Office of the Washington State Auditor
Pat McCarthy

October 31, 2019

Board of Commissioners
Jefferson Healthcare
Port Townsend, 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 financial statements of Jefferson Healthcare for the fiscal years ended December 31, 2018 and 2017. The District contracted with the CPA firm for this audit and requested that we accept it 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

Insurance Building, P.O. Box 40021 • Olympia, Washington 98504-0021 • (360) 902-0370 • Pat.McCarthy@sao.wa.gov

Jefferson County
Public Hospital District No. 2
doing business as
Jefferson Healthcare

Basic Financial Statements and
Independent Auditors' Reports

December 31, 2018 and 2017

DINGUS | ZARECOR & ASSOCIATES PLLC
Certified Public Accountants

Jefferson County Public Hospital District No. 2
doing business as Jefferson Healthcare
Table of Contents

DINGUS | ZARECOR & ASSOCIATES PLLC
Certified Public Accountants

INDEPENDENT AUDITORS' REPORT

Board of Commissioners
Jefferson County Public Hospital District No. 2
doing business as Jefferson Healthcare
Port Townsend, Washington

Report on the Financial Statements

We have audited the accompanying financial statements of Jefferson County Public Hospital District No. 2 doing business as Jefferson Healthcare (the District) as of and for the years ended December 31, 2018 and 2017, and the related notes to the financial statements, which collectively comprise the District's basic 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 controls relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' 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 auditors' 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 auditors consider internal controls 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 audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the District as of December 31, 2018 and 2017, and the changes in its financial position and cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

12015 East Main Avenue | Spokane Valley, WA 99206 | 509.242.0874 | www.dzacpa.com

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 3 through 7 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 audits of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated June 3, 2019, on our consideration of the District's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters for the year ended December 31, 2018. We issued a similar report for the year ended December 31, 2017, dated May 30, 2018, which has not been included with the 2018 financial and compliance report. The purpose of those reports 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 the effectiveness of the District's internal control over financial reporting or on compliance. Those reports are an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the District's internal control over financial reporting and compliance.

Dingus, Zarecor & Associates PLLC

Spokane Valley, Washington
June 3, 2019

Our management's discussion and analysis of Jefferson County Public Hospital District No. 2 doing business as Jefferson Healthcare's (the District) financial performance provides an overview of the District's financial activities for the years ended December 31, 2018 and 2017. Please read it in conjunction with the District's basic financial statements, which begin on page 8.

Financial Highlights

- The District's net position increased in each of the past two years by $4,358,791, or 9 percent, in 2018 and $2,629,348, or 5 percent, in 2017.
- The District reported operating income of $4,365,785 in 2018 and $2,582,467 in 2017. Operating income increased by $1,783,318 in 2018 and decreased by $1,872,445 in 2017.
- Net nonoperating revenues and expenses decreased by $53,875 in 2018 compared to 2017 and $67,565 in 2017 compared to 2016.

Using This Annual Report

The District's basic 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 District, including resources held by the District that are designated for specific purposes by contributors, grantors, or enabling legislation.

The Statement of Net Position and Statement of Revenues, Expenses, and Changes in Net Position

Our analysis of the District's finances begins below. One of the most important questions asked about the District's finances is, "Is the District as a whole better or worse off as a result of the year's activities?" The Statement of Net Position and the Statement of Revenues, Expenses, and Changes in Net Position report information about the District's resources and its activities in a way that helps answer this question. These statements include all restricted and unrestricted assets and all liabilities using the accrual basis of accounting. All of the current year's revenues and expenses are taken into account regardless of when the cash is received or paid.

These two statements report the District's net position and changes in it. You can think of the District's net position — the difference between assets and liabilities — as one way to measure the District's financial health, or financial position. Over time, increases or decreases in the District's net position are one indicator of whether its financial health is improving or deteriorating. You will need to consider other nonfinancial factors, however, such as changes in the District's patient base and measures of the quality of service provided to the community, as well as local economic factors to assess the overall health of the District.

The Statement of Cash Flows

The final required statement is the Statement of Cash Flows. The statement reports cash receipts, cash payments, and net changes in cash resulting from operations, investing, and financing activities. It provides answers to such questions as, "Where did cash come from?"; "What was cash used for?"; and "What was the change in the cash balance during the reporting period?"

The District's Net Position

The District's net position is the difference between its assets and liabilities reported in the Statements of Net Position on pages 8 and 9. The District's net position increased by $4,358,791, or 9 percent, in 2018, and $2,629,348, or 5 percent, in 2017, as shown in Table 1.

Table 1. Assets, Liabilities, and Net Position

	2018	2017	2016
Assets			
Current assets	**$ 51,430,797**	$ 47,591,033	$ 45,524,679
Capital assets, net	**43,371,965**	44,495,901	41,068,450
Total assets	**$ 94,802,762**	$ 92,086,934	$ 86,593,129
Liabilities			
Current liabilities	**$ 10,985,266**	$ 11,389,523	$ 10,181,969
Long-term debts, net of current maturities	**28,489,938**	29,728,644	28,071,741
	39,475,204	41,118,167	38,253,710
Net position			
Net investment in capital assets	**12,947,479**	11,512,522	10,626,814
Restricted	**544,882**	1,626,907	544,634
Unrestricted	**41,835,197**	37,829,338	37,167,971
	55,327,558	50,968,767	48,339,419
Total liabilities and net position	**$ 94,802,762**	$ 92,086,934	$ 86,593,129

Current assets in 2018 include cash and cash equivalents (55 percent of total current assets), accounts receivable (40 percent), supply inventory (4 percent), and prepaid expenses (1 percent). The majority of the increase in current assets for 2018 was from an increase in cash and cash equivalents and accounts receivable. The increase in cash and cash equivalents is due primarily to holding additional cash as expenses grow, as well as intentionally growing days cash on hand to be more in line with industry best practices; higher cash levels allow the District to better respond to potential unknowns and reimbursement pressures going forward. The increase in accounts receivable is due primarily to growth in patient volumes and related receivables. Capital assets, net, decreased in 2018 with material information technology and electronic health records' related assets becoming fully depreciated.

Current assets in 2017 include cash and cash equivalents (55 percent of total current assets), accounts receivable (39 percent), supply inventory (4 percent), and prepaid expenses (2 percent). The majority of the increase in current assets for 2017 was from an increase in cash and cash equivalents due primarily to holding additional cash as the expenses grow. Capital assets, net increased in 2017 with the build out of shell space in the emergency and specialty services building, as well as the acquisition of a building on the District's campus in which the District previously held the master lease.

Operating Results and Changes in the District's Net Position

In 2018, the District's net position increased by $4,358,791, or 9 percent, as shown in Table 2. This increase is generally related to an increase in net patient service revenue. The District added or expanded many service lines in 2017 that continued to grow their capacity in 2018, including dermatology, orthopedics, and cardiology.

In 2017, the District's net position increased by $2,629,348, or 5 percent, as shown in Table 2. This increase is generally related to an increase in net patient service revenue. The District experienced growth in dermatology, sleep services, cardiology services, and clinic visit revenues in 2017 by completing construction of related space and adding appointment providers in these departments.

Table 2. Operating Results and Changes in Net Position

	2018	2017	2016
Operating revenues			
Net patient service revenue	**$ 106,725,425**	$ 96,471,090	$ 85,362,227
Electronic health records incentive payments	**85,000**	(139,301)	182,750
340B contract pharmacies	**3,473,711**	2,953,967	3,202,317
Other operating revenues	**2,194,755**	1,682,747	1,133,914
Total operating revenues	**112,478,891**	100,968,503	89,881,208
Operating expenses			
Salaries and benefits	**67,300,967**	61,093,528	52,081,612
Supplies	**18,386,976**	15,499,587	13,387,358
Depreciation and amortization	**4,703,575**	4,413,391	4,065,182
Other operating expenses	**17,721,588**	17,379,530	15,892,144
Total operating expenses	**108,113,106**	98,386,036	85,426,296
Operating income	**4,365,785**	2,582,467	4,454,912
Nonoperating revenues (expenses)			
Taxation	**518,463**	455,211	454,759
Investment income	**381,308**	144,451	103,462
Interest expense	**(1,055,232)**	(893,613)	(541,665)
Gain (loss) on disposal of capital assets	**2,922**	(30,218)	39,355
Contributions	**145,545**	371,050	58,535
Total nonoperating revenues (expenses), net	**(6,994)**	46,881	114,446
Change in net position	**4,358,791**	2,629,348	4,569,358
Net position, beginning of year	**50,968,767**	48,339,419	43,770,061
Net position, end of year	**$ 55,327,558**	$ 50,968,767	$ 48,339,419

The first component of the overall change in the District's net position is operating income (loss) — the difference between net patient service revenues and the expenses incurred to perform those services. In each of the past three years, the District has reported an operating income. Operating income increased by $1,783,318 from 2017 to 2018.

The primary components of the increase in operating income for 2018 are:

- An increase in net patient service revenue of $10,254,335, or 10.6 percent, between 2017 and 2018; the increase is due to increased patient volumes, maximizing capacity in service lines that expanded in 2017, and higher Medicare reimbursement rates in 2018.
- An increase in revenue from the 340B pharmaceuticals program of $519,744, or 17.6 percent, from 2017 to 2018. The growth of this program is primarily due to increased utilization of 340B-eligible pharmacies by District patients and the increase of Medicare patients in Jefferson County.
- An increase in salaries/wages and benefits expenses of $6,207,439 from 2017 to 2018; this increase correlates with the growth in patient levels and services offered, as well as annual wage increases.
- An increase in other operating revenue of $512,008 from 2017 to 2018. The increase in other operating revenue primarily consists of funds received from the Olympic Community of Health, the accountable community of health for Jefferson, Clallam, and Kitsap counties for Medicaid transformation work.

Operating income decreased by $1,872,445 from 2016 to 2017.

The primary components of the decrease in operating income for 2017 are:

- Net patient service revenue increased between 2016 and 2017 by $11,108,863. This growth was primarily related to adding dermatology and cardiology services and increasing volumes in the emergency department, outpatient services, and clinics. The District actively recruited providers in 2017 to grow services to respond to patient demand.
- A decrease in the electronic health records incentive payments of $322,051 between 2016 and 2017; 2017 included a payback related to an audit of 2013-2015 incentives.
- An increase in salaries and wages expenses of $7,062,425 from 2016 to 2017; this increase correlates with the growth in patient levels and services offered, as well as annual wage increases. Several employed providers joined the District team in 2017. Adding these employees also caused an increase in employee benefits of $1,949,491 between 2016 and 2017.
- An increase in professional fees of $1,565,308 between 2016 and 2017 related to contracting for medical services in the cardiology department, physical therapy department, surgery department, and primary care clinics.
- An increase in supplies expense of approximately $2,112,229 from 2016 to 2017; this increase was primarily due to the growth of orthopedic services and related high costs of prosthetic devices.

Another important factor to consider in evaluating operating income is the District's commitment to providing care for patients with little or no health insurance or other means for payment. This service to the community is consistent with the goals established by the District when it became a hospital district in 1975. Uncompensated care provided to these patients increased by $925,813 in 2018, compared to an increase of $510,297 in 2017. The primary cause of this increase was the enhancement of the charity care program in September 2017 to address the difficulty of affording healthcare services for lower income patients; 2018 was the first full year of this enhancement.

Nonoperating Revenues and Expenses

Nonoperating revenues consist primarily of property taxes levied by the District, interest revenue, and rental income. Nonoperating revenues and expenses decreased by $53,875 in 2018 and $67,565 in 2017. The District receives operating grants from various state and federal agencies for specific programs. These are discussed in detail in Note 1 to the financial statements. Operating grants received from the various state and federal programs increased from $18,636 in 2017 to $162,400 in 2018.

The District received contributions of $145,545 and $371,050 during 2018 and 2017, respectively. These contributions are primarily from the Hospice Foundation for Jefferson Healthcare, the Jefferson Healthcare Foundation, and the Jefferson Healthcare Hospital Auxiliary.

The District's Cash Flows

Changes in the District's cash flows are consistent with changes in operating incomes and nonoperating revenues and expenses discussed earlier.

Capital Assets and Debt Administration

Capital Assets

Net capital assets decreased by $1,123,936, or 3 percent, in 2018. This net decrease includes purchases (including construction in progress) of $3,563,125 and depreciation expense of $4,703,575. Net capital assets increased by $3,427,451, or 8 percent, in 2017. This net increase includes purchases (including construction in progress) of $5,164,127 and depreciation expense of $4,413,391.

The activity in 2018 includes construction, architect, and other fees for components of building out shell space on the second and third floors of the emergency and specialty services building, and beginning construction on enhancements to an existing rural health clinic to offer dental services in 2019.

The activity in 2017 includes construction, architect, and other fees for components of building out shell space on the second floor of the emergency and specialty services building and purchasing a medical office building previously leased by the District.

At the end of 2018, the District had $43,371,965 invested in capital assets, net of accumulated depreciation, as detailed in Note 6 to the financial statements.

Debt

At December 31, 2018, the District had $28,489,938 in long-term debt obligations, a decrease of $1,238,706, or 4 percent, from December 31, 2017. The decrease is primarily related to paying scheduled payments on existing debt without incurring additional debt.

The District's formal debt issuances cannot be issued without approval of the District's Board of Commissioners. The amount of debt issued is subject to limitations that apply to the District.

Contacting the District's Financial Management

This financial report is designed to provide our patients, suppliers, taxpayers, and creditors with a general overview of the District's finances and to show the District's accountability for the money it receives. If you have questions about this report or need additional information, contact the District administration at 834 Sheridan Street, Port Townsend, Washington 98368-2443.

Jefferson County Public Hospital District No. 2
doing business as Jefferson Healthcare
Statements of Net Position
December 31, 2018 and 2017

ASSETS	**2018**	**2017**
Current assets		
Cash and cash equivalents	**$ 5,320,270**	$ 5,247,535
Receivables:		
Patient accounts, net	**13,337,926**	11,489,852
Estimated third-party payor settlements	**6,628,444**	6,378,144
340B contract pharmacies	**273,161**	384,084
Other	**194,530**	331,806
Inventories	**2,136,372**	2,054,189
Prepaid expenses and other assets	**748,848**	1,016,175
Cash and cash equivalents restricted or limited as to use	**22,779,883**	20,679,142
Taxes receivable restricted or limited as to use	**11,363**	10,106
Total current assets	**51,430,797**	47,591,033
Noncurrent assets, capital assets, net	**43,371,965**	44,495,901
Total assets	**$ 94,802,762**	$ 92,086,934

See accompanying notes to basic financial statements.

Jefferson County Public Hospital District No. 2
doing business as Jefferson Healthcare
Statements of Net Position (Continued)
December 31, 2018 and 2017

LIABILITIES AND NET POSITION	**2018**	**2017**
Current liabilities		
Accounts payable	**$ 2,819,830**	$ 3,401,107
Accounts payable, capital	**385,670**	1,748,569
Accrued payroll and related liabilities	**2,780,748**	1,617,677
Accrued paid time off	**3,259,055**	2,839,919
Accrued interest payable	**321,337**	329,316
Electronic health records incentive payback	**191,085**	276,085
Current portion of long-term debt	**1,227,541**	1,176,850
Total current liabilities	**10,985,266**	11,389,523
Noncurrent liabilities		
Long-term debt, net of current portion	**28,489,938**	29,728,644
Total noncurrent liabilities	**28,489,938**	29,728,644
Total liabilities	**39,475,204**	41,118,167
Net position		
Net investment in capital assets	**12,947,479**	11,512,522
Restricted under bond agreements	**544,882**	1,626,907
Unrestricted	**41,835,197**	37,829,338
Total net position	**55,327,558**	50,968,767
Total liabilities and net position	**$ 94,802,762**	$ 92,086,934

See accompanying notes to basic financial statements.

Jefferson County Public Hospital District No. 2
doing business as Jefferson Healthcare
Statements of Revenues, Expenses, and Changes in Net Position
Years Ended December 31, 2018 and 2017

	2018	2017
Operating revenues		
Net patient service revenue	**$ 106,725,425**	$ 96,471,090
Electronic health records incentive payments (payback)	**85,000**	(139,301)
340B contract pharmacies	**3,473,711**	2,953,967
Grants	**162,400**	18,636
Other	**2,032,355**	1,664,111
Total operating revenues	**112,478,891**	100,968,503
Operating expenses		
Salaries and wages	**53,801,639**	49,279,454
Employee benefits	**13,499,328**	11,814,074
Professional fees	**6,098,592**	6,476,317
Purchased services	**5,039,231**	5,003,480
Supplies	**18,386,976**	15,499,587
Insurance	**740,154**	608,885
Leases and rentals	**1,547,347**	1,403,953
Depreciation	**4,703,575**	4,413,391
Repairs and maintenance	**634,623**	546,341
Utilities	**1,146,728**	1,018,815
Licenses and taxes	**641,426**	662,547
Other	**1,873,487**	1,659,192
Total operating expenses	**108,113,106**	98,386,036
Operating income	**4,365,785**	2,582,467
Nonoperating revenues (expenses)		
Taxation for maintenance and operations	**507,298**	441,328
Taxation for debt service	**11,165**	13,883
Investment income	**381,308**	144,451
Interest expense	**(1,055,232)**	(893,613)
Gain (loss) on disposal of capital assets	**2,922**	(30,218)
Contributions	**145,545**	371,050
Total nonoperating revenues (expenses), net	**(6,994)**	46,881
Change in net position	**4,358,791**	2,629,348
Net position, beginning of year	**50,968,767**	48,339,419
Net position, end of year	**$ 55,327,558**	$ 50,968,767

See accompanying notes to basic financial statements.

Jefferson County Public Hospital District No. 2
doing business as Jefferson Healthcare
Statements of Cash Flows
Years Ended December 31, 2018 and 2017

	2018	2017
Increase (Decrease) in Cash and Cash Equivalents		
Cash flows from operating activities		
Cash received from and on behalf of patients	**$ 104,627,051**	$ 96,732,024
Cash received from electronic health records incentive payments	**-**	259,980
Cash received from 340B contract pharmacies	**3,584,634**	3,152,965
Cash received from other revenue	**2,169,631**	1,488,293
Cash received from operating grants	**162,400**	18,636
Cash paid to and on behalf of employees	**(65,718,760)**	(60,587,066)
Cash paid to suppliers and contractors	**(36,504,697)**	(33,780,445)
Net cash provided by operating activities	**8,320,259**	7,284,387
Cash flows from noncapital financing activities		
Cash received from contributions	**145,545**	371,050
Taxes received for maintenance and operations	**507,298**	441,328
Net cash provided by noncapital financing activities	**652,843**	812,378
Cash flows from capital and related financing activities		
Purchase of capital assets	**(4,939,616)**	(7,919,638)
Principal payments on long-term debt	**(1,176,850)**	(22,765,989)
Proceeds from issuance of long-term debt	**-**	25,042,221
Interest paid	**(1,074,376)**	(579,524)
Taxes received for bond principal and interest	**9,908**	14,259
Net cash used in capital and related financing activities	**(7,180,934)**	(6,208,671)
Cash flows from investing activities, interest received	**381,308**	144,451
Net increase in cash and cash equivalents	**2,173,476**	2,032,545
Cash and cash equivalents, beginning of year	**25,926,677**	23,894,132
Cash and cash equivalents, end of year	**$ 28,100,153**	$ 25,926,677

See accompanying notes to basic financial statements.

Jefferson County Public Hospital District No. 2
doing business as Jefferson Healthcare
Statements of Cash Flows (Continued)
Years Ended December 31, 2018 and 2017

	2018	2017
Reconciliation of Cash and Cash Equivalents to the Statements of Net Position		
Cash and cash equivalents	**$ 5,320,270**	$ 5,247,535
Cash and cash equivalents restricted or limited as to use	**22,779,883**	20,679,142
Total cash and cash equivalents	**$ 28,100,153**	$ 25,926,677
Reconciliation of Operating Income to Net Cash Provided by Operating Activities		
Operating income	**$ 4,365,785**	$ 2,582,467
Adjustments to reconcile operating income to net cash provided by operating activities		
Depreciation	**4,703,575**	4,413,391
Provision for bad debts	**2,539,972**	2,778,473
Decrease (increase) in assets:		
Receivables:		
Patient accounts, net	**(4,388,046)**	(3,896,845)
Estimated third-party payor settlements	**(250,300)**	1,379,306
Electronic health records incentive payments	**-**	123,196
340B contract pharmacies	**110,923**	198,998
Other	**137,276**	(175,818)
Inventories	**(82,183)**	(236,090)
Prepaid expenses and other assets	**267,327**	(205,405)
Increase (decrease) in liabilities:		
Accounts payable	**(581,277)**	(459,833)
Accrued payroll and related liabilities	**1,163,071**	294,630
Accrued paid time off	**419,136**	211,832
Electronic health records incentive payback	**(85,000)**	276,085
Net cash provided by operating activities	**$ 8,320,259**	$ 7,284,387

See accompanying notes to basic financial statements.

1. Reporting Entity and Summary of Significant Accounting Policies:

a. Reporting Entity

Jefferson County Public Hospital District No. 2 doing business as Jefferson Healthcare (the District) is organized as a municipal corporation pursuant to the laws of the state of Washington for municipal corporations. The primary purpose of the District is to operate Jefferson Healthcare (the Hospital), the principal provider of acute healthcare services for Port Townsend and surrounding communities. Port Townsend is located on Washington State Highway 20 at the northeast corner of the Olympic Peninsula. The District also operates six rural health clinics. Four of these clinics are in Port Townsend and the remaining two are located in Quilcene, Washington and Port Ludlow, Washington.

The Hospital is a Centers for Medicare and Medicaid Services five-star rated critical access hospital with 25 set up acute care beds. Services offered by the District include medical, swing bed, surgical, labor/delivery and nursery care, 24-hour emergency, laboratory, imaging services, orthopedics, oncology, physical therapy, home health, hospice, cardiac rehabilitation, dermatology, cardiology, primary care, and a wellness program. Members of the medical staff include specialists in each of the services lines provided by the District.

The District is not a component unit of Jefferson County. The District does not have any material component units.

As organized, the District is exempt from federal income tax. The Board of Commissioners is made up of five community members elected to six-year terms.

b. Summary of Significant Accounting Policies

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

Enterprise fund accounting – The District's accounting policies conform to accounting principles generally accepted in the United States of America as applicable to proprietary funds of governments. The District uses enterprise fund accounting. Revenue and expenses are recognized on the accrual basis using the economic resources measurement focus.

Cash and cash equivalents – Cash and cash equivalents include investments in highly liquid debt instruments with an original maturity of three months or less. Cash receipts are deposited directly to the District's depository accounts at a bank. Periodically, such cash is transferred to the operating accounts held by the Jefferson County Treasurer (County Treasurer), and warrants are issued against these accounts.

Inventories – Inventories consist of medical supplies, drugs, and food and are stated at cost using the first-in, first-out method.

1. Reporting Entity and Summary of Significant Accounting Policies (continued):

b. Summary of Significant Accounting Policies (continued)

Assets restricted or limited as to use – Assets restricted or limited as to use include assets set aside by the Board of Commissioners for future capital improvements and other uses over which the Board retains control and could subsequently use for other purposes; assets set aside for repayment of principal and interest on bond indebtedness; and assets set aside for capital acquisition with bond proceeds.

Compensated absences – The District's employees earn paid time off (PTO) for vacation, holidays, and short-term illnesses based upon years of service. The related liability is accrued during the period in which it is earned. Depending on years of service, PTO accrues from .0711 to .1365 per hour worked each year. The District's policy is to permit employees to accumulate up to a maximum of 428 hours. Upon reaching 428 hours, any excess PTO earned that would extend an employee over the stated maximum is not paid to the employee.

In December of each year, employees can elect to cash out up to 60 hours of PTO the following May and December, for an annual maximum of 120 hours, as long as a minimum of 200 hours of PTO is retained. Employees can also elect to defer up to 60 hours of PTO into their 457 plan, as long as a minimum of 200 hours of PTO is retained.

Net position – Net position of the District is classified into three components. *Net investment in capital assets* 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. *Restricted net position* is noncapital net position that must be used for a particular purpose, as specified by creditors, grantors, or contributors external to the District. *Unrestricted net position* is the remaining net position that does not meet the definition of *net investment in capital assets* or *restricted*.

Operating revenues and expenses – The District's statements of revenues, expenses, and changes in net position distinguish between operating and nonoperating revenues and expenses. Operating revenues result from exchange transactions, including grants for specific operating activities associated with providing healthcare services — the District's principal activity. Nonexchange revenues, including taxes and contributions received for purposes other than capital asset acquisition, are reported as nonoperating revenues. Operating expenses are all expenses incurred to provide healthcare services, other than financing costs.

Restricted resources – When the District has both restricted and unrestricted resources available to finance a particular program, it is the District's policy to use restricted resources before unrestricted resources.

Grants and contributions – From time to time, the District receives grants from the state of Washington and others as well as contributions from individuals and private organizations. Revenues from grants and contributions (including contributions of capital assets) are recognized when all eligibility requirements are met. Grants and contributions may be restricted for either specific operating purposes or for capital purposes. Amounts that are restricted to specific capital acquisitions are reported after nonoperating revenues and expenses. Grants that are for specific projects or purposes related to the District's operating activities are reported as operating revenue. Grants that are used to subsidize operating deficits are reported as nonoperating revenue. Contributions, except for capital contributions, are reported as nonoperating revenue.

1. Reporting Entity and Summary of Significant Accounting Policies (continued):

b. Summary of Significant Accounting Policies (continued)

Reclassifications – Certain items included in the accompanying 2017 financial statements have been reclassified to conform to the 2018 presentation, with no effect on the previously reported change in net position.

Subsequent events – The District has evaluated subsequent events through June 3, 2019, the date on which the financial statements were available to be issued.

Upcoming accounting standard pronouncements – In November 2016, the Governmental Accounting Standards Board (GASB) issued Statement No. 83, *Certain Asset Retirement Obligations*, which addresses accounting and financial reporting for certain asset retirement obligations (AROs). An ARO is a legally enforceable liability associated with the retirement of a tangible capital asset. Specifically, this statement requires a government entity with legal obligations to perform future asset retirement activities related to its tangible capital assets to recognize a liability based on the guidance in this statement. This statement establishes criteria for determining the timing and pattern of recognition of a liability and a corresponding deferred outflow of resources for AROs. The determination of when a liability is incurred should be based on the occurrence of external laws, regulations, contracts, or court judgments, together with the occurrence of an internal event obligating a government entity to perform asset retirement activities. This statement requires the measurement of an ARO to be based on the best estimate of the current value of outlays expected to be incurred. The new guidance is effective for the District's year ending December 31, 2019, although earlier application is encouraged. The District has not elected to implement this statement early; however, management is still evaluating the impact, if any, of this statement in the year of adoption.

In June 2017, the GASB issued Statement No. 87, *Leases*, which increases the usefulness of governments' financial statements by requiring recognition of certain lease assets and liabilities for leases previously classified as operating leases and recognized as inflows of resources or outflows of resources based on the payment provisions of the contract. It establishes a single model for lease accounting based on the foundational principle that leases are financings of the right to use an underlying asset. Under this statement, a lessee is required to recognize a lease liability and an intangible asset representing the lessee's right to use the leased asset, thereby enhancing the relevance and consistency of information about governments' leasing activities. The new guidance is effective for the District's year ending December 31, 2020, although earlier application is encouraged. The District has not elected to implement this statement early; however, management is still evaluating the impact, if any, of this statement in the year of adoption.

1. Reporting Entity and Summary of Significant Accounting Policies (continued):

b. Summary of Significant Accounting Policies (continued)

Upcoming accounting standard pronouncements (continued) – In March 2018, the GASB issued Statement No. 88, *Certain Disclosures Related to Debt, Including Direct Borrowing and Direct Placements*, to improve the information that is disclosed in governmental entity financial statements related to debt, including direct borrowing and direct placements. It also clarifies which liabilities government entities should include when disclosing information related to debt. The statement defines debt and requires additional essential information related to debt to be disclosed in the notes to financial statements, including unused lines of credit, assets pledged as collateral for the debt, and terms specified in debt agreements related to significant events of default with finance-related consequences, significant termination events with finance-related consequences, and significant subjective acceleration clauses. This statement also requires that existing and additional information be provided for direct borrowings and direct placement of debt separately from other debt. The new guidance is effective for the District's year ending December 31, 2019, although earlier application is encouraged. The District has not elected to implement this statement early; however, management is still evaluating the impact, if any, of this statement in the year of adoption.

In June 2018, the GASB issued Statement No. 89, *Accounting for Interest Cost Incurred Before the End of a Construction Period*. The objectives of this statement are (1) to enhance the relevance and comparability of information about capital assets and the cost of borrowing for a reporting period and (2) to simplify accounting for interest cost incurred before the end of a construction period. The new guidance is effective for the District's year ending December 31, 2020. Management is currently evaluating the effect this statement will have on the financial statements and related disclosures.

2. Bank Deposits and Investments:

The Revised Code of Washington (RCW), Chapter 39, authorizes municipal governments to invest their funds in a variety of investments including federal, state, and local government certificates, notes, or bonds; the Washington State Local Government Investment Pool; savings accounts in qualified public depositories; and certain other investments. The District has elected to use the County Treasurer to be its treasurer to issue warrants and make investments. Amounts invested in the Washington State Local Government Investment Pool at December 31, 2018 and 2017, were $22,728,699 and $20,635,678, respectively. The Washington State Local Government Investment Pool consists of investments in federal, state, and local government certificates and savings accounts in qualified public depositories.

All cash and cash equivalents held by the County Treasurer or deposited with qualified public depositories are protected against loss by the State of Washington Public Deposit Protection Commission, as provided by RCW Chapter 39.58, subject to certain limitations. Qualified public depositories, including First Federal and Union Bank, pledge securities with this commission, which are available to insure public deposits within the state of Washington. The cash on deposit with these banks is also insured through the Federal Deposit Insurance Corporation (FDIC).

2. Bank Deposits and Investments (continued):

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

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

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

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

3. Patient Accounts Receivable:

Patient accounts receivable are reduced by an allowance for uncollectible accounts. In evaluating the collectibility of accounts receivable, the District analyzes its past history and identifies trends for each of its major payor sources of revenue to estimate the appropriate allowance for uncollectible accounts and provision for bad debts. Management regularly reviews data about these major payor sources of revenue in evaluating the sufficiency of the allowance for uncollectible accounts. For receivables associated with services provided to patients who have third-party coverage, the District analyzes contractually due amounts and provides an allowance for uncollectible accounts and a provision for bad debts, if necessary (for example, for expected uncollectible deductibles and copayments on accounts for which the third-party payor has not yet paid, or for payors who are known to be having financial difficulties that make the realization of amounts due unlikely). For receivables associated with self-pay patients (which include both patients without insurance and patients with deductible and copayment balances due for which third-party coverage exists for part of the bill), the District records a significant provision for bad debts in the period of service on the basis of its past experience, which indicates that many patients are unable or unwilling to pay the portion of their bill for which they are financially responsible. The difference between the standard rates (or the discounted rates if negotiated) and the amounts actually collected after all reasonable collection efforts have been exhausted is charged off against the allowance for uncollectible accounts.

The District's allowance for uncollectible accounts for self-pay patients has not changed significantly from the prior years. The District does not maintain a material allowance for uncollectible accounts from third-party payors, nor did it have significant writeoffs from third-party payors.

3. Patient Accounts Receivable (continued):

Patient accounts receivable reported as current assets consisted of these amounts:

	2018	2017
Patients and their insurance carriers	$ **9,033,259**	$ 9,416,682
Medicare	**5,621,217**	3,996,066
Medicaid	**1,810,450**	1,720,104
	16,464,926	15,132,852
Less allowance for uncollectible accounts	**(3,127,000)**	(3,643,000)
Patient accounts receivable, net	$ **13,337,926**	$ 11,489,852

4. Assets Restricted or Limited as to Use:

The composition of assets restricted or limited as to use was as follows:

	2018	2017
Cash and cash equivalents		
Restricted under 2013 limited tax general obligation bond agreement for principal and interest payment	$ **45,214**	$ 78,777
Restricted under 2017 limited tax general obligation bond agreement for principal and interest payment	**494,310**	470,441
Restricted by bond for capital acquisition	**-**	1,072,012
Internally designated by the Board for capital improvements, home health and hospice operations, and other purposes	**22,240,359**	19,057,912
Total cash and cash equivalents restricted or limited as to use	$ **22,779,883**	$ 20,679,142
Taxes receivable		
Restricted under 2013 limited tax general obligation bond agreement for principal and interest payment	$ **5,358**	$ 5,677
Internally designated by the Board for capital improvements, home health and hospice operations, and other purposes	**6,005**	4,429
Total taxes receivable restricted or limited as to use	$ **11,363**	$ 10,106

5. Property Taxes:

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

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

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

The District's portion of the regular tax levy available for maintenance and operations was $0.05264 and $0.04181 per $1,000 on a total assessed valuation of $5,081,047,913 and $4,822,149,172, for a total regular levy of $267,458 and $201,618 in 2018 and 2017, respectively.

The District's portion of the regular levy pledged for the Limited Tax General Obligation (LTGO) bond repayment was $0.03838 and $0.04640 per $1,000 on a total assessed valuation of $5,081,047,913 and $4,822,149,172, for a total pledged portion of the regular levy of $195,000 and $223,750 in 2018 and 2017, respectively.

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

6. Capital Assets:

The District capitalizes assets whose costs exceed $5,000 and with an estimated useful life of more than one year; lesser amounts are expensed. Capital assets are stated at cost or estimated fair value at the date of donation. Expenditures for maintenance and repairs are charged to operations as incurred; betterments and major renewals are capitalized. When such assets are disposed of, the related costs and accumulated depreciation are removed from the accounts and the resulting gain or loss is classified in nonoperating revenues or expenses.

All capital assets, other than land and construction in progress, are depreciated using the straight-line method over the shorter period of the lease term or the estimated useful life of the equipment. Useful lives have been estimated as follows:

Land improvements	5 to 25 years
Buildings and improvements	5 to 40 years
Equipment	3 to 25 years
Leasehold improvements	3 to 15 years

6. Capital Assets (continued):

Capital asset additions, retirements, transfers, and balances were as follows:

	Balance December 31, 2017	Additions	Retirements	Transfers	Balance December 31, 2018
Capital assets not being depreciated					
Land	$ 718,068	$ -	$ -	$ -	**$ 718,068**
Construction in progress	169,964	2,510,797	-	(1,143,789)	**1,536,972**
Total capital assets not being depreciated	888,032	2,510,797	-	(1,143,789)	**2,255,040**
Capital assets being depreciated					
Land improvements	4,028,158	-	-	-	**4,028,158**
Buildings and improvements	39,695,927	-	-	-	**39,695,927**
Equipment	36,515,216	1,075,920	(23,592)	1,057,574	**38,625,118**
Leasehold improvements	1,206,041	-	-	86,215	**1,292,256**
Total capital assets being depreciated	81,445,342	1,075,920	(23,592)	1,143,789	**83,641,459**
Less accumulated depreciation for					
Land improvements	(1,004,306)	(255,933)	-	-	**(1,260,239)**
Buildings and improvements	(16,412,673)	(1,882,660)	-	-	**(18,295,333)**
Equipment	(19,940,233)	(2,403,824)	16,514	-	**(22,327,543)**
Leasehold improvements	(480,261)	(161,158)	-	-	**(641,419)**
Total accumulated depreciation	(37,837,473)	(4,703,575)	16,514	-	**(42,524,534)**
Total capital assets being depreciated, net	43,607,869	(3,627,655)	(7,078)	1,143,789	**41,116,925**
Capital assets, net	**$ 44,495,901**	**$ (1,116,858)**	**$ (7,078)**	**$ -**	**$ 43,371,965**

Construction in progress as of December 31, 2018, consisted primarily of the construction on the dermatology and cardiology clinics located on the second floor of the District’s emergency and specialty services building. Construction was completed in February 2019 with insignificant additional costs to complete. The remaining balance of construction in progress consisted primarily of the renovation of existing space owned by the District, which expanded an existing rural health clinic in the Sheridan building to offer dental services. The construction of space for dental services in the Sheridan building is expected to cost approximately $1,742,000 to complete, with an expected completion date of June 2019.

6. Capital Assets (continued):

	Balance December 31, 2016	Additions	Retirements	Transfers	Balance December 31, 2017
Capital assets not being depreciated					
Land	$ 565,776	$ -	$ -	$ 152,292	**$ 718,068**
Construction in progress	1,501,340	5,192,684	-	(6,524,060)	**169,964**
Total capital assets not being depreciated	2,067,116	5,192,684	-	(6,371,768)	**888,032**
Capital assets being depreciated					
Land improvements	4,098,006	-	(69,848)	-	**4,028,158**
Buildings and improvements	35,330,704	2,682,729	(85,000)	1,767,494	**39,695,927**
Equipment	35,096,039	23,303	(2,579,741)	3,975,615	**36,515,216**
Leasehold improvements	577,382	-	-	628,659	**1,206,041**
Total capital assets being depreciated	75,102,131	2,706,032	(2,734,589)	6,371,768	**81,445,342**
Less accumulated depreciation for					
Land improvements	(818,223)	(255,931)	69,848	-	**(1,004,306)**
Buildings and improvements	(14,671,318)	(1,826,355)	85,000	-	**(16,412,673)**
Equipment	(20,270,813)	(2,191,287)	2,521,867	-	**(19,940,233)**
Leasehold improvements	(340,443)	(139,818)	-	-	**(480,261)**
Total accumulated depreciation	(36,100,797)	(4,413,391)	2,676,715	-	**(37,837,473)**
Total capital assets being depreciated, net	39,001,334	(1,707,359)	(57,874)	6,371,768	**43,607,869**
Capital assets, net	**$ 41,068,450**	**$ 3,485,325**	**$ (57,874)**	**$ -**	**$ 44,495,901**

7. Long-term Debt:

A schedule of changes in the District's long-term debt is as follows:

	Balance December 31, 2017	Additions	Reductions	Balance December 31, 2018	Amounts Due Within One Year
Bonds and notes payable					
Note payable to individuals	$ 33,825	$ -	$ (17,224)	$ 16,601	$ 16,601
Note payable to individuals	4,800,611	-	(397,337)	4,403,274	418,394
2013 LTGO bonds	1,180,000	-	(180,000)	1,000,000	190,000
2017 LTGO bonds	5,150,000	-	(116,198)	5,033,802	121,866
2017 Revenue bonds	19,675,000	-	(466,091)	19,208,909	480,680
Bond premiums	66,058	-	(11,165)	54,893	-
Total long-term debt	**$ 30,905,494**	**$ -**	**$ (1,188,015)**	**$ 29,717,479**	**$ 1,227,541**

	Balance December 31, 2016	Additions	Reductions	Balance December 31, 2017	Amounts Due Within One Year
Bonds and notes payable					
Note payable to individuals	$ 50,169	$ 17,224	$ (33,568)	$ 33,825	$ 17,224
Note payable to individuals	5,177,951	19,997	(397,337)	4,800,611	397,337
2013 LTGO bonds	1,355,000	180,000	(355,000)	1,180,000	180,000
2015 LTGO bonds	5,150,000	-	(5,150,000)	-	-
2017 LTGO bonds	-	5,150,000	-	5,150,000	116,198
2017 Revenue bonds	-	19,675,000	-	19,675,000	466,091
Revenue bond anticipation notes	16,830,084	-	(16,830,084)	-	-
Bond premiums	77,222	-	(11,164)	66,058	-
Total long-term debt	**$ 28,640,426**	**$ 25,042,221**	**$ (22,777,153)**	**$ 30,905,494**	**$ 1,176,850**

The terms and due dates of the District's long-term debt are as follows:

- Note payable, dated October 23, 2004, in the original amount of $200,000, for the purchase of land. The note is due in monthly installments of $1,567, including interest at 5.5 percent, through November 2019. The note is secured by the related land.
- Note payable, dated July 2, 2012, in the original amount of $6,630,000, for the purchase of a building. The note is due in monthly installments of $53,036, including interest at 5.175 percent, through July 2027. The note is secured by the related land and building.
- LTGO Refunding Bonds, dated April 16, 2013, in the original amount of $2,050,000, for the purpose of refinancing the District's existing LTGO Bonds, dated June 1, 2004. The bonds are payable annually on December 1 in the remaining principal amounts ranging from $190,000 to $220,000 through 2023. The bonds are subject to redemption prior to their stated maturities. Interest at rates from 3.0 percent to 4.0 percent is due semiannually on June 1 and December 1. The District has irrevocably pledged to include in its budget and levy taxes annually on all of the property within the District subject to taxation in amounts that will be sufficient to pay the principal and interest on the bonds as they become due.

7. Long-term Debt (continued):

- LTGO Refunding Bonds, dated May 6, 2015, in the original amount of $5,150,000, for the construction of the District's emergency and specialty services building. The District made interest-only payments at variable rates of 1.05 percent to 1.236 percent through July 2017, at which time the bond was paid in full.
- Revenue bond anticipation note, dated May 6, 2015, in the original amount of $19,675,000, for the construction of the District's emergency and specialty services building. The District was obligated to make interest-only payments at variable rates of 1.06 percent to 1.3856 percent through July 2017, at which time the bond was paid in full.
- 2017 LTGO Bonds:
  - LTGO Bond, 2017A, dated July 26, 2017, in the original amount of $1,250,000, for the purpose of refinancing the District's interim financing LTGO Bond, dated May 6, 2015, for the construction of the District's emergency and specialty services building. The bond is payable annually on July 26 in the remaining principal amounts ranging from $40,900 to $48,600. Interest at a rate of 2.89 percent is due semiannually on January 26 and July 26. The bond is subject to a mandatory tender for purchase by the District on July 26, 2025, for the remaining principal balance of $899,400. The registered owner of the bond is Key Government Finance, Inc.
  - LTGO Bond, 2017C, dated July 26, 2017, in the original amount of $3,900,000, for the purpose of refinancing the District's interim financing LTGO Bond, dated May 6, 2015, for the construction of the District's emergency and specialty services building. The bond is payable semiannually on January 26 and July 26 in installments of $102,258, including interest at 3.25 percent, through July 26, 2047. The registered owner of the bond is the United States Department of Agriculture (USDA).
- 2017 Revenue Bonds:
  - Hospital Revenue Bond, 2017B, dated July 26, 2017, in the original amount of $6,030,000, for the purpose of refinancing the District's interim financing revenue bond anticipation note, dated May 6, 2015, for the construction of the District's emergency and specialty services building. The bond is payable annually on July 26 in the remaining principal amounts ranging from $197,400 to $254,400. Interest at a rate of 2.89 percent is due semiannually on January 26 and July 26. The bond is subject to a mandatory tender for purchase by the District on July 26, 2025, for the remaining principal balance of $4,309,900. The registered owner of the bond is Key Government Finance, Inc.
  - Hospital Revenue Bond, 2017D, dated July 26, 2017, in the original amount of $1,945,000, for the purpose of refinancing the District's interim financing revenue bond anticipation note, dated May 6, 2015, for the construction of the District's emergency and specialty services building. The bond is payable semiannually on January 26 and July 26 in installments of $50,998, including interest at 3.25 percent, through July 26, 2047. The registered owner of the bond is the USDA.
  - Hospital Revenue Bond, 2017E, dated July 26, 2017, in the original amount of $6,000,000. The bond is payable semiannually on January 26 and July 26 in installments of $157,320, including interest at 3.25 percent, through July 26, 2047. The registered owner of the bond is the USDA.

7. Long-term Debt (continued):

- 2017 Revenue Bonds (continued):
  - Hospital Revenue Bond, 2017F, dated July 26, 2017, in the original amount of $5,700,000. The bond is payable semiannually on January 26 and July 26 in installments of $149,454, including interest at 3.25 percent, through July 26, 2047. The registered owner of the bond is the USDA.

Aggregate annual principal and interest payments over the terms of long-term debt are as follows:

Years Ending	LTGO Bonds			Revenue Bonds and Notes Payable			Total Long-term Debt		
December 31,	Principal	Interest	Total	Principal	Interest	Total	Principal	Interest	Total
2019	$ 311,866	$ 196,683	**$ 508,549**	$ 915,675	819,465	**$ 1,735,140**	$ 1,227,541	$ 1,016,148	**$ 2,243,689**
2020	315,819	187,148	**502,967**	936,327	781,867	**1,718,194**	1,252,146	969,015	**2,221,161**
2021	324,759	175,588	**500,347**	975,061	743,062	**1,718,123**	1,299,820	918,650	**2,218,470**
2022	338,788	163,705	**502,493**	1,015,645	702,538	**1,718,183**	1,354,433	866,243	**2,220,676**
2023	358,011	151,293	**509,304**	1,058,057	660,209	**1,718,266**	1,416,068	811,502	**2,227,570**
2024-2028	1,503,049	570,889	**2,073,938**	8,646,430	2,274,337	**10,920,767**	10,149,479	2,845,226	**12,994,705**
2029-2033	596,678	425,902	**1,022,580**	2,087,608	1,490,112	**3,577,720**	2,684,286	1,916,014	**4,600,300**
2034-2038	701,044	261,672	**962,716**	2,452,756	1,124,963	**3,577,719**	3,153,800	1,386,635	**4,540,435**
2039-2043	823,666	199,914	**1,023,580**	2,881,774	695,945	**3,577,719**	3,705,440	895,859	**4,601,299**
2044-2047	760,122	56,551	**816,673**	2,659,451	197,858	**2,857,309**	3,419,573	254,409	**3,673,982**
	$ 6,033,802	**$ 2,389,345**	**$ 8,423,147**	**$ 23,628,784**	**$ 9,490,356**	**$ 33,119,140**	**29,662,586**	**$ 11,879,701**	**$ 41,542,287**

8. Commitments Under Noncancellable Operating Leases:

Following is a summary of future minimum obligations under noncancellable operating leases for equipment and buildings:

Years	Amount
2019	$ 1,060,435
2020	625,028
2021	543,151
2022	393,869
2023	272,918
2024-2025	448,745
	$ 3,344,146

9. Net Patient Service Revenue:

The District recognizes patient service revenue associated with services provided to patients who have third-party payor coverage on the basis of contractual rates for the services rendered. For uninsured patients who do not qualify for charity care, the District recognizes revenue on the basis of its standard rates for services provided (or on the basis of discounted rates, if negotiated or provided by policy). On the basis of historical experience, a significant portion of the District's uninsured patients will be unable or unwilling to pay for the services provided. Thus, the District records a significant provision for bad debts related to uninsured patients in the period the services are provided. The District's provisions for bad debts and writeoffs have not changed significantly from the prior year. The District changed its charity care and uninsured discount policies during 2017, which resulted in more patients qualifying. This change has resulted in an increase in charity care in 2018. Patient service revenue, net of contractual adjustments and discounts (but before the provision for bad debts), recognized in the period from these major payor sources, is as follows:

	2018	2017
Patient service revenue (net of contractual adjustments and discounts):		
Medicare	**$ 59,201,235**	$ 50,712,735
Medicaid	**14,074,270**	14,115,751
Other third-party payors	**35,512,042**	33,604,324
Patients	**2,841,089**	2,254,179
	111,628,636	100,686,989
Less:		
Charity care	**(2,363,239)**	(1,437,426)
Provision for bad debts	**(2,539,972)**	(2,778,473)
Net patient service revenue	**$ 106,725,425**	$ 96,471,090

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

- *Medicare* – The District has been designated a critical access hospital by Medicare and is reimbursed for inpatient and outpatient services and rural health clinic visits on a cost basis as defined and limited by the Medicare program. Physician services outside the rural health clinic are paid on a fee schedule. Home health and hospice services are reimbursed on a prospective rate per episode of care. The District is reimbursed for cost reimbursable items at a tentative rate with final settlement determined after submission of annual cost reports by the District and audits thereof by the Medicare administrative contractor.

- *Medicaid* – Inpatient and outpatient services provided to Medicaid program beneficiaries are reimbursed under a cost reimbursement methodology. The District is reimbursed at a tentative rate with final settlement determined after submission of annual cost reports by the District and review thereof by the Washington State Health Care Authority. Rural health clinic services are paid on a prospectively set rate per visit.

9. Net Patient Service Revenue (continued):

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

Laws and regulations governing Medicare, Medicaid, and other programs are extremely complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term. Net patient service revenue increased by approximately $699,000 and $747,000 in 2018 and 2017, respectively, due to differences between original estimates and final settlements or revised estimates. Net patient service revenue also decreased by approximately $542,000 and $30,000 in 2018 and 2017, respectively, due to settlement estimates for rural health clinic Medicaid managed care encounters.

The District provides charity care to patients who are financially unable to pay for the healthcare services they receive. The District's policy is not to pursue collection of amounts determined to qualify as charity care. Accordingly, the District does not report these amounts in net operating revenues or in the allowance for uncollectible accounts. The District determines the costs associated with providing charity care by aggregating the applicable direct and indirect costs, including salaries and wages, benefits, supplies, and other operating expenses, based on data from its costing system. The costs of caring for charity care patients for the years ended December 31, 2018 and 2017 were approximately $1,135,000 and $682,000, respectively. The District did not receive any gifts or grants to subsidize charity services during 2018 and 2017.

10. Electronic Health Records Incentive Payments:

Medicaid electronic health records (EHR) incentive payments are provided to incent hospitals and eligible providers to become meaningful users of EHR technology, not to reimburse providers for the cost of acquiring EHR assets. EHR incentive payments are therefore reported as operating revenue.

The District recognized the first of its four Medicaid incentive payments in 2012, the year that certified EHR technology was adopted, implemented, or upgraded or when such technology was meaningfully used under the Medicare EHR incentive program. The subsequent three payments were issued when meaningful use was demonstrated under Medicare. The District's final Medicaid incentive payments were recognized as revenue in 2015. An audit of the District's Medicaid EHR incentive payments resulted in a $276,085 payback. A liability, net of an $85,000 Medicaid EHR receivable, has been recorded as a liability at December 31, 2018.

Medicaid incentive payments of $85,000 and $136,784 relating to eligible providers in the rural health clinics were recognized as revenue in 2018 and 2017, respectively.

11. Deferred Compensation Plan and Pension Plan:

The District has a deferred compensation plan created in accordance with Internal Revenue Code §457. The name of the plan is Jefferson Healthcare §457 Deferred Compensation Plan (the Compensation Plan). The Compensation Plan is available to eligible employees and permits them to defer a portion of their salary until withdrawn in future years. The deferred compensation is not available to employees until termination, retirement, death, or unforeseeable emergency.

11. Deferred Compensation Plan and Pension Plan (continued):

Employee contributions to the Compensation Plan totaled approximately $2,599,000 and $2,414,000 for the years ended December 31, 2018 and 2017, respectively.

The District provides a 401(a) profit-sharing pension plan for all employees with at least two years of service. The name of the plan is Jefferson Healthcare Employee's Retirement Plan (the Profit-Sharing Plan). The District makes nonelective contributions to the Profit-Sharing Plan of 5 percent for all eligible employees' salaries annually. The District funds all retirement contributions and employees are not allowed to contribute to the Profit-Sharing Plan. Contributions to the Profit-Sharing Plan totaled approximately $1,692,000 and $1,801,000 for the years ended December 31, 2018 and 2017, respectively.

The District has an additional deferred compensation plan for members of the Hospital's strategic leadership group (SLG) in their first two years of employment, prior to being eligible to participate in the Profit-Sharing Plan described above. The name of the plan is Jefferson Healthcare Strategic Leadership Group Deferred Compensation Plan (the SLG Compensation Plan). The District makes nonelective contributions to the SLG Compensation Plan of 11 percent for all eligible employees' salaries annually. The District funds all retirement contributions and employees are not allowed to contribute to the SLG Compensation Plan. Contributions to the Plan totaled approximately $82,000 and $66,000 for the years ended December 31, 2018 and 2017, respectively. Once an SLG member has attained two years of service, employer contributions are then made to the Profit-Sharing Plan described above.

The plans are administered by the District. The District has the authority to amend the plans.

12. Risk Management and Contingencies:

Medical malpractice claims – The District has professional liability insurance coverage with Physicians Insurance. The policy provides protection on a "claims-made" basis whereby claims filed in the current year are covered by the current policy. If there are occurrences in the current year, these will only be covered in the year the claim is filed if claims-made coverage is obtained in that year or if the District purchases insurance to cover prior acts. The current professional liability insurance provides $1,000,000 per claim of primary coverage with an annual aggregate limit of $5,000,000. The policy has no deductible.

The District also has excess professional liability insurance with Physicians Insurance on a "claims-made" basis. The excess malpractice insurance provides $15,000,000 per claim of primary coverage with an aggregate limit of $15,000,000. The policy has no deductible.

Risk management – The District is exposed to various risks of loss from torts; theft of, damage to, and destruction of assets; business interruption; errors and omissions; employee injuries and illnesses; natural disasters; and employee health, dental, and accident benefits. Commercial insurance coverage is purchased for claims arising from such matters. Settled claims have not exceeded this commercial coverage in any of the three preceding years.

12. Risk Management and Contingencies (continued):

Self-insurance risk pools – The District has a self-insured workers' compensation plan and a self-insured unemployment plan for its employees. The District participates in the Public Hospital District Workers' Compensation Trust and the Public Hospital District Unemployment Trust, which are self-insurance risk pools administered by the Washington State Hospital Association. The District pays its share of actual workers' compensation claims, unemployment claims, maintenance of reserves, and administrative expenses. In 2018 and 2017, the Public Hospital District Workers' Compensation Trust assessed its financial condition and decided that it has excess financial reserves that it would return to the member districts through a dividend distribution. Payments by the District charged to workers' compensation expense were approximately $241,000 net of a $343,950 dividend distribution and $220,000 net of a $324,109 dividend in 2018 and 2017, respectively. Payments by the District charged to unemployment expense were approximately ($16,000) net of a dividend distribution of $131,453 in 2018. Payments by the District charged to unemployment expense were approximately $70,000 net of a dividend distribution of $89,983 in 2017.

Industry regulations – The healthcare industry is subject to numerous laws and regulations of federal, state, and local governments. These laws and regulations include, but are not necessarily limited to, matters such as licensure, accreditations, and government healthcare program participation requirements, reimbursement for patient services, and Medicare and Medicaid fraud and abuse. Government activity continues with respect to investigations and allegations concerning possible violations of fraud and abuse statutes and regulations by 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 the District is in compliance with fraud and abuse statutes, as well as other applicable government laws and regulations.

While no regulatory inquiries have been made, compliance with such laws and regulations can be subject to future government review and interpretation, as well as regulatory actions unknown or unasserted at this time.

13. Concentration of Risk:

Patient accounts receivable – The District grants credit without collateral to its patients, most of whom are local residents, and are insured under third-party payor agreements. The majority of these patients are geographically concentrated in and around eastern Jefferson County.

The mix of receivables from patients was as follows:

	2018	**2017**
Medicare	**49 %**	42 %
Medicaid	**15**	16
Other third-party payors	**25**	27
Patients	**11**	15
	100 %	100 %

13. Concentration of Risk (continued):

Physicians – The District is dependent on local physicians practicing in its service area to provide admissions and utilize hospital services on an outpatient basis. A decrease in the number of physicians providing these services or changes in their utilization patterns may have an adverse effect on hospital operations.

Collective bargaining unit – The District has two collective bargaining agreements with the United Food and Commercial Workers LOCAL 21:

- Effective November 1, 2018, the District renewed its contract with the labor union for its clinic, professional, technical, service and maintenance, business office, and medical records employees. The contract is effective through October 31, 2021. The clinic was previously negotiated separately from the professional, technical, service and maintenance, business office, and medical records employees.
- Effective November 1, 2018, the District renewed its contract with the labor union for its nursing employees. The contract is effective through October 31, 2021.

As of December 31, 2018 and 2017, approximately 64 percent and 61 percent, respectively, of the Districts' employees were represented by the union under these collective bargaining agreements with United Food and Commercial Workers LOCAL 21.

DINGUS | ZARECOR & ASSOCIATES PLLC
Certified Public Accountants

INDEPENDENT AUDITORS' 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*

Board of Commissioners
Jefferson County Public Hospital District No. 2
doing business as Jefferson Healthcare
Port Townsend, Washington

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 Jefferson County Public Hospital District No. 2 doing business as Jefferson Healthcare (the District) as of and for the year ended December 31, 2018, and the related notes to the financial statements, which collectively comprise the District's basic financial statements as listed in the table of contents, and have issued our report thereon dated June 3, 2019.

Internal Control Over Financial Reporting

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

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

12015 East Main Avenue | Spokane Valley, WA 99206 | 509.242.0874 | www.dzacpa.com

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the District's financial statements are free from material misstatement, we performed tests of 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.

Dingus, Zarecor & Associates PLLC

Spokane Valley, Washington
June 3, 2019

Jefferson County Public Hospital District No. 2
doing business as Jefferson Healthcare
Summary Schedule of Prior Audit Findings
Year Ended December 31, 2018

The audit for the year ended December 31, 2017, reported no audit findings, nor were there any unresolved prior year findings for years ended December 31, 2016, or prior. Therefore, there are no matters to report in this schedule for the year ended December 31, 2018.