Office of the Washington State Auditor
Pat McCarthy

June 17, 2019

Board of Commissioners
Olympic Medical Center
Port Angeles, Washington

Contracted CPA Firm's Audit Report on Financial Statements

We have reviewed the audit report issued by a certified public accounting (CPA) firm on the Olympic Medical Center's financial statements for the fiscal year ended December 31, 2018. The District contracted with the CPA firm for this audit and requested that we accept in lieu of performing our own audit.

Based on this review, we have accepted this report in lieu of the audit required by RCW 43.09.260. The Office of the Washington State Auditor did not audit the accompanying financial statements and, accordingly, we do not express an opinion on those financial statements.

This report is being published on the Office of the Washington State Auditor website as a matter of public record.

Sincerely,

Pat McCarthy

State Auditor

Olympia, WA

REPORT OF INDEPENDENT AUDITORS
AND FINANCIAL STATEMENTS

PUBLIC HOSPITAL DISTRICT NO. 2 OF CLALLAM COUNTY, WASHINGTON
dba OLYMPIC MEDICAL CENTER

December 31, 2018 and 2017

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Report of Independent Auditors

To the Board of Commissioners
Public Hospital District No. 2 of Clallam County, Washington
dba Olympic Medical Center

Report on the Financial Statements

We have audited the accompanying financial statements of Public Hospital District No. 2 of Clallam County, Washington, dba Olympic Medical Center (the Medical Center) as of and for the years ended December 31, 2018 and 2017, and the related notes to the financial statements, which collectively comprise the Medical Center's financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

Basis for Qualified Opinion

The Medical Center has excluded from liabilities and net position in the accompanying statement of net position as of December 31, 2018, and operating expenses in the accompanying statement of revenues, expenses, and changes in net position for the year ended December 31, 2018, the accounting and the related disclosures for postemployment benefits other than pensions (OPEB) in accordance with Governmental Accounting Standards Board (GASB) Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions* (GASB 75). If the Medical Center had adopted GASB 75, the cumulative effect of restatement of $20,161,156 would have been recorded in 2018 and a total OPEB liability of $22,992,557, deferred inflows of resources of $666,536, and deferred outflows of resources of $1,357,767 would have been recognized as of December 31, 2018. Accordingly, OPEB expenses of $2,140,170 would have been recognized in 2018 and net position would have been reduced by $22,301,326 as of December 31, 2018.

The Medical Center has excluded from liabilities and net position in the accompanying statement of net position as of December 31, 2017, and operating expenses in the accompanying statement of revenues, expenses, and changes in net position for the year ended December 31, 2017, the accounting and the related disclosures for OPEB in accordance with GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions* (GASB 45). Accounting principles generally accepted in the United States of America require the recognition of an OPEB liability for the difference between the actuarially determined annual required contribution for the OPEB plan and amounts actually contributed during a period. Quantification of the effects of that departure on the financial statements in accordance with GASB 45 is not practicable as of and for the year ended December 31, 2017.

Qualified Opinion

In our opinion, except for the effects of the matter described in the Basis for Qualified Opinion paragraph, the financial statements referred to above present fairly, in all material respects, the financial position of the Medical Center as of December 31, 2018 and 2017, and the changes in financial position and cash flows thereof for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matter

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the accompanying management's discussion and analysis on pages 4 through 12 be presented to supplement the financial statements. Such information, although not a part of the financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the 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 financial statements, and other knowledge we obtained during our audit of the financial statements. Although our opinion on the financial statements are not affected, the matter described in the Basis for Qualified Opinion paragraph represents a material departure from the prescribed guidelines for the accompanying management's discussion and analysis.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated February 15, 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 solely 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 the effectiveness of the Medical Center's 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.

Moss Adams LLP

Everett, Washington
February 15, 2019

This discussion and analysis provides an overview of the financial position and financial activities of Public Hospital District No. 2 of Clallam County, Washington, doing business as Olympic Medical Center (the Medical Center). Please read it in conjunction with the Medical Center's financial statements and accompanying notes, which follow this section.

Decision to Not Adopt Governmental Accounting Standards Board Statement (GASB) No. 75 – *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions (OPEB)*

The Medical Center is currently a participating employer in the health care plan managed by the state's Public Employees Benefit Board (PEBB). Embedded in the health plan are certain health care benefits to eligible retirees that qualify as OPEB that Olympic Medical Center was previously unware of and therefore did not record under GASB 45 from inception. The postemployment benefits are not part of the expressed or contracted employee benefits guaranteed by the Medical Center. Per GASB 45 and now GASB 75, a liability must be recognized to account for the postemployment benefits. It is the viewpoint of the Medical Center that no liability would exist due to the fact that the postemployment benefits would no longer be offered if a different health plan were to be selected. To avoid the extreme financial fluctuations that would result if the liability were recognized and then reversed if the medical plan is changed, and in light of the fact that the Medical Center is currently reviewing other health plans, the Medical Center has chosen to depart from GASB. The Medical Center believes the departure more accurately presents the financial status of the Medical Center to the users of the financial statements.

Financial Highlights

- One of the core components of the Medical Center's 2018–2020 strategic plan is to update the Sequim campus master plan, beginning with the completion of the Olympic Medical Cancer Center expansion. In 2018, the Medical Center made extensive design and planning progress in order to begin construction in early 2019. This is an investment in facilities and services to appropriately meet the community need.
- The Medical Center's net position increased by $681,000 in 2018 and decreased by $2.5 million in 2017.
- The Medical Center's total operating revenue was $200.8 million in 2018 compared with $180.4 million in 2017.
- The Medical Center invested approximately $7.5 million in capital assets, including improved medical facilities and new medical equipment in 2018 and approximately $9.5 million in 2017, including improved medical facilities and new medical equipment.

Overview of the Financial Statements

The Medical Center's financial statements consist of three statements: a statement of net position; a statement of revenues, expenses, and changes in net position; and a statement of cash flows. These financial statements and related notes provide information about the activities of the Medical Center, including resources held by the Medical Center that are held for specific purposes. The statement of net position includes all of the Medical Center'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 statement of revenues, expenses, and changes in net position reports all of the revenues and expenses during the time period indicated. The statement of cash flows reports the cash provided by the Medical Center's operating activities, as well as other cash sources such as investment income and cash payments for additions and improvements.

Volumes and Statistics

Following are key operating statistics:

Medical Center Key Operating Statistics

	2018	2017	2016	2018 - 2017 % Change
Available beds	67	67	67	0%
Admissions	4,217	4,379	4,373	-4%
Patient days	14,536	14,414	14,549	1%
Imaging procedures	94,169	90,432	93,768	4%
Oncology procedures	32,589	29,546	27,548	10%
Surgery cases	8,066	6,973	6,423	16%
Emergency room visits	29,463	29,865	31,949	-1%
Home health visits	51,477	47,938	39,298	7%
Clinic visits	155,560	139,394	111,274	12%
Full-time equivalent employees	1,255	1,227	1,116	2%

Statement of Net Position

The following is a presentation of certain financial information derived from the Medical Center's statement of net position (amounts in thousands):

	2018	2017	2016	2018 - 2017 Change
Assets				
Total current assets	$ 29,579	$ 26,987	$ 25,374	$ 2,592
Assets limited as to use	56,005	36,041	48,413	19,964
Capital assets, net	114,654	117,687	118,901	(3,033)
Other assets	2,407	2,254	2,254	153
Total assets	$ 202,645	$ 182,969	$ 194,942	$ 19,676
Liabilities				
Current liabilities	$ 19,859	$ 18,211	$ 22,761	$ 1,648
Long-term debt, net of current portion	55,200	37,853	42,378	17,347
Other long-term liabilities	1,065	1,065	1,455	-
Total liabilities	76,124	57,129	66,594	18,995
Net position				
Invested in capital assets, net of related debt	82,681	87,345	89,946	(4,664)
Unrestricted	43,840	38,495	38,402	5,345
Total net position	126,521	125,840	128,348	681
Total liabilities and net position	$ 202,645	$ 182,969	$ 194,942	$ 19,676

Statement of Net Position (continued)

Current assets in 2018 included cash and investments (25%), total receivables (60%), supplies inventory (8%), and prepaid expenses (7%). Current assets increased by 10% in 2018, primarily in cash and investments.

Current assets in 2017 included cash and investments (18%), total receivables (65%), supplies inventory (8%), and prepaid expenses (9%). Current assets increased by 6% in 2017, primarily in receivables.

Assets limited as to use in 2018 totaling $56 million included capital reserves of $28.7 million, reserve for accrued liabilities of $1.8 million, and bond proceeds restricted for capital purchases of $25.5 million.

Assets limited as to use in 2017 totaling $36 million included capital reserves of $25.6 million, reserve for accrued liabilities of $1.7 million, and bond proceeds restricted for capital purchases of $9.1 million.

Total assets increased $19.7 million (11%) in 2018 primarily due to Board Designated Assets, which increased $20 million.

Total assets decreased $12 million (6%) in 2017 primarily due to Board Designated Assets, which decreased $12.4 million.

In 2018, total current liabilities increased by 9% from 2017. Current liabilities in 2018 included accounts payable (30%), accrued vacation and payroll (51%), current portion of long-term debt (12%), and other liabilities (8%). Current liabilities in 2017 included accounts payable (34%), accrued vacation and payroll (50%), current portion of long-term debt (9%), and other liabilities (7%).

Long-term debt, net of current portion, increased by $17.3 million in 2018. Long-term debt, net of current portion, increased by $4.5 million in 2017.

Total net position increased by $681,000 to $126.5 million at the end of 2018. The total consists of $82.7 million invested in capital assets, net of related debt, and $43.8 million of unrestricted net position.

Total net position decreased by $2.5 million to $125.8 million at the end of 2017. The total consists of $87.3 million invested in capital assets, net of related debt, and $38.5 million of unrestricted net position.

Statement of Revenues, Expenses, and Changes in Net Position

The following is a summary of 2018 compared with 2017 and 2016 annual amounts (amounts in thousands):

	2018	2017	2016	2018 - 2017 Change
Total operating revenue	$ 200,761	$ 180,450	$ 167,267	$ 20,311
Operating expenses				
Wages and benefits	124,962	115,451	100,279	9,511
Professional fees	9,664	8,888	8,016	776
Supplies	31,498	27,162	26,392	4,336
Purchased services, maintenance, and other	22,162	20,259	18,298	1,903
Insurance	1,039	699	1,098	340
Depreciation and amortization	10,477	10,656	9,004	(179)
Total operating expenses	199,802	183,115	163,087	16,687
Operating income (loss)	959	(2,665)	4,180	3,624
Net nonoperating revenue (expense)	(278)	158	111	(436)
Change in net position	$ 681	$ (2,507)	$ 4,291	$ 3,188

Total operating revenue was $20.3 million more in 2018 as a result of increased volumes in outpatient services.

Total operating revenue was $13.2 million more in 2017 as a result of increased volumes in outpatient services.

Total bad debt provision and charity care provided was $5.6 million in 2018 compared with $5.0 million in 2017 and $4.2 million in 2016. Uncompensated care continued to stabilize over 2018 and 2017.

Statement of Revenues, Expenses, and Changes in Net Position (continued)

The following is a summary of the Medical Center's gross revenue by payor:

	2018	2017	2016
Medicare	59%	58%	59%
Medicaid	16%	17%	16%
Other government	8%	8%	8%
Total governmental payors	83%	83%	83%
Commercial insurance	16%	16%	16%
Private pay	1%	1%	1%
Total	100%	100%	100%

Combined wages and benefits increased by 8% in 2018 and 15.1% in 2017. Supplies increased by 16% in 2018 and 3% in 2017. Purchased services, maintenance, and other increased by 9% in 2018 and 11% in 2017. Professional fees increased by 9% in 2018 and 11% in 2017.

Charitable contributions received by the Medical Center in 2018 totaled $714,000, compared with $422,000 in 2017, and $189,000 in 2016. The monetary contributions primarily came from the Olympic Medical Center Foundation, the Olympic Memorial Hospital Auxiliary, and the Sequim Dungeness Hospital Guild.

The Medical Center had an operating income of $959,000 in 2018 compared to operating loss of $2.7 million in 2017.

The Medical Center's Cash Flows

The following is a summary of cash flows in 2018, 2017, and 2016 (amounts in thousands):

	2018	2017	2016	2018 - 2017 Change
Net cash from operating activities	$ 8,053	$ 550	$ 10,663	$ 7,503
Cash from tax revenue	4,439	4,572	4,418	(133)
Net cash from capital and related financing activities	9,340	(18,706)	(15,238)	28,046
Net cash from investing activities	(1,421)	4,376	9,681	(5,797)
Net change in cash and cash equivalents	$ 20,411	$ (9,208)	$ 9,524	$ 29,619

Net cash from operating activities was $8.1 million in 2018, compared with $550,000 in 2017. $10.5 million was spent on the purchase of capital assets in 2018.

Net cash from operating activities was $550,000 in 2017, compared with $10.7 million in 2016. $12.6 million was spent on the purchase of capital assets in 2017.

Capital Assets

At the end of 2018, the Medical Center had $114.7 million invested in capital assets, net of accumulated depreciation, as detailed in Note 4 to the financial statements. In 2018, the Medical Center purchased new capital assets costing approximately $7.5 million. In 2017, the Medical Center purchased new capital assets costing approximately $9.4 million.

Major capital acquisitions in 2018 included replacement of hospital beds and infusion pumps ($1.3 million) and design of the Cancer Center Expansion ($0.4 million). The remainder was spent on other building improvements, equipment, and information systems.

Major capital acquisitions in 2017 included expansion of outpatient services regarding the Port Angeles Medical Office Building ($2.3 million) and design of the Cancer Center Expansion ($0.9 million). The remainder was spent on other building improvements, equipment, and information systems.

On February 15, 2017, the Medical Center's Board of Commissioners approved an architectural contract with Coates Design Architects for the design of the Cancer Center Expansion. The architectural contract for $0.8 million was signed on February 15, 2017. On June 6, 2018, the Medical Center's Board of Commissioners approved an amendment to the architectural contract with Coates Design Architects to include the scope for the Sequim Primary Care Expansion Project. The architectural contract amendment for $0.5 million was dated May 23, 2018. On November 21, 2018, the Medical Center's Board of Commissioners approved a construction contract with JMG Constructors, LLC for the Sequim Cancer Center Expansion Project. The construction contract for $4.4 million was signed on December 11, 2018. As of December 31, 2018, the Medical Center's remaining commitment is $0.5 million for Coates Design and $4.4 million for JMG Constructors, LLC. In 2017, the Medical Center had remaining commitments of $0.4 million for the Central Sterile Processing Expansion Project and $0.5 million for the architectural design of the Cancer Care Center Expansion. The Medical Center has a remaining commitment of $0.1 million for the Central Sterile Processing Expansion Project.

See Note 4 for additional information.

Debt

The Medical Center currently has long-term limited tax general obligation (LTGO) debt outstanding in the amount of $57.5 million. This amount consists of the following: 1) $0.8 million remaining of a $10 million bank loan payable over the term of 10 years to pay for the emergency department expansion and related capital equipment. These funds were repurposed in 2012 to pay off $7.5 million in long-term debt issued in 2005 and 2006. The loan was made directly by a bank, has fixed interest of 2.87%, and is callable at the option of the Medical Center after five years. The loan was completed in the second quarter of 2011; 2) $0.1 million remaining of a $10 million bank loan payable over the term of 7 years to purchase an electronic health record system and complete other capital projects. The loan was made directly by a bank and has fixed interest of 1.63%. The loan was completed in the fourth quarter of 2012; 3) $18.0 million remaining of a $20 million bank loan payable over the term of 25 years to expand, make improvements to, and equip the Medical Center's facilities. The loan was made directly by a bank and has fixed interest for 10 years of 3.69%, and is callable at the option of the Medical Center after 10 years. The loan was completed in the fourth quarter of 2013; 4) $18.9 remaining of a $20 million bank loan payable over the term of 25 years in order to refinance part of 2011 and 2012 debt balances, expand, make improvements to, and equip the District's health care facilities. The loan was made directly by a bank and has fixed interest for 10 years of 3.04%, and is callable at the option of the Medical Center after 10 years. The loan was completed in the fourth quarter of 2016; 5) $19.6 million remaining of a $20 million bank loan payable over the term of 20 years to expand, make improvements to, and equip the Medical Center's facilities. The loan was made directly by a bank and has fixed interest for 10 years of 4.14%, and is callable at the option of the Medical Center after 7 years. The loan was completed in the second quarter of 2018.

See Note 5 for additional information.

Budget Comparison

The following is a comparison of 2018 actual revenues, expenses, and changes in net position results to 2018 budgeted amounts (amounts in thousands):

	Actual	Budget	Variance
Operating revenues			
Net patient service revenue	$ 190,816	$188,935	$ 1,881
Property rental, cafeteria, taxes, and other	9,945	13,586	(3,641)
Total operating revenue	200,761	202,521	(1,760)
Operating expenses			
Wages and benefits	124,962	125,321	(359)
Professional fees	9,664	8,392	1,272
Supplies	31,498	33,263	(1,765)
Purchased services, maintenance, and other	22,162	20,206	1,956
Insurance	1,039	1,168	(129)
Depreciation and amortization	10,477	10,580	(103)
Total operating expenses	199,802	198,930	872
Operating income (loss)	959	3,591	(2,632)
Net nonoperating revenue (expense)	(278)	500	(778)
Change in net position	$ 681	$ 4,091	$ (3,410)

The Medical Center's operating revenue for 2018 was 0.9% lower than budgeted. Total operating expenses for 2018 were higher than budgeted by 0.4%.

The resulting margins for 2018 were 0.48% for operating margin and 0.34% for total margin, compared with budgeted margins of 1.8% and 2.0%, respectively.

Issues Facing the Medical Center

The Medical Center's payor mix of approximately 83% governmental payors is very challenging due to generally low governmental reimbursement levels and the fact that governmental reimbursement reductions have such a significant financial impact on the Medical Center. In addition, cost of healthcare continues to increase in pharmaceutical supplies, medical supplies, medical service, and staffing. Due to nationwide shortages of medical providers and other medical professionals, the cost of recruiting and retaining qualified medical professionals are increasing as well.

Because the Medical Center is faced with the reimbursement cuts and cost challenges mentioned above, keeping up with the capital needs of the Medical Center will become more challenging as well.

Summary of Financial Position and Financial Activity in 2018

Overall, the Medical Center's financial performance in 2018 was challenged as a result of 1) increases in workforce costs, 2) escalating construction and medical equipment costs, and 3) continued downward pressure on reimbursement.

The Medical Center is focused on continuing to improve clinical quality and patient safety; providing excellent service and access to all patients, regardless of their insurance or ability to pay; and meeting community needs in core areas of service. Achievement of these goals requires significant investments in capital assets and personnel. The Medical Center's financial position will need to remain strong to continue to achieve these goals.

Contacting the Medical Center's Financial Management

This financial report is designed to provide patients, suppliers, taxpayers, and creditors with a general overview of the Medical Center's finances and to show the Medical Center's accountability for the money it receives. If you have questions about this report or need additional financial information, contact the Medical Center Finance Office at Olympic Medical Center, 939 Caroline, Port Angeles, Washington 98362.

Public Hospital District No. 2 of Clallam County, Washington
dba Olympic Medical Center
Statements of Net Position

ASSETS

	December 31, 2018	December 31, 2017
CURRENT ASSETS		
Cash	$ 7,058,183	$ 4,517,648
Short-term investments	360,064	353,699
Accounts receivable, net of estimated uncollectibles of $3,800,000 and $3,400,000 in 2018 and 2017, respectively	17,689,493	17,556,344
Supplies inventory	2,280,390	2,059,052
Prepaid expenses	2,191,209	2,500,383
Total current assets	29,579,339	26,987,126
ASSETS LIMITED AS TO USE	56,005,469	36,040,602
CAPITAL ASSETS		
Land	9,830,130	9,830,130
Construction in progress	4,349,849	2,373,982
Depreciable capital assets, net of accumulated depreciation	100,473,831	105,482,648
	114,653,810	117,686,760
OTHER ASSETS	2,406,266	2,254,298
Total assets	$ 202,644,884	$ 182,968,786

LIABILITIES AND NET POSITION

	2018	2017
CURRENT LIABILITIES		
Accounts payable	$ 5,869,921	$ 6,158,991
Accrued salaries, wages, and payroll taxes	5,946,430	5,251,091
Accrued vacation	4,128,122	3,894,083
Other current liabilities	491,936	450,935
Estimated third-party payor settlements	1,126,901	881,409
Current portion of long-term debt	2,295,815	1,574,438
Total current liabilities	19,859,125	18,210,947
LONG-TERM DEBT, net of current portion	55,200,141	37,853,109
OTHER LONG-TERM LIABILITIES	1,064,513	1,064,513
Total liabilities	76,123,779	57,128,569
NET POSITION		
Invested in capital assets, net of related debt	82,681,453	87,344,930
Unrestricted	43,839,652	38,495,287
Total net position	126,521,105	125,840,217
Total liabilities and net position	$ 202,644,884	$ 182,968,786

See accompanying notes.

Statements of Revenues, Expenses, and Changes in Net Position

	Years Ended December 31, 2018	Years Ended December 31, 2017
OPERATING REVENUES		
Net patient service revenue (net of provision for bad debts of $3,000,000 in 2018 and $2,300,000 in 2017)	$ 190,816,241	$ 173,471,456
Tax revenue for maintenance and operations	4,437,121	4,570,480
Property rental, cafeteria, and other revenue	5,508,075	2,407,956
Total operating revenue	200,761,437	180,449,892
OPERATING EXPENSES		
Salaries and wages	96,536,706	89,102,752
Employee benefits	28,425,560	26,348,654
Professional fees	9,664,260	8,887,739
Supplies	31,498,198	27,162,202
Purchased services, maintenance, and other	22,161,526	20,259,390
Insurance	1,038,804	698,948
Depreciation and amortization	10,477,119	10,655,598
Total operating expenses	199,802,173	183,115,283
OPERATING INCOME (LOSS)	959,264	(2,665,391)
NONOPERATING REVENUES (EXPENSES)		
Investment income	679,815	687,378
Interest expense	(1,643,810)	(940,156)
Other	685,619	410,861
Net nonoperating revenue (expense)	(278,376)	158,083
CHANGE IN NET POSITION	680,888	(2,507,308)
NET POSITION, beginning of year	125,840,217	128,347,525
NET POSITION, end of year	$ 126,521,105	$ 125,840,217

See accompanying notes.

Public Hospital District No. 2 of Clallam County, Washington
dba Olympic Medical Center
Statements of Cash Flows

Increase (Decrease) in Cash and Cash Equivalents

	Years Ended December 31,	
	2018	2017
CASH FLOWS FROM OPERATING ACTIVITIES		
Receipts from and on behalf of patients	$ 190,926,826	$ 170,564,145
Payments to suppliers and contractors	(64,348,754)	(57,976,488)
Payments to employees	(124,032,888)	(114,445,435)
Other receipts and payments, net	5,508,075	2,407,956
Net cash from operating activities	8,053,259	550,178
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Tax revenue considered a noncapital financing activity	4,438,879	4,571,882
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Proceeds from sale of capital assets	31,947	16,044
Proceeds from debt issuance	20,000,000	-
Principal payments on long-term debt	(1,931,591)	(5,522,565)
Purchase of capital assets	(7,157,733)	(12,563,011)
Interest paid on long-term debt, net of capitalized portion	(1,602,809)	(636,885)
Net cash from capital and related financing activities	9,339,814	(18,706,417)
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from sale/maturity of investments	3,707,304	44,724,689
Purchase of investments	(5,932,810)	(40,869,430)
Cash from investment income, net of amount capitalized	804,610	520,873
Net cash from investing activities	(1,420,896)	4,376,132
NET CHANGE IN CASH AND CASH EQUIVALENTS	20,411,056	(9,208,225)
CASH AND CASH EQUIVALENTS, beginning of year	15,766,683	24,974,908
CASH AND CASH EQUIVALENTS, end of year	$ 36,177,739	$ 15,766,683
RECONCILIATION OF CASH AND CASH EQUIVALENTS TO STATEMENT OF NET POSITION		
Cash	$ 7,058,183	$ 4,517,648
Cash and cash equivalents in short-term investments	360,064	353,699
Cash and cash equivalents in assets limited as to use	28,759,492	10,895,336
	$ 36,177,739	$ 15,766,683

 See accompanying notes.

Increase (Decrease) in Cash and Cash Equivalents

	Years Ended December 31, 2018	2017
RECONCILIATION OF OPERATING INCOME TO NET CASH FROM OPERATING ACTIVITIES		
Operating income (loss)	$ 959,264	$ (2,665,391)
Tax revenue considered a noncapital financing activity	(4,437,121)	(4,570,480)
Adjustments to reconcile operating income (expense) to net cash from operating activities		
Depreciation and amortization	10,344,934	10,056,265
Provision for bad debts	2,968,728	2,313,127
Loss on disposal of assets	132,185	599,333
Changes in operating assets and liabilities		
Accounts receivable	(3,103,635)	(4,168,619)
Supplies inventory	(221,338)	46,330
Estimated third-party payor settlements	245,492	(1,051,819)
Prepaid expenses	309,174	(330,047)
Accounts payable	(73,802)	(294,265)
Accrued liabilities	929,378	1,005,971
Other long-term liabilities	-	(390,227)
Net cash from operating activities	$ 8,053,259	$ 550,178
SUPPLEMENTAL DISCLOSURE OF NONCASH INVESTING, CAPITAL, AND FINANCING ACTIVITIES		
Change in capital assets included in accounts payable	$ (215,268)	$ (3,516,060)

Note 1 – Reporting Entity and Summary of Significant Accounting Policies

Reporting entity – Public Hospital District No. 2 of Clallam County, Washington (dba Olympic Medical Center), serving Port Angeles and Sequim, Washington, and surrounding communities, is organized as a municipal corporation pursuant to the laws of the state of Washington.

Olympic Medical Center (the Medical Center) operates Olympic Memorial Hospital (the Hospital), a general acute-care facility that maintains 126 licensed beds including a birth center. The Medical Center has three divisions: the Hospital; Olympic Medical Physicians, which includes 15 physician clinics; and Olympic Medical Home Health, which provides home health care services. The Hospital division also includes Olympic Medical Imaging Centers, Olympic Medical Cancer Center, Olympic Medical Surgical Services, Olympic Medical Cardiac Services, Olympic Medical Physical Therapy and Rehabilitation, and Olympic Medical Laboratory. The majority of the Medical Center's patients live in Clallam County.

Use of estimates – The preparation of financial statements in accordance with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

Fund accounting – The Medical Center uses the proprietary fund method of accounting whereby revenue and expenses are recognized on the accrual basis.

Cash and cash equivalents – Cash and cash equivalents have original maturity dates of three months or less. For purposes of reporting cash flows, cash and cash equivalents include cash on hand, cash on deposit, and deposits in the local government investment pool. Cash and cash equivalents are included in the following lines on the statement of net position: cash, short-term investments, and assets limited as to use.

Supplies inventory – Supplies inventory, consisting of medicine and medical supplies, is valued at the lower of cost (computed on the first-in, first-out basis) or net realizable value.

Investments in debt securities – Investments in debt securities are reported at fair value except for investments in debt securities with maturities of less than one year at the time of purchase. These investments are reported at amortized cost. Interest, dividends, and gains and losses, both realized and unrealized, on investments in debt securities are included in nonoperating income when earned.

Capital assets – Capital asset acquisitions are recorded at cost. Contributed capital assets are reported at their estimated fair value at the time of their donation. Expenditures for maintenance and repairs are charged to operations as incurred. Betterments and major renewals are capitalized. It is the Medical Center's policy to capitalize assets that cost $2,000 or more and have a useful life of two years or greater.

Note 1 – Reporting Entity and Summary of Significant Accounting Policies (continued)

All capital assets other than land are depreciated or amortized using the straight-line method of depreciation using these asset lives:

Land improvements	5–25 years
Buildings and equipment	5–40 years
Fixed equipment	3–25 years
Movable equipment	2–20 years

Other long-term liabilities – The Medical Center has purchased claims-made liability insurance coverage that covers only asserted malpractice claims. The Medical Center recognizes expenses associated with reported claims and estimated claims incurred but not reported in the period in which the incidents are estimated to have occurred, rather than when a claim is asserted. Expenses associated with these incidents are based on historical actuarial assumptions of settlement costs and management estimates.

Risk management – The Medical Center 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 illness; natural disasters; medical malpractice; and, employee health, dental, and accident benefits. Commercial insurance coverage is purchased for claims arising from such matters. Settled claims have not exceeded this commercial coverage in any of the three preceding years.

Net position – Net position of the Medical Center is classified into four components. *Invested in capital assets, net of related debt* consists of capital assets net of accumulated depreciation and reduced by the balances of any outstanding borrowings used to finance the purchase or construction of those assets offset by any unspent proceeds of these borrowings. *Restricted expendable net positions* are noncapital net positions that must be used for a particular purpose, as specified by creditors, grantors, or contributors external to the Medical Center. *Restricted nonexpendable net position* equals the principal portion of permanent endowments. *Unrestricted net position* is the remaining net position that does not meet the definition of *invested in capital assets, net of related debt* or *restricted*. There were no restricted net positions as of December 31, 2018 and 2017.

Operating revenues and expenses – The Medical Center's statement of revenues, expenses, and changes in net position distinguishes between operating and nonoperating revenues and expenses. Operating revenues result from exchange transactions associated with providing health care services—the Medical Center's principal activity. Nonoperating revenues, including taxes, grants, and contributions received for purposes other than capital asset acquisition, are reported as other operating revenues. Operating expenses are all expenses incurred to provide health care services.

Tax revenue for maintenance and operations – Property taxes are levied by the county on the Medical Center's behalf and are intended to finance the Medical Center's activities of the same calendar year. Amounts levied are based on assessed property values.

Note 1 – Reporting Entity and Summary of Significant Accounting Policies (continued)

Charity care – The Medical Center provides care to indigent patients who meet certain criteria under its charity care policies. Because the Medical Center does not pursue collection of amounts determined to qualify as charity care, they are not reported as revenue. Forgone revenue for charity care provided during 2018 and 2017, measured by the Medical Center's standard charges, was approximately $2,649,000 and $2,655,000, respectively.

Federal income tax – The Medical Center is a municipal corporation and is exempt from federal income tax.

Subsequent events – Subsequent events are events or transactions that occur after the statement of net position date but before financial statements are available to be issued. The Medical Center recognizes in the financial statements the effects of all subsequent events that provide additional evidence about conditions that existed at the date of the statement of net position, including the estimates inherent in the process of preparing the financial statements. The Medical Center's financial statements do not recognize subsequent events that provide evidence about conditions that did not exist at the date of the statement of net position but arose after the statement of net position date and before the financial statements are available to be issued.

The Medical Center has evaluated subsequent events through February 15, 2019, which is the date the financial statements are available to be issued.

Note 2 – Patient Service Revenue

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

Reimbursement received from certain third-party payors is subject to audit and retroactive adjustment. Provision for possible adjustment as a result of audits is recorded in the financial statements. When reimbursement settlements are received, or when information becomes available with respect to reimbursement changes, any variations from amounts previously accrued are accounted for in the period in which the settlements are received or the change in information becomes available.

The Medical Center has arrangements with third-party payors that provide for payments to the Medical Center at amounts different from its established rates. A summary of the payment arrangements with major third-party payors is as follows:

Note 2 – Patient Service Revenue (continued)

Medicare – Inpatient acute-care services rendered to Medicare program beneficiaries are paid at predetermined, specific rates for each hospital discharge. Discharges are classified according to a list of diagnosis-related groups (DRGs). Each DRG has a payment weight assigned to it, based on the average resources used to treat Medicare patients in that DRG. The Medical Center's classification of DRGs and the appropriateness of the related patient admission are subject to an independent review by a peer review organization. Most outpatient services to Medicare beneficiaries are paid prospectively based on ambulatory payment classifications (APCs). Physicians and other providers are paid on a fee schedule. The Hospital's cost reports have been reviewed and/or audited by the Medicare fiscal intermediary through 2015. Net revenue from the Medicare program totaled approximately $97,496,000 and $89,087,000 for 2018 and 2017, respectively. Unsecured net patient accounts receivable due from Medicare at December 31, 2018 and 2017, were approximately $6,796,000 and $6,779,000, respectively.

Medicaid – On July 1, 2005, a new inpatient Medicaid reimbursement methodology for all noncritical access Washington State governmental hospitals was implemented called "Certified Public Expenditures." Under this program, the Medical Center is paid for inpatient Medicaid services based on costs, including certain costs of uncompensated care. The estimated costs for inpatient care are calculated as a ratio of cost to charges from a base year (two years before the service year). Under the program, the Medical Center will be reimbursed the higher of the full cost of service or "baseline" reimbursement that would have been received based on the pre-July 1 inpatient payment system. Outpatient services are paid on a fee schedule or a percentage of allowed charges based on a ratio of the Medical Center's allowable operating expenses to total allowable revenue. Physicians and other providers are paid on a fee schedule. Net revenue from the Medicaid program totaled approximately $24,251,000 and $21,332,000 for 2018 and 2017, respectively. Unsecured net patient accounts receivable due from Medicaid at December 31, 2018 and 2017, were approximately $1,400,000 and $1,128,000, respectively.

The Medical Center has also entered into various payment arrangements with certain commercial insurance carriers, health maintenance organizations, and preferred provider organizations.

The following are the components of net patient service revenue for the years ended December 31:

	2018	2017
Gross patient service charges	$ 403,824,486	$ 364,179,824
Adjustments to patient service charges		
Contractual discounts	207,390,339	185,740,119
Provision for bad debts	2,968,728	2,313,127
Charity care	2,649,178	2,655,122
	213,008,245	190,708,368
Net patient service revenue	$ 190,816,241	$ 173,471,456

Note 3 – Deposits and Investments

The Board of Commissioners has internally designated assets to provide for capital improvements and other requirements. The carrying amounts of these, as well as other deposits and investments, are included in the Medical Center's statements of net position as follows:

	2018	2017
Cash	$ 7,058,183	$ 4,517,648
Short-term investments	360,064	353,699
Assets limited as to use		
Capital reserves	28,725,030	25,240,957
Reserve for accrued liabilities	1,756,840	1,713,928
Bond proceeds restricted for capital improvements	25,523,599	9,085,717
Total deposits and investments	$ 63,423,716	$ 40,911,949

Deposits – Deposits with financial institutions are either insured or collateralized. Deposits must be made with financial institutions qualified by the Washington Public Deposit Protection Commission (PDPC). The deposits of the Medical Center are covered by the Federal Deposit Insurance Corporation (FDIC). Collateral protection in excess of the FDIC limit is provided by the Washington PDPC, a multi-financial institution collateral pool. Pledged securities under the PDPC collateral pool are held by the PDPC's agent in the name of the collateral pool.

Investments – Eligible investments are only those securities and deposits authorized by statute. Eligible investments include:

- Obligations of the U.S. government
- Obligations of U.S. government agencies or government-sponsored corporations
- Obligations of Washington State and its agencies, or of other states and local governments in one of the three highest credit ratings of a nationally recognized rating organization
- Bankers' acceptances with the highest credit rating
- Commercial paper with the highest credit rating
- Repurchase agreements with collateral exceeding 102% of cost and consisting of authorized investments
- State Treasurer's local government investment pool
- Certificates of deposit with financial institutions qualified by the Washington Public Deposit Protection Commission

Note 3 – Deposits and Investments (continued)

Credit risk – Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. The Medical Center's investment policy limits the types of securities to those authorized by statute; therefore, credit risk is very limited. Obligations of the U.S. government and agencies are rated AAA by Standard and Poor's or Moody's credit rating organizations. Obligations of other states and local governments are rated A or higher by Standard and Poor's or Moody's and have one of the three highest ratings of nationally recognized rating organizations and are general obligations of those entities. The Medical Center's portfolio currently includes no bankers' acceptances or commercial paper.

The composition of investments, reported at fair value by investment type at December 31, 2018, and excluding unrestricted cash, short-term investments, and other assets limited as to use balances of $39,084,207 is as follows:

Investment Type	Quoted Prices in Active Markets for Identical Assets (Level 1)	Percentage of Totals
U.S. government agency obligations	$ 6,476,542	27%
State and local government obligations	17,862,967	73%
Total	$ 24,339,509	100%

The composition of investments, reported at fair value by investment type at December 31, 2017, and excluding unrestricted cash, short-term investments, and other assets limited as to use balances of $18,636,513, is as follows:

Investment Type	Quoted Prices in Active Markets for Identical Assets (Level 1)	Percentage of Totals
U.S. government agency obligations	$ 4,622,564	21%
State and local government obligations	17,652,872	79%
Total	$ 22,275,436	100%

Note 3 – Deposits and Investments (continued)

Custodial credit risk – Custodial credit risk is the risk that in the event of a failure of the counterparty, the Medical Center will not be able to recover the value of the investment or collateral securities that are in the possession of an outside party. All U.S. government, U.S. government agency, and state and local agency securities are held by the Medical Center's safekeeping custodian acting as an independent third party and carry no custodial credit risk. Cash deposits and certificates of deposit are collateralized by the State Collateral Pool that insures public deposits and carry no custodial credit risk. Deposits with the state investment pool are covered by the state's master custodial agreement and carry no custodial credit risk.

Concentration of credit risk – Concentration of credit risk is the risk of loss attributed to the magnitude of the Medical Center's investment in a single issuer. The Medical Center mitigates credit risk by limiting the percentage of the portfolio invested with any one issuer.

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. The Medical Center manages interest rate risk by having policy limitations on the maximum maturity of any one security and limits to 35% the percentage of the investment portfolio maturing in more than five years. As of December 31, 2018, the weighted-average maturity of the portfolio was less than five years.

Internally designated assets and bond proceeds are generally carried at fair market value. Internally designated assets, short-term investments, and bond proceeds are held in the following investments:

	2018	2017
U.S. government agency obligations	$ 6,476,542	$ 4,622,564
State and local government obligations	17,862,967	17,652,872
Local government investment pool	18,748,382	2,163,318
Cash and cash equivalents - LTGO bond proceeds	10,371,174	9,085,717
Certificates of deposit	2,906,468	2,869,830
	$ 56,365,533	$ 36,394,301

Note 4 – Capital Assets

Capital asset additions, retirements, and balances for the years ended December 31, 2018 and 2017, were as follows:

	Balance January 1, 2018	Additions	Sales and Retirements	Account Transfers	Balance December 31, 2018
ASSETS AT COST					
Land	$ 9,830,130	$ -	$ -	$ -	$ 9,830,130
Land improvements	9,084,382	811	-	131,704	9,216,897
Buildings and improvements	107,515,608	-	-	765,049	108,280,657
Fixed equipment	33,356,917	1,270	-	393,873	33,752,060
Movable equipment	73,735,722	127,037	7,613,670	4,080,505	70,329,594
Construction in progress	2,373,982	7,346,998	-	(5,371,131)	4,349,849
	235,896,741	7,476,116	7,613,670	-	235,759,187
LESS ACCUMULATED DEPRECIATION					
Land improvements	2,815,945	504,859	-	-	3,320,804
Buildings and improvements	48,361,706	3,322,447	-	-	51,684,153
Fixed equipment	18,072,394	1,267,702	-	-	19,340,096
Movable equipment	48,959,936	5,249,926	7,449,538	-	46,760,324
	118,209,981	10,344,934	7,449,538	-	121,105,377
	$ 117,686,760	$ (2,868,818)	$ 164,132	$ -	$ 114,653,810

Note 4 – Capital Assets (continued)

	Balance January 1, 2017	Additions	Sales and Retirements	Account Transfers	Balance December 31, 2017
ASSETS AT COST					
Land	$ 9,720,919	$ 109,211	$ -	$ -	$ 9,830,130
Land improvements	4,132,161	1,101	-	4,951,120	9,084,382
Buildings and improvements	93,372,210	116,860	977,075	15,003,613	107,515,608
Fixed equipment	24,008,029	-	-	9,348,888	33,356,917
Movable equipment	74,543,494	-	6,225,694	5,417,922	73,735,722
Construction in progress	27,864,885	9,230,640	-	(34,721,543)	2,373,982
	233,641,698	9,457,812	7,202,769	-	235,896,741
LESS ACCUMULATED DEPRECIATION					
Land improvements	2,426,966	388,979	-	-	2,815,945
Buildings and improvements	45,484,098	3,312,134	434,526	-	48,361,706
Fixed equipment	16,976,511	1,095,883	-	-	18,072,394
Movable equipment	49,853,533	5,259,269	6,152,866	-	48,959,936
	114,741,108	10,056,265	6,587,392	-	118,209,981
	$ 118,900,590	$ (598,453)	$ 615,377	$ -	$ 117,686,760

The Medical Center recorded $103,000 and $421,000 of net capitalized interest in 2018 and 2017, respectively. The loss on disposal of assets of $132,185 and $599,333 as of December 31, 2018 and 2017, respectively, was included in the depreciation and amortization line on the statements of revenues, expenses, and changes in net position.

Note 5 – Long-Term Debt

During the second quarter of 2011, the Medical Center issued $10 million of debt directly with a bank. The debt has a 10-year term with fixed interest at 2.87% and is callable at the option of the Medical Center after five years or prior with a penalty. Principal and interest payments are due every six months with level payments, and the collateral for the debt is the Medical Center’s revenues and tax levy.

During the fourth quarter of 2012, the Medical Center issued $10 million of debt directly with a bank. The debt has a seven-year term with fixed interest at 1.63% and is callable at the option of the Medical Center with a penalty. Principal and interest payments are due every six months with level payments, and the collateral for the debt is the Medical Center’s revenues and tax levy.

Note 5 – Long-Term Debt (continued)

During the fourth quarter of 2013, the Medical Center entered into a $20 million debt agreement directly with a bank. The debt has a 25-year term with fixed interest at 3.69% through November 30, 2023, at which point the bank has the option to tender the bond without premium or penalty. For the period beginning December 1, 2023, the bond shall bear interest at 3.69% plus or minus .00675% for each one basis point variance in the 10-year U.S. Treasury Constant Maturity Note rate or other applicable Index Rate as defined by the bank. Principal and interest payments are due every six months with level payments, and the collateral for the debt is the Medical Center's revenues and tax levy.

During the fourth quarter of 2016, the Medical Center entered into a $20 million debt agreement directly with a bank. The debt has a 25-year term with fixed interest at 3.04% through December 1, 2026, at which point the bank has the option to tender the bond without premium or penalty. For the period beginning December 2, 2026, the bond shall bear interest at 3.04% plus or minus .00675% for each one basis point variance in the 10-year U.S. Treasury Constant Maturity Note rate or other applicable Index Rate as defined by the bank. Principal and interest payments are due every six months with level payments, and the collateral for the debt is the Medical Center's revenues and tax levy.

During the second quarter of 2018, the Medical Center entered into a $20 million debt agreement directly with a bank. The debt has a 20-year term with fixed interest at 4.14% through June 1, 2028, at which point the bank has the option to tender the bond without premium or penalty. For the period beginning June 2, 2028, the bond shall bear interest at 4.14% plus or minus .0079% for each one basis point variance in the 10-year U.S. Treasury Constant Maturity Note rate or other applicable Index Rate as defined by the bank. Principal and interest payments are due every six months with level payments, and the collateral for the debt is the Medical Center's revenues and tax levy.

Principal and interest repayments on long-term debt are as follows:

	Principal	Interest
2019	$ 2,295,815	$ 2,058,244
2020	2,226,214	1,979,378
2021	2,285,334	1,814,322
2022	2,085,113	1,818,930
2023	2,162,071	1,742,420
2024 - 2041	46,441,409	12,517,061
	$ 57,495,956	$ 21,930,355

Note 5 – Long-Term Debt (continued)

The schedule of long-term debt activity for the years ended December 31, 2018 and 2017, is as follows:

	Balance December 31, 2017	Additions	Reductions	Balance December 31, 2018	Principal Amounts Due Within One Year	Interest Amounts Due Within One Year
Long-term debt						
LTGO Bond 2011	$ 1,111,131	$ -	$ (270,769)	$ 840,362	$ 278,657	$ 22,436
LTGO Bond 2012	290,903	-	(144,254)	146,649	146,656	1,818
LTGO Bond 2013	18,593,816	-	(599,463)	17,994,353	621,787	658,308
LTGO Bond 2016	19,431,697	-	(559,952)	18,871,745	577,145	569,347
LTGO Bond 2018	-	20,000,000	(357,153)	19,642,847	671,570	806,335
Total long-term debt	$ 39,427,547	$ 20,000,000	$ (1,931,591)	$ 57,495,956	$ 2,295,815	$ 2,058,244
Other liabilities						
Other long-term liabilities	$ 1,064,513	$ -	$ -	$ 1,064,513	$ -	$ -

	Balance December 31, 2016	Additions	Reductions	Balance December 31, 2017	Principal Amounts Due Within One Year	Interest Amounts Due Within One Year
Long-term debt						
LTGO Bond 2011	$ 3,355,604	$ -	$ (2,244,473)	$ 1,111,131	$ 270,728	$ 30,371
LTGO Bond 2012	2,422,205	-	(2,131,302)	290,903	144,255	4,212
LTGO Bond 2013	19,172,303	-	(578,487)	18,593,816	599,463	680,633
LTGO Bond 2016	20,000,000	-	(568,303)	19,431,697	559,992	586,500
Total long-term debt	$ 44,950,112	$ -	$ (5,522,565)	$ 39,427,547	$ 1,574,438	$ 1,301,716
Other liabilities						
Other long-term liabilities	$ 1,454,740	$ -	$ (390,227)	$ 1,064,513	$ -	$ -

Note 6 – Property Taxes

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

Taxes are due in two equal installments on April 30 and October 31. Collections are distributed monthly by the County Treasurer.

The Medical Center is permitted by law to levy up to $0.75 per $1,000 of assessed valuation for general purposes. The Washington State Constitution and Washington State Law, RCW 84-55-010, limit the rate. The Medical Center may also levy taxes at a lower rate. Additional amounts of tax need to be authorized by a vote of the residents of Clallam County.

Note 6 – Property Taxes (continued)

For 2018, the Medical Center's regular levy was $0.53531 per $1,000 of assessed valuation. The Medical Center received $4,437,000 from the County for the regular levy and revenues related to the harvest of timber within the community. For 2017, the Medical Center's regular levy was $.56822 per $1,000 of assessed valuation. The Medical Center received $4,570,000 from the County for the regular levy and revenues related to the harvest of timber within the community.

Property taxes are recorded as receivables when levied. Because state law allows for sale of property for failure to pay taxes, no estimate of uncollectible taxes is made.

Note 7 – Employee Benefit Plans

The Medical Center has a defined contribution pension plan covering substantially all qualified employees. All qualified employees may participate in the Medical Center's retirement plan. The employer's annual contribution is set by the plan documents. The Medical Center's liability under the plan is limited to its annual contribution. It is the Medical Center's policy to currently fund pension costs accrued under this plan.

The Medical Center has deferred compensation plans created in accordance with Internal Revenue Code Section 457 and Revenue Code Section 403(b). The plans are available to eligible employees and permit them to defer a portion of their salary until withdrawn in future years. The Medical Center makes contributions based on a percentage of certain employees' compensation. The deferred compensation is not available to employees until termination, retirement, death, or unforeseeable emergency. The Medical Center fully funds all compensation deferred under the plan agreements through deposits.

Contributions to the employee benefit plans from both the Medical Center and employees totaled approximately $13,204,000 in 2018 and $9,386,000 in 2017.

The Medical Center provides health care benefits for employees through a health plan managed by the Public Employees Benefit Board (PEBB). In addition to health care benefits for eligible employees, eligible retirees and spouses are entitled to subsidies associated with postemployment medical benefits provided through PEBB, which is an agent multiple-employer defined benefit plan. The PEBB was created within the Washington State Health Care Authority to administer medical, dental, and life insurance plans for public employees and retirees. No assets are accumulated in a related trust.

Note 8 – Collective Bargaining Agreements

At December 31, 2018, the Medical Center had a total of approximately 1,504 employees. Of this total, approximately 906 are covered by collective bargaining agreements.

Note 9 – Contingencies

Litigation – The Medical Center is involved in litigation arising in the ordinary course of business. Based on consultation with legal counsel, management estimates that these matters will be resolved without material adverse effect on the Medical Center's future financial position or results from operations.

Compliance with laws and regulations – The Medical Center is subject to many complex federal, state, and local laws and regulations. Compliance with these laws and regulations is subject to government review and interpretation, and unknown or unasserted regulatory actions. Government activity with respect to investigations and allegations regarding possible violations of these laws and regulations by health care providers, including those related to medical necessity, coding, and billing for services, has increased significantly. Violations of these laws can result in large fines and penalties, sanctions on providing future services, and repayment of past patient service revenues. The Medical Center has implemented a voluntary corporate compliance program, which includes guidance for all Medical Center employees' adherence to applicable laws and regulations. Management believes any actions that may result from investigations of noncompliance with laws and regulations will not have a material effect on the Medical Center's future financial position or results of operations.

Note 10 – Concentration of Credit Risk

The Medical Center grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payor agreements. The mix of receivables from patients and third-party payors at December 31, 2018 and 2017, was as follows:

	2018	2017
Medicare	45%	46%
Medicaid	12%	11%
Other third-party payors	29%	30%
Patients	14%	13%
	100%	100%

Note 11 – Disclosures About Fair Value of Financial Instruments

The following methods and assumptions were used to estimate the fair value of each class of financial instrument for which it is practicable to estimate that value:

Cash equivalents and short-term investments – The carrying amount reported on the statements of net position approximates fair value.

Assets limited as to use – The carrying amount approximates the fair values of investments. The fair values are estimated based on quoted market prices, if available, or estimated using quoted market prices of similar investments.

Note 11 – Disclosures About Fair Value of Financial Instruments (continued)

Accounts payable and accrued expenses – The carrying amount reported on the statements of net position for accounts payable and accrued expenses approximates fair value.

Estimated third-party payor settlements – The carrying amount reported on the statements of net position for estimated third-party payor settlements approximates fair value.

Long-term debt – The Medical Center is not able to estimate the fair value of its bonds because there is no trading of the bonds in secondary markets to establish a current fair value, as the bonds were privately placed with a financial institution.

Note 12 – Operating Leases

The Medical Center leases certain facilities and equipment under operating lease arrangements. The following is a schedule by year of future minimum lease payments as of December 31, 2018:

2019	$ 314,525
2020	297,488
2021	287,265
2022	245,265
2023	240,298
2024 - 2028	333,627
Total minimum lease payments	$ 1,718,468

Rent expense on operating leases for 2018 and 2017 was $347,000 and $331,000, respectively.

MOSSADAMS

Report of Independent Auditors 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*

To the Board of Commissioners
Public Hospital District No. 2 of Clallam County, Washington
dba Olympic Medical Center

We have audited, in accordance with the 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 Public Hospital District No. 2 of Clallam County, Washington, dba Olympic Medical Center (the Medical Center) as of and for the year ended December 31, 2018, and the related notes to the financial statements, which collectively comprise the Medical Center's financial statements, and have issued our report thereon dated February 15, 2019. Our report is qualified because obligations for postemployment benefits other than pension were not recorded and related disclosures were omitted.

Internal Control Over Financial Reporting

In planning and performing our audit 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 opinion 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 entity'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 its 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 entity’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 entity’s internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Moss Adams LLP

Everett, Washington
February 15, 2019