts that convey the right to use a nonfinancial asset in an exchange or exchange-like transaction for a term exceeding 12 months are defined by the GASB as a lease. VMC is currently analyzing the impact of this statement.

(3) Net Patient Service Revenue

Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payers, and others for services rendered, including estimated retroactive adjustments and estimated risk share settlements under reimbursement agreements with third-party payers. 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. In 2018 and 2017, net patient service revenue includes approximately $402,000 and $1,570,000, respectively, relating to prior years' net Medicare and Medicaid cost report settlements and revised estimates, including disproportionate share reimbursement.

The following are the components of net patient service revenue for the primary government for the years ended June 30, 2018 and 2017:

	VMC	
	2018	**2017**
Gross patient service revenue	$ 2,021,898,198	1,831,406,708
Less adjustments to patient service revenue:		
Financial assistance	(25,050,647)	(21,407,021)
Contractual discounts	(1,377,677,473)	(1,252,232,857)
Provision for uncollectible accounts	(20,549,829)	(13,108,798)
Total adjustments to patient service revenue	(1,423,277,949)	(1,286,748,676)
Net patient service revenue	$ 598,620,249	544,658,032

VMC grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payer agreements. The mix of gross patient service charges by primary payor and accounts receivable from significant payers as of and for the years ended June 30, 2018 and 2017 were as follows:

	2018	
	VMC	
	Patient service charges	**Accounts receivable**
Medicare	37 %	32 %
Medicaid	21	22
Commercial and other	38	40
Self pay	2	5
Exchange (HIX)	2	1
Total	100 %	100 %

	2017	
	VMC	
	Patient service charges	Accounts receivable
Medicare	36 %	33 %
Medicaid	23	21
Commercial and other	38	40
Self pay	2	5
Exchange (HIX)	1	1
Total	100 %	100 %

(a) Medicaid Certified Public Expenditure Reimbursement

Public hospitals located in the State of Washington that are not certified as critical access hospitals, are reimbursed at the "full cost" of Medicaid covered services under the public hospital certified public expenditure (CPE) payment method.

"Full cost" payments are determined using the respective hospital's Medicaid ratio of cost to charges to determine the cost for covered medically necessary services. The costs will be certified as actual expenditures by the hospital and the State claim will be allowed federal match on the amount of the related certified public expenditures. Per the Centers for Medicare and Medicaid Services (CMS) approved Medicaid State Plan, participating hospitals receive only the federal match portion of the allowable costs. VMC recognized $7,277,822 and $6,174,712 of revenue under this program for the years ended June 30, 2018 and 2017, respectively.

In addition, VMC receives the federal match portion of Disproportionate Share Payments (DSH), which are the lesser of qualifying uncompensated care cost or the hospital's specific limit. VMC received $17,035,608 and $17,215,167 in DSH funding under this program for the years ended June 30, 2018 and 2017, respectively. VMC recognized $13,152,390 and $13,698,865 from DSH funding for the years ended June 30, 2018 and 2017, respectively. DSH payments are included in net patient service revenues in the statements of revenues, expenses, and changes in net position.

CPE payments are subject to retrospective determination of actual costs once VMC's Medicare Cost Report is audited by CMS. CPE program payments are not considered final until retrospective cost reconciliation is complete, after VMC receives its Medicare Notice of Program Reimbursements (NPR) for the corresponding cost reporting year. To date, beginning with the 2006 CPE year, State Fiscal Years 2006 to 2011 CPE program years have had a final settlement.

As of June 30, 2018 and 2017, for fiscal years 2010 through 2018 VMC had estimated payables of $20.0 million and $18.0 million, respectively, which are included as liabilities in other accrued liabilities, including estimated third-party payer settlements in the accompanying statements of net position.

(b) Professional Services Supplemental Payment (PSSP) Program

The professional services supplemental payment (PSSP) and provider access payment (PAP) program are programs managed by the Washington State Health Care Authority (WSHCA) benefiting certain public hospitals.

Under the programs, VMC receives supplemental Medicaid payments for the physician and other professional services for which they bill. These supplemental payments equal the difference between the standard Medicaid reimbursement and the upper payment limit allowable by federal law. VMC provides the nonfederal share of the supplemental payments that will be used to obtain the matching federal funds.

VMC paid $171,462 and $240,063 for the years ended June 30, 2018 and 2017, respectively, in supplemental payments, via Intergovernmental Transfers (IGTs) to WSHCA related to professional claims paid for the PSSP program. Those amounts are included in net patient service revenue in the statements of revenues, expenses, and changes in net position.

WSHCA used the federal match funds to make professional services payments to VMC. VMC received $403,348 and $596,893 in supplemental payments for the years ended June 30, 2018 and 2017, respectively. VMC recognized net revenue of $198,887 and $341,830 from the PSSP program for the years ended June 30, 2018 and 2017, respectively. These payments are included in net patient service revenues in the statements of revenues, expenses, and changes in net position.

VMC paid $3,558,734 and $3,250,273 for the years ended June 30, 2018 and 2017, respectively, in supplemental payment, via Intergovernmental Transfers (IGTs) to WSHCA related to professional claims paid for the PAP program. Those amounts are included in the net patient service revenue in the statements of revenues, expenses, and changes in net position.

WSHCA used the federal match funds to make professional services payments to VMC for the PAP program. VMC received $8,365,324 and $13,694,003 in supplemental payments for the years ended June 30, 2018 and 2017, respectively. VMC recognized net revenue of $7,300,000 and $7,250,000 from the PAP program for the years ended June 30, 2018 and 2017, respectively. These payments are included in net patient service revenue in the statements of revenues, expense, and changes in net position.

(c) Hospital Safety Net Program

The Hospital Safety Net Assessment Act (HSNA) uses local funds obtained through an assessment levied on Prospective Payment System (PPS) hospitals and federal matching funds to increase Medicaid payments to hospitals. Under this program, PPS program hospitals are assessed a fee on all non-Medicare patient days. Under the HSNA program, PPS hospitals receive supplemental Medicaid payments, Critical Access Hospitals receive disproportionate share payments and CPE hospitals receive state grants. CMS approved the most recent program in 2015. The program has an expiration date of June 30, 2021.

VMC is exempt from the assessment as the hospital is operated by an agency of the state government and also participates in the CPE program.

VMC received grant funding of $2.1 million and $2.2 million for the years ended June 30, 2018 and 2017 respectively, which is recorded in other operating revenue in the statements of revenues, expenses, and changes in net position.

(4) Property Tax Revenue

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

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

The District is permitted by law to levy up to $0.75 per $1,000 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. Greater amounts of tax, above the limit, need to be for a specific capital project and authorized by the vote of the people.

For the calendar year 2018, the District's tax levy rate was $0.50 per assessed $1,000 in property value pursuant to the District's authorized tax levy in December 2017 resulting in a tax levy of $23,199,721.

For the calendar year 2017, the District's tax levy rate was $0.50 per assessed $1,000 in property value pursuant to the District's authorized tax levy in November 2016 resulting in a tax levy of $22,453,903.

Property taxes are recorded as receivables when levied. Because State law allows for the sale of property for failure to pay taxes, no estimate of uncollectible taxes is made. Given property taxes are recorded on a calendar-year basis, the property tax receivable balances at June 30, 2018 and 2017 are $11,298,408 and $10,950,936, respectively, and are shown as current assets in the statements of net position.

Revenues from taxation are $22,722,217 and $21,490,047, for the fiscal 2018 and 2017 years, respectively, and are recorded as nonoperating revenue in the statements of revenues, expenses and changes in net position.

The District has pledged its future tax revenues, as well as operating revenues, to repay its limited tax general obligation and revenue bonds issued in 2004, 2008, 2010, 2011, and 2016 to finance construction, other capital improvements, medical equipment and technology, and information technology systems.

(5) Deposits and Investments

Chapter 39.59 Revised Code of Washington (RCW) authorizes VMC to make investments in accordance with Washington State law. VMC also has a formalized investment policy that VMC may, through formal interlocal agreement, invest funds not immediately required for expenditure with the King County Investment Pool (the Pool) and/or the Washington State Treasurer's Local Government Investment Pool

(the LGIP), which are classified as cash equivalents on the statement of net position, or may separately invest such funds in either actively managed individual portfolio or mutual fund accounts that meet all statutory investment requirements.

Eligible investments include obligations secured by the U.S. Treasury, other obligations of the United States or its agencies, certificates of deposit with approved institutions, eligible bankers' acceptances, eligible commercial paper and corporate notes, and repurchase and reverse repurchase agreements. Investments of debt proceeds are governed by the provisions of the debt agreements, which also must meet statutory requirements.

The related required assessed risks for each type of investment are disclosed below.

At June 30, 2018 and 2017, deposits and investments of VMC consist of the following:

	2018	2017
Unrestricted cash	$ 25,326,109	24,123,439
Unrestricted investments and cash equivalents:		
U.S. Treasury and agency securities and bonds	119,045,471	127,764,795
Commercial paper	5,464,782	—
Corporate notes	12,689,038	—
Investment pools	20,952,392	49,178,676
Municipal bonds	639,007	182,978
	158,790,690	177,126,449
Restricted assets:		
Cash and cash equivalents	1,442,763	687,920
U.S. Treasury and agency securities and bonds	6,145,618	12,140,023
Municipal bonds	654,219	1,154,842
Other assets	5,793,939	5,233,273
	14,036,539	19,216,058
	$ 198,153,338	220,465,946

Other assets are related to the cash surrender value of life insurance and an unearned compensation plan, the latter of which is self-directed by the participant of the plan which includes money market funds and other eligible investments as authorized by state law. While the investments are currently in VMC's name and available to VMC's creditors, the payment of unearned compensation to the participant will be for the

resulting value of the self-directed investments. Therefore, the risk of loss has been transferred to the participant.

(a) Credit Risk

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. VMC's investment policy provides guidelines for its fund managers and lists specific allowable investments as prescribed by state law. The policy provides the ability of portfolio managers to employ varying investment styles so diversification can be maximized within statutory requirements.

Credit risk is measured by the assignment of a rating by a nationally recognized statistical rating organization (NRSRO). VMC follows state statute, which provides that commercial paper, negotiable certificates of deposit, and banker's acceptances must be rated at least A-1 by Standard and Poor's (S&P) and P-1 by Moody's Investors Service, Inc., and fixed income holdings are limited to securities that are issued by or fully guaranteed by the U.S. Treasury, U.S. government-sponsored enterprises, or U.S. government agencies, including U.S. government agency mortgage-backed securities. Money market funds are limited to those with an average credit quality of AAA by S&P.

According to GASB Statement No. 40, *Deposit and Investment Risk Disclosures – an amendment of GASB Statements No. 3*, unless there is information to the contrary, obligations of the U.S. government or obligations explicitly guaranteed by the U.S. government are not considered to have credit risk and do not require disclosure of credit quality.

As of June 30, 2018 and 2017, VMC's investment in the Pool was not rated by a NRSRO. In compliance with state statutes, Pool policies authorize investments in U.S. Treasury securities, U.S. agency and mortgage-backed securities, municipal securities (rated at least A by two NRSROs), commercial paper (rated at least the equivalent of A-1 by two NRSROs), certificates of deposit issued by qualified public depositories, repurchase agreements, and the LGIP managed by the Washington State Treasurer's Office.

Assets and liabilities that are recorded at fair value are required to be grouped in three levels, based on the markets in which the assets and liabilities are traded and the observability of the inputs used to determine fair value. The three levels are:

Level 1 – Quoted prices (unadjusted) in active markets for identical assets or liabilities that a government can access at the measurement date

Level 2 – Inputs other than quoted prices included within Level 1 that are observable for an asset or liability, either directly or indirectly

Level 3 – Unobservable inputs for an asset or liability

The composition of investments, reported at fair value by investment type and rating at June 30, 2018 and excluding unrestricted and restricted cash balances of $26,768,872, is as follows:

Investment type	Level 1	Level 2	Ratings	Percentage of total
U.S. Treasury	$ —	68,843,625	AA+/A-1+	45.8 %
U.S. agency securities	—	42,269,976	AA+	28.1
U.S. agency mortgages	—	14,077,488	AA+	9.4
Municipal bonds	—	1,293,226	Various	0.9
Commercial paper	5,464,782	—	A-1/A-1+	3.6
Corporate notes	—	12,689,038	Various	8.4
Other assets	5,793,939	—	Not rated	3.8
Total investments by fair value level	$ 11,258,721	139,173,353		100.0 %

The composition of investments, reported at fair value by investment type and rating at June 30, 2017 and excluding unrestricted and restricted cash balances of $24,811,359, is as follows:

Investment type	Level 1	Level 2	Ratings	Percentage of total
U.S. Treasury	$ —	58,088,225	AA+/A-1+	39.7 %
U.S. agency securities	—	61,828,044	AA+/A-1+	42.2
U.S. agency mortgages	—	19,988,549	AA+	13.6
Municipal bonds	—	1,337,820	Various	0.9
Other assets	5,233,273	—	Not rated	3.6
Total investments by fair value level	$ 5,233,273	141,242,638		100.0 %

In 2018, the fair value table above was revised because the U.S. Treasury, U.S. agency securities, U.S. agency mortgages, and Municipal bonds were presented as Level 1 at June 30, 2017. The securities are Level 2 at both June 30, 2018 and 2017 as these investments have inputs other than quoted prices that are observable for an asset or liability, either directly or indirectly.

Concentration of credit risk is the risk associated with a lack of diversification, such as having substantial investments in a few individual issuers, thereby exposing the organization to greater risks resulting from adverse economic, political, regulatory, geographic, or credit developments.

VMC's investment policy follows applicable Washington state statutes in defining authorized investments and any required credit ratings.

There are no investments whose fair value exceeds 5% of total investments that are with any one issuer other than the U.S. Treasury, U.S. agency, or U.S. government-sponsored entities. Corporate notes are investments with several companies where each company note does not exceed 5% of total investments. As of June 30, 2018 and 2017, for those investments that require composition disclosure, VMC holds investments in U.S. government-sponsored entities totaling 16% and 20% of its total investments in the table above less other assets in Federal National Mortgage Association securities, 9% and 16% of its total investments in the table above less other assets in Federal Home Loan Mortgage Corporation securities, and 8% and 10%, respectively, of its total investments in the table above less other assets in Government National Mortgage Association securities.

(b) Custodial Credit Risk

Custodial credit risk is the risk that, in the event of a failure of the custodian, VMC may not be able to recover the value of the investment or collateral securities that are in possession of an outside party.

With respect to investments, custodial credit risk generally applies only to direct investments of marketable securities. Custodial credit risk typically does not apply to VMC's indirect investments in securities through the use of mutual funds or governmental investment pools (such as the Pool and LGIP).

In the individually managed portfolios (which include bond proceeds and tax revenues), VMC's securities are registered in VMC's name by the custodial bank as an agent for VMC.

(c) Interest Rate Risk

Interest rate risk is the risk that changes in interest rates of debt instruments will adversely affect the fair value of an investment. Generally, the longer the maturity of an investment is, the greater the sensitivity of its fair value to changes in market interest rates.

One of the ways VMC manages its exposure to interest rate risk is by purchasing a combination of shorter and longer-term investments and by timing cash flows from maturities so that a portion of the portfolio is maturing or coming close to maturing evenly over time as necessary to provide cash flow and liquidity needed for operations.

As a way of limiting its exposure to fair value losses arising from rising interest rates, VMC's investment policy limits its investment portfolio to maturities as follows:

Issuer/instrument	Maximum length of maturity
U.S. Treasury bonds, certificates, and bills	10 years
Other obligations of the U.S. government or its agencies	10 years
Statutorily allowed certificates of deposit	24 months
Commercial paper	270 days
Municipal bonds	10 years
Corporate notes	3 years
General obligation bonds of any state/local government	10 years

Securities purchased in the Pool must have a final maturity, or weighted average life, of no longer than five years. Although the Pool's market value is calculated on a monthly basis, unrealized gains or losses are not distributed to participants. The Pool distributes earnings monthly using an amortized cost methodology.

Information about the sensitivity of the fair values of VMC's investments (including investments held by the bond trustee) to market interest rate fluctuations is provided by the following table, which shows the distribution of VMC's investments by maturity. Investments in pooled assets such as investment pools are shown using the weighted average duration of the underlying assets.

2018		Remaining maturity (in months)			
Investment type	Fair value	12 months or less	13 to 24 months	25 to 48 months	More than 48 months
U.S. Treasury	$ 68,843,625	27,674,691	28,075,542	13,093,392	—
U.S. agency securities	42,269,976	12,907,589	14,735,580	14,626,807	—
U.S. agency mortgages	14,077,488	526,500	784,600	624,785	12,141,603
King County investment Pool	20,952,392	—	20,952,392	—	—
Municipal bonds	1,293,226	424,732	198,494	—	670,000
Commercial paper	5,464,782	5,464,782	—	—	—
Corporate notes	12,689,038	—	—	7,831,130	4,857,908
Other assets	5,793,939	—	—	—	5,793,939
	$ 171,384,466	46,998,294	64,746,608	36,176,114	23,463,450

2017		Remaining maturity (in months)				
Investment type	Fair value	12 months or less	13 to 24 months	25 to 48 months	More than 48 months
U.S. Treasury	$ 58,088,225	12,857,913	10,228,461	34,263,787	738,064
U.S. agency securities	61,828,044	15,058,967	16,286,165	21,584,581	8,898,331
U.S. agency mortgages	19,988,549	538,476	1,280,097	2,100,568	16,069,408
King County investment Pool	49,178,676	—	49,178,676	—	—
Municipal bonds	1,337,820	40,162	426,700	200,958	670,000
Other assets	5,233,273	—	—	—	5,233,273
	$ 195,654,587	28,495,518	77,400,099	58,149,894	31,609,076

(6) Capital Assets

(a) VMC's Capital Assets

The activity in VMC's capital asset and related accumulated depreciation accounts for years ended June 30, 2018 and 2017 is set forth below:

	Balance June 30, 2017	Additions	Transfers	Retirements	Balance June 30, 2018
Nondepreciable capital assets:					
Land	$ 13,413,733	—	—	—	13,413,733
Construction in progress	29,776,963	46,871,693	(32,056,746)	—	44,591,910
Total capital assets, not being depreciated	43,190,696	46,871,693	(32,056,746)	—	58,005,643
Capital assets, being depreciated:					
Land improvements	18,852,304	—	6,958	(544)	18,858,718
Buildings, renovations and furnishings	437,828,353	2,146,900	17,827,684	(442,522)	457,360,415
Fixed equipment	23,632,565	—	589,173	(1,522,522)	22,699,216
Movable equipment	180,615,160	1,163,962	12,181,150	(27,450,824)	166,509,448
Minor equipment	21,922,782	217,059	1,451,781	(2,451,931)	21,139,691
Total capital assets, being depreciated	682,851,164	3,527,921	32,056,746	(31,868,343)	686,567,488
Total capital assets at historical cost	726,041,860	50,399,614	—	(31,868,343)	744,573,131
Less accumulated depreciation for:					
Land improvements	(11,784,399)	(359,280)	—	544	(12,143,135)
Buildings, renovations and furnishings	(179,487,884)	(14,509,448)	—	442,522	(193,554,810)
Fixed equipment	(21,786,686)	(308,428)	—	1,522,522	(20,572,592)
Movable equipment	(136,595,002)	(16,059,394)	—	27,313,968	(125,340,428)
Minor equipment	(13,818,463)	(2,047,289)	—	2,443,289	(13,422,463)
Total accumulated depreciation	(363,472,434)	(33,283,839)	—	31,722,845	(365,033,428)
Total capital assets, net	$ 362,569,426	17,115,775	—	(145,498)	379,539,703

	Balance June 30, 2016	Additions	Transfers	Retirements	Balance June 30, 2017
Nondepreciable capital assets:					
Land	$ 13,413,733	—	—	—	13,413,733
Construction in progress	13,508,462	46,212,377	(29,943,876)	—	29,776,963
Total capital assets, not being depreciated	26,922,195	46,212,377	(29,943,876)	—	43,190,696
Capital assets, being depreciated:					
Land improvements	18,615,914	—	236,390	—	18,852,304
Buildings, renovations and furnishings	426,368,234	—	11,549,666	(89,547)	437,828,353
Fixed equipment	23,604,783	—	27,782	—	23,632,565
Movable equipment	188,061,096	—	15,526,828	(22,972,764)	180,615,160
Minor equipment	19,383,329	—	2,603,210	(63,757)	21,922,782
Total capital assets, being depreciated	676,033,356	—	29,943,876	(23,126,068)	682,851,164
Total capital assets at historical cost	702,955,551	46,212,377	—	(23,126,068)	726,041,860
Less accumulated depreciation for:					
Land improvements	(11,375,017)	(409,382)	—	—	(11,784,399)
Buildings, renovations and furnishings	(166,054,974)	(13,522,457)	—	89,547	(179,487,884)
Fixed equipment	(21,443,436)	(343,250)	—	—	(21,786,686)
Movable equipment	(143,914,188)	(15,583,030)	—	22,902,216	(136,595,002)
Minor equipment	(12,085,148)	(1,791,756)	—	58,441	(13,818,463)
Total accumulated depreciation	(354,872,763)	(31,649,875)	—	23,050,204	(363,472,434)
Total capital assets, net	$ 348,082,788	14,562,502	—	(75,864)	362,569,426

Included in movable equipment at June 30, 2018 and 2017 is $4,258,362 and $4,589,162, respectively, of equipment under capital lease. Accumulated amortization of the equipment under capital lease totaling $4,258,362 and $4,589,162 is included in accumulated depreciation at June 30, 2018 and 2017, respectively.

Depreciation expense was $33,283,839 and $31,649,875 for the years ended June 30, 2018 and 2017, respectively and includes $272,534 and $283,337 of nonoperating depreciation expense. This nonoperating expense is associated with medical office buildings rented or leased to physician practices and others and, therefore, are not considered within the operations of VMC. Therefore, $33,011,305 and $31,366,538 in depreciation expense is reflected in operating expenses in the statements of revenues, expenses, and changes in net position for the years ended June 30, 2018 and 2017, respectively.

(b) Discretely Presented Component Unit's Capital Assets

The activity in the component unit's capital asset and related accumulated depreciation accounts for the years ended June 30, 2018 and 2017 is set forth below:

	Balance June 30, 2017	Additions	Transfers	Retirements	Balance June 30, 2018
Buildings, renovations and furnishings	$ 270,350	—	—	(2,664)	267,686
Movable equipment	5,867,245	22,213	109,506	(38,281)	5,960,683
Total capital assets, being depreciated	6,137,595	22,213	109,506	(40,945)	6,228,369
Total capital assets, being depreciated at historical cost	6,137,595	22,213	109,506	(40,945)	6,228,369
Less accumulated depreciation for:					
Buildings, renovations and furnishings	(76,319)	(37,743)	—	1,184	(112,878)
Movable equipment	(5,020,592)	(118,046)	(109,506)	38,281	(5,209,863)
Total accumulated depreciation	(5,096,911)	(155,789)	(109,506)	39,465	(5,322,741)
Total capital assets, net	$ 1,040,684	(133,576)	—	(1,480)	905,628

	Balance June 30, 2016	Additions	Transfers	Retirements	Balance June 30, 2017
Buildings, renovations and furnishings	$ 270,350	—	—	—	270,350
Movable equipment	5,987,168	115,847	—	(235,770)	5,867,245
Total capital assets, being depreciated	6,257,518	115,847	—	(235,770)	6,137,595
Total capital assets, being depreciated historical cost	6,257,518	115,847	—	(235,770)	6,137,595

	Balance June 30, 2016	Additions	Transfers	Retirements	Balance June 30, 2017
Less accumulated depreciation for:					
Buildings, renovations and furnishings	$ (68,662)	(7,657)	—	—	(76,319)
Movable equipment	(5,069,297)	(187,065)	—	235,770	(5,020,592)
Total accumulated depreciation	(5,137,959)	(194,722)	—	235,770	(5,096,911)
Total capital assets, net	$ 1,119,559	(78,875)	—	—	1,040,684

(7) Long-Term Debt and Capital Lease Obligations

(a) Primary Government's Long-Term Debt

Long-term debt, consists of the following as of June 30:

	2018	2017
Limited tax general obligation bonds:		
2016 series, 4% to 5%, due serially on December 1, in amounts from $2,750,000 in 2020 to $16,455,000 in 2038, plus interest due semiannually, including unamortized premium of $19,232,541	$ 213,132,540	214,739,853
2011 term bond, 2.19%, due in June and December, in yearly amounts from $3,300,000 in 2018 to $2,035,517 in 2022, plus interest due semiannually, net of unamortized loss on refinance of $145,304	13,406,109	16,620,579
2008 term bond, 5%, due serially on December 1, in amounts from $2,460,000 in 2018 to $3,320,000 in 2019, plus interest due semiannually, net of unamortized discount of $54 and unamortized loss on refinancing of $9,194	3,310,753	5,740,214
2004 series, 3.75% to 4.25%, due serially on December 1, in amount of $1,260,000 in 2018, plus interest due in 2018	—	1,257,722
Revenue bonds:		
2010 series A, 3.00% to 5.125%, due serially in June, in amounts from $1,790,000 in 2018 to $2,395,000 in 2024, plus interest due semiannually, net of unamortized discount of $62,437, and unamortized loss on refinance of $64,107	12,593,455	14,318,237

	2018	2017
Build America bonds:		
2010 series B, 7.90% to 8.00%, due serially in June, in amounts from $2,520,000 in 2025 to $5,485,000 in 2040, plus interest due semiannually	$ 61,155,000	61,155,000
Total long-term debt	303,597,857	313,831,605
Less current portion	(10,129,509)	(8,810,000)
Total long-term debt, net of current portion	$ 293,468,348	305,021,605

(i) Long-Term Debt Overview

Series 2016 Bond Issue

The 2016 Limited Tax General Obligation Refunding Bond was issued for the principal amount of $193,900,000. These proceeds were used to refund the majority of the 2008 bonds. The District has pledged tax revenues to secure the bonds. The difference between the cash flows required to service the old debt and the cash flows required to service the new debt and complete the refunding was $19,917,231. The economic gain was $13,289,849. The deferred amount on the refunding is being amortized over the life of the bond and is recorded in deferred outflow of resources in the statements of net position.

Series 2011 Bond Issue

The 2011 Limited Tax General Obligation Refunding Bond was issued for $35,636,412. The District has pledged tax revenues to secure the bonds.

Series 2010 Revenue Bond Issue

The Series 2010 Bonds were issued in two subseries. $25,145,000 in federally tax-exempt revenue bonds (Series 2010A) and $61,155,000 in federally taxable revenue Build America Bonds (BABs) (Series 2010B). Both series are fixed rate. Revenues of the District are pledged for the payment of the bonds.

The Series 2010B term BAB bonds were issued to construct, renovate, remodel, and equip projects at VMC and satellite facilities, including completion of the top floors of VMC's Emergency Services Tower and the construction of a freestanding emergency department within the District's boundaries. The Series 2010B term BAB bonds of $61,155,000 were issued with interest rates ranging from 7.9% to 8.0% and mature in 2030 and 2040.

Under the BAB bonds, the District receives a direct cash subsidy payment from the United States Department of the Treasury equal to 35% of the interest payable on the Series 2010B Bonds as of each interest payment date. For the years ended June 30, 2018 and 2017, the District received $1,593,678 and $1,588,559, respectively, in subsidy payments, which are recorded in other nonoperating revenues in the statements of revenues, expenses, and changes in net position.

Series 2008 Bond Issue

The District issued $218,220,000 in limited tax general obligation and refunding bonds, Series 2008A and 2008B.

Series 2008A is insured by a rated bond insurer. Series 2008B was for $104,905,000 5.25% term bonds, beginning with $8,920,000 maturing in 2023 to $69,260,000 maturing in 2037. Series 2008B is uninsured. The District has pledged tax revenues to secure the bonds. Majority of the 2008 bonds were refunded by the 2016 bonds.

(ii) Debt Compliance

Under the terms of its financing agreements, the District has agreed to meet certain covenants. Bond covenants related to the Limited Tax General Obligation (LTGO) bonds require budgeting for making annual levies of taxes, within constitutional and statutory tax limitations provided by law upon on all property within the District subject to taxation, together with any other money legally available, to be sufficient to pay the principal and interest of the LTGO bonds.

Financing covenants associated with the District's revenue bonds require maintaining an amount within the Reserve Account equal to the Reserve Requirement for all covered revenue bonds (the 2010 series only). That amount is equal to the lesser of the maximum annual debt service with respect to the 2010 bond series, an aggregate of the sum of 10% of the initial principal amount of the 2010 bond series, or 125% of the Average Annual Debt Service on the 2010 bond series. There is also a coverage requirement specific to only the 2010 Bond Series that the amount of net income available for debt service (less depreciation) is equal to at least 125% of the maximum annual debt service, reduced by the amount of all Refundable Credits received or due to be received related to the Build America Bond subsidy, within the computation period.

Additional covenants require continued disclosure through the Municipal Securities Rulemaking Board, compliance with limits of encumbrances, indebtedness, disposition of assets, and transfer services.

(iii) Long-Term Debt Maturities

The following schedule shows debt service requirements for the next five years and thereafter, as of June 30, 2018, for both principal and interest. Total unamortized premiums, discounts and loss on refinancing are $18,951,445 as of June 30, 2018.

	Principal	Interest	Total
2019	$ 10,129,509	15,488,277	25,617,786
2020	7,615,188	15,184,237	22,799,425
2021	7,916,198	14,929,604	22,845,802
2022	5,765,517	14,656,583	20,422,100
2023	10,205,000	14,285,963	24,490,963
2024–2028	59,290,000	62,603,084	121,893,084
2029–2033	75,880,000	43,798,430	119,678,430
2034–2038	97,155,000	19,536,875	116,691,875
2039–2042	10,690,000	1,294,000	11,984,000
Total payments	$ 284,646,412	201,777,053	486,423,465

(iv) Change in Total Long-Term Liabilities

Changes in total liabilities during the fiscal years ended June 30, 2018 and 2017 are summarized below:

	Balance June 30, 2017	Increases	Decreases	Balance June 30, 2018	Due within one year
Limited tax general obligation bonds:					
2016 Series	$ 214,739,853	—	(1,607,313)	213,132,540	—
2011 Series	16,620,579	—	(3,214,470)	13,406,109	4,939,509
2008 Series	5,740,214	—	(2,429,461)	3,310,753	3,320,000
2004 Series	1,257,722	—	(1,257,722)	—	—
Revenue bond:					
2010 Series A	14,318,237	—	(1,724,782)	12,593,455	1,870,000
Build America bonds:					
2010 Series B	61,155,000	—	—	61,155,000	—
Total long-term debt	313,831,605	—	(10,233,748)	303,597,857	10,129,509
Unearned compensation	5,233,273	560,666	—	5,793,939	—
Total liabilities	$ 319,064,878	560,666	(10,233,748)	309,391,796	10,129,509

	Balance June 30, 2016	Increases	Decreases	Balance June 30, 2017	Due within one year
Limited tax general obligation bonds:					
2016 Series	$ —	215,523,593	(783,740)	214,739,853	—
2011 Series	19,239,559	—	(2,618,980)	16,620,579	3,300,000
2008 Series	209,046,544	—	(203,306,330)	5,740,214	2,460,000
2004 Series	2,458,541	—	(1,200,819)	1,257,722	1,260,000
Revenue bond:					
2010 Series A	15,959,008	—	(1,640,771)	14,318,237	1,790,000
Build America bonds:					
2010 Series B	61,155,000	—	—	61,155,000	—
Total long-term debt	307,858,652	215,523,593	(209,550,640)	313,831,605	8,810,000
Unearned compensation	3,528,900	1,738,848	(34,475)	5,233,273	—
Total liabilities	$ 311,387,552	217,262,441	(209,585,115)	319,064,878	8,810,000

(b) Discretely Presented Component Unit's Capital Lease Obligations

The capital lease obligations as of June 30, 2018 and 2017 consist of equipment leases with a present value of $78,075 and $322,334, respectively with total monthly payments of $22,691, including imputed interest of 2.37%, maturing in 2019.

The schedule of changes in capital leases is as follows:

	Balance June 30, 2017	Increases	Decreases	Balance June 30, 2018	Due within one year
Capital lease obligations	$ 322,334	—	(244,259)	78,075	78,075

	Balance June 30, 2016	Increases	Decreases	Balance June 30, 2017	Due within one year
Capital lease obligations	$ 603,179	—	(280,845)	322,334	244,258

Future minimum lease payments and the present value of net minimum lease payments are as follows:

Fiscal year ending June 30:		
2019	$	78,480
Total minimum lease payments		78,480
Less amount representing interest		(405)
Net		78,075
Less current portion		(78,075)
Present value of capital lease, net of current portion	$	—

(8) Risk Management

VMC is exposed to risk of loss related to professional and general liability, employee medical, dental, and pharmaceutical claims, and injuries to employees. VMC maintains a program of purchased insurance and excess insurance coverage for professional and general liability, as well as self-insurance liabilities. VMC is exposed to various risks of loss from torts; theft of, damage to, and destruction of assets; business interruption; errors and omissions; employee injuries and illnesses; and natural disasters. Commercial insurance coverage is purchased for claims arising from such matters and no claims have exceeded such coverage. As with any company that purchases insurance coverage, in the event a claim exceeds the amount of coverage purchased, the amount exceeding the coverage is the responsibility of the company, in this case, VMC.

The self-insurance liability represents the estimated ultimate cost of settling claims resulting from events that have occurred on or before the statement of net position date. The liability includes amounts that will be required for future payments of employee and dependent health benefit claims, as well as workers' compensation claims that have been reported and claims related to events that have occurred but have not been reported, and a tail liability for professional and general liability.

(a) Professional and General Liability

VMC purchases insurance from a third-party insurance carrier for professional and general liability. Insurance limits are $2,000,000 per claim with an $8,500,000 annual aggregate, on an occurrence basis. VMC also maintains excess commercial insurance above the first layer of $2,000,000/$8,500,000 on a claims-made basis with a limit of liability of $25,000,000 per occurrence and $25,000,000 annual aggregate.

(b) Changes in the Self-Insurance Liability – Tail Liability

VMC has established a liability based on the requirement of GASB Statement No. 10, *Accounting and Financial Reporting for Risk Financing and Related Insurance Issues*, which requires that a liability for claims be reported if information prior to the issuance of the financial statements indicates that it is

probable that a liability has been incurred at the date of the financial statements and the amount of the loss can be reasonably estimated. The liability includes the amount that will be required for future payments of claims that have been reported and claims related to events that have occurred but have not been reported and an estimated tail liability for any claims in excess of coverage with the excess insurance policies on a claims-made basis.

Changes in the self-insurance liability as it relates to the tail liability for professional liability insurance as of June 30, 2018 and 2017 are noted below:

Liability at June 30, 2016	$	1,380,000
Incurred claims and changes in estimates		60,000
Claims payments		—
Liability at June 30, 2017		1,440,000
Incurred claims and changes in estimates		—
Claims payments		—
Liability at June 30, 2018	$	1,440,000

The self-insurance liability is included in the interest, patient refunds and other liabilities in the statements of net position.

(c) Employee Medical

VMC is self-insured for medical and dental benefits. The accrued liabilities for the self-insured component of the plan include the unpaid portion of claims that have been reported and estimates for claims that have been incurred but not reported. VMC also carries stop-loss coverage for claims in excess of the $275,000 specific deductible for both calendar year 2018 and 2017, and $183,000 and $122,000 aggregating specific deductible for calendar year 2018 and 2017, respectively. VMC has recorded an actuarially estimated liability for health claims that have been incurred but not reported of $2,798,824 and $2,828,073 as of June 30, 2018 and 2017, respectively. These liabilities are included in accrued salaries, wages, and employee benefits liabilities in the accompanying VMC statements of net position. The health benefit claims liability at June 30, 2018 and 2017 is based on undiscounted calculations.

(d) Workers' Compensation

VMC is self-insured for workers' compensation claims up to $500,000 per claim in 2018 and 2017. Excess insurance coverage is purchased for risk above the per claim self-insured retention level. The accrued liabilities of the plan include the self-insured components of unpaid portion of claims that have been reported and estimates for claims that have been incurred but not reported. VMC has recorded an actuarially determined estimated liability for workers' compensation claims of $5,233,638 and $5,218,091 at June 30, 2018 and 2017, respectively, which are included in accrued salaries, wages, and benefits liabilities in the accompanying VMC statements of net position. The workers' compensation current liability at June 30, 2018 and 2017 is based on undiscounted calculations.

(9) Retirement Plans

VMC offers its employees two deferred compensation plans created in accordance with Internal Revenue Code Sections 403(b) and 457. The plans, available to all employees, permit them to defer a portion of their salary until future years. Employee contributions to the plans totaled $19,522,410 and $16,011,686 for the years ended June 30, 2018 and 2017, respectively. The deferred compensation is payable to employees upon termination, retirement, death, or unforeseen emergency.

VMC contributes a 5% employer contribution into the 403(b) plan for all employee groups with a 2% employer match on a 2% employee contribution.

Employer contributions into the 403(b) plan totaled $14,670,609 and $14,431,965 for the years ended June 30, 2018 and 2017, respectively.

It is the opinion of internal legal counsel that VMC has no uninsured liability for losses under the plans. Under both plans, the participants select investments from alternatives offered by the plans, and the funds are held in trust/custodial accounts with the custodians, who are under contract with VMC to manage the plans. Investment selection by a participant may be changed each pay period. VMC manages none of the investment selections. By making the selections, enrollees accept and assume all risks that pertain to the plan and its administration.

In accordance with the Internal Revenue Service code, and accounted for in accordance with GASB Statement No. 32, *Accounting and Financial Reporting for Internal Revenue Code Section 457 Deferred Compensation Plans*, VMC placed the deferred compensation plan assets of the plans into a trust for the exclusive benefit of plan participants and beneficiaries.

VMC has limited administrative involvement and does not perform the investing function for either plan, as each plan has an investment advisor. VMC does not hold the assets of either plan in a trustee capacity and does not perform fiduciary accountability for the plan.

(10) Related-Party Transactions

VMC has engaged in a number of transactions with related parties. These transactions are recorded by VMC as either revenue or expense transactions because economic benefits are either provided or received by VMC. VMC records cash transfers between VMC and related parties that are not the result of economic benefits and are presented as nonoperating expense within net position.

(a) University of Washington

A total of $7,509,000 and $9,564,000 was paid and recognized by VMC to divisions of the University for the years ended June 30, 2018 and 2017, respectively, for transactions primarily related to reference laboratory work, providing contracted nursing assistance with the Valley Nurse Line, and management assistance within various departments. The expenses are recorded as purchased services expense in the statements of revenues, expenses, and changes in net position. VMC received and recognized $762,000 and $732,000 in revenue from related parties for the years ended June 30, 2018 and 2017, respectively. The revenue is recorded as other operating revenue in the statements of revenues, expenses, and changes in net position.

(b) Intra-Governmental Transactions

VMC and its discretely presented component unit engage in a number of transactions with each other. These transactions are primarily for lease of medical office space and operational services.

(i) Lease of Medical Office Space

The component unit has several lease agreements with VMC. Office space for two different locations is leased from VMC for $362,706 and $351,581 for the years ended June 30, 2018 and 2017, respectively. The leases expire in December 2019, and April 2020, respectively. The component unit has $544,399 in total outstanding minimum lease payments due to VMC.

(ii) Operational Services

During the years ended June 30, 2018 and 2017, IPV provided radiology services on behalf of VMC, which reimburses IPV for those services. VMC pays IPV for services rendered, which is represented by $9,695,235 and $9,694,837 in VMC's purchased services expense for 2018 and 2017 respectively. VMC receives members' distributions from IPV, which is represented by $6,764,564 and $6,602,766 in VMC's other operating revenue for 2018 and 2017 respectively.

(c) State of Washington

The State of Washington Medicaid Transformation Demonstration (MTD) program which commenced in fiscal year 2018 is a five year contract between the state and CMS, authorizing up to $1.5 billion federal matching funds to promote innovative, sustainable and systemic changes that improve the overall health of the state. WSHCA requested intergovernmental transfers from other state and local public entities to finance a portion of the nonfederal share. VMC recorded $3.3 million in intergovernmental transfers to the state, which is included in funding to affiliates in the statement of revenues, expenses, and changes in net position.

The state of Washington submitted and received approval for incentive payments under the MTD program, of which VMC received $3.6 million, which is included in funding from affiliates in the statement of revenues, expenses, and changes in net position.

(11) Commitments and Contingencies

(a) Operating Leases

VMC leases certain medical office space and equipment under operating lease arrangements with its discretely presented component unit and third parties. Similarly, the discretely presented component unit leases certain medical office space and equipment under operating leases with VMC and third parties. Total rental expense in the year ended June 30, 2018 was $10,396,841 and $362,706 for VMC and the discretely presented component unit, respectively. Total rental expense in the year ended June 30, 2017 was $8,567,950 and $351,581 for VMC and the discretely presented component unit, respectively. Rental expense is included in purchased services expense in the statements of revenues, expenses, and changes in net position.

The following schedule shows future minimum lease payments by fiscal year for VMC and the discretely presented component unit as of June 30, 2018:

		VMC	Component unit
2019	$	11,385,583	367,536
2020		11,288,249	176,863
2021		10,616,176	—
2022		10,276,158	—
2023		9,276,172	—
Thereafter		23,755,815	—
Total minimum lease payments	$	76,598,153	544,399

(b) Construction Commitments

VMC has current commitments at June 30, 2018 of $26,397,060 related to various construction projects, equipment purchases and information technology implementations. VMC intends to use capital funds for these commitments.

(c) Regulatory Environment

The healthcare industry is subject to numerous laws and regulations from federal, state, and local governments. These laws and regulations include, but are not limited to, matters such as licensure, accreditation, governmental healthcare program participation requirements, reimbursement for patient services, and Medicare and Medicaid fraud and abuse. Government agencies are actively conducting investigations concerning possible violations of fraud and abuse statutes and regulations by healthcare providers. Violations of these laws and regulations could result in expulsion from government healthcare programs, together with the imposition of significant fines and penalties, as well as significant repayments for patient services previously billed. Management believes that VMC is in compliance with the fraud and abuse regulations as well as other applicable government 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 unasserted at this time.

(d) Litigation

VMC is involved in litigation and regulatory investigations arising in the course of business. After consultation with legal counsel, management estimates that these matters will be resolved without material adverse effect to VMC’s future financial position or results from operations.

(e) Collective Bargaining Agreements

VMC has a total of approximately 3,622 employees. Of this total, approximately 69% and 70% are covered collective bargaining agreements as of June 30, 2018 and 2017, respectively. Nurses are represented by Service Employees International Union (SEIU) 1199 and other healthcare and support workers are represented by Office and Professional Employees International Union (OPEIU), United Food and Commercial Workers (UFCW), and International Union of Operating Engineers (IUOE) Operating Engineers. The collective bargaining agreements with SEIU 1199 expire on June 30, 2019. OPEIU, UFCW, and IUOE Operating Engineers expire on October 31, 2020; March 31, 2020 and October 31, 2020, respectively.

King County Public Hospital District No. 1
Schedule of Expenditures of Federal Awards
For the Year Ended June 30, 2018

Federal Agency (Pass-Through Agency)	Federal Program	CFDA Number	Other Award Number	Expenditures			Passed through to Subrecipients	Note
				From Pass-Through Awards	From Direct Awards	Total		
CENTERS FOR DISEASE CONTROL AND PREVENTION, HEALTH AND HUMAN SERVICES, DEPARTMENT OF (via Washington State Department of Health)	Immunization Cooperative Agreements	93.268	C17123	946,980	-	946,980	-	Note 3
CENTERS FOR DISEASE CONTROL AND PREVENTION, HEALTH AND HUMAN SERVICES, DEPARTMENT OF (via Washington State Department of Health)	Epidemiology and Laboratory Capacity for Infectious Diseases (ELC)	93.323	N22098	10,000	-	10,000	-	
		Total Federal Awards Expended:		**956,980**	**-**	**956,980**	**-**	

The accompanying notes are an integral part of this schedule.

PUBLIC HOSPITAL DISTRICT NO. 1 OF KING COUNTY
VALLEY MEDICAL CENTER

NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
For the Year Ended June 30, 2018

NOTE 1 – BASIS OF ACCOUNTING

This schedule is prepared on the same basis of accounting as the District's financial statements. The District reports its financial information in a form which complies with the pronouncements of the Governmental Accounting Standards Board and the "Audit and Accounting Guide for Healthcare Organizations" of the American Institute of Certified Public Accountants.

NOTE 2 – PROGRAM COSTS

The amounts shown as current year expenditures represent only the federal grant portion of the program costs. Entire program costs, including the District's portion, may be more than shown.

NOTE 3 – NONCASH AWARDS - VACCINATIONS

The amount of vaccine reported on the schedule is the value of vaccines received by the District during the current year and priced as prescribed by the Washington State Department of Health.

NOTE 4 – INDIRECT (F&A) COSTS

The District elected to use the 10% de minimis cost rate as covered in 2 CFR §200.414 Indirect (F&A) costs.

ABOUT THE STATE AUDITOR'S OFFICE

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

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

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

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

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

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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