



**Office of the Washington State Auditor
Pat McCarthy**

December 10, 2020

Board of Commissioners
Skagit Regional Health
Mount Vernon, 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 Skagit County Public Hospital District No. 1, dba Skagit Regional Health, for the fiscal years ended December 31, 2019 and 2018. 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

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REPORT OF INDEPENDENT AUDITORS
AND FINANCIAL STATEMENTS

PUBLIC HOSPITAL DISTRICT NO. 1 OF SKAGIT COUNTY,
WASHINGTON

December 31, 2019 and 2018



MOSSADAMS

Table of Contents

	PAGE
Report of Independent Auditors	1–2
Management’s Discussion and Analysis	3–21
Financial Statements	
Statements of net position	22–23
Statements of revenues, expenses, and changes in net position	24
Statements of cash flows	25–26
Notes to financial statements	27–51
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 <i>Government Auditing Standards</i>	52–53
Required Supplementary Information	
Schedule of changes in total other post-employment benefits and related ratios	54

Report of Independent Auditors

To the Board of Commissioners
Public Hospital District No. 1 of Skagit County, Washington

Report on the Financial Statements

We have audited the accompanying financial statements of Public Hospital District No. 1 of Skagit County, Washington (the District) as of and for the years ended December 31, 2019 and 2018, and the related notes to the financial statements, which collectively comprise the District'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 audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Public Hospital District No. 1 of Skagit County, Washington, as of December 31, 2019 and 2018, and the results of its operations and its cash flows 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 3 through 21 and the Schedule of Changes in Total Other Post-Employment Benefits and Related Ratios on page 54 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, which considers it to be an essential part of financial reporting for placing the financial statements in the 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. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated May 8, 2020, on our consideration of the District's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is 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 District'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 District's internal control over financial reporting and compliance.



Everett, Washington
May 8, 2020

Public Hospital District No. 1 of Skagit County, Washington

Management's Discussion and Analysis

This discussion and analysis provides an overview of the financial position and financial activities of Public Hospital District No. 1 of Skagit County, Washington (the District). The District, doing business as Skagit Valley Hospital (SVH), added the clinic division on July 1, 2010. The clinic division, which is known as Skagit Regional Clinics (SRC), was acquired when Skagit Valley Hospital employed the physicians of the former Skagit Valley Medical Center (SVMC) and started operations. On January 1, 2011, the District created the system name Skagit Regional Health (SRH). This name encompasses both SVH and the SRC operations. On June 1, 2016, the District began leasing the facilities of Public Hospital District No. 3 of Snohomish County and providing hospital and clinic services under the name Cascade Valley Hospital and Clinics (CVH).

Please read this discussion and analysis in conjunction with the accompanying financial statements and accompanying notes, which follow this section.

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. 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 cash is received or paid. These two statements report the District's net position and changes in it. Over time, increases or decreases in the District's net position are one indicator of whether its financial health is improving or deteriorating.

Financial Highlights

- SRH's total operating revenue grew by 6.5%, or \$26.1 million, from \$398.6 million in 2018 to \$424.8 million in 2019. Over the same period, total operating expenses grew by 7.4%, or \$29.3 million, from \$395.2 million in 2018 to \$424.5 million in 2018.
- SRH ended 2019 with operating income of \$0.3 million. This represents a \$3.2 million decline over the 2018 operating income of \$3.5 million. In 2019, SRH also added net nonoperating income of \$6.7 million, a gain on transfer of assets of \$2.3 million, and capital contributions of \$2.3 million.
- In September 2019, the District carried out the advance refunding of a portion of the outstanding Unlimited Tax General Obligation Bonds, 2012 with the issuance of the issued the Unlimited Tax General Obligation Bond, 2019. The advance refunding will save the District's taxpayers a total of \$3,126,813 and a net present value savings of \$2,886,456 at the time of issuance.
- In December 2019, the District carried out the advance refunding of the outstanding Hospital Revenue Bonds, 2010 with the issuance of the Hospital Revenue Refunding Bond, 2019. The advance refunding will save the District \$8,425,503 and a net present value savings of \$6,611,503.
- The District expanded on a partnership with Skagit Radiology to open the Skagit Imaging Pavilion in September 2019 north of Skagit Valley Hospital in Mount Vernon and bring the first 3D mammography units to the community. The center also features the latest in several more diagnostic imaging modalities including Magnetic Resonance Imaging (MRI), ultrasound, Computed Tomography (CT) and stereotactic biopsy. The Skagit Valley Hospital Foundation raised \$2 million to help equip the Women's Imaging Center where the 3D mammography units are located.

Public Hospital District No. 1 of Skagit County, Washington

Management's Discussion and Analysis (continued)

Financial Highlights (continued)

- The District Board voted unanimously, on Nov. 17, 2017, to select Brian Ivie, a highly experienced health care leader, as the new President, Chief Executive Officer (CEO), and Superintendent of SRH. His experience includes service as President and Chief Executive Officer of three facilities operated by Dignity Health including Mercy San Juan Medical Center, a 370-bed acute care facility in Carmichael, California; Methodist Hospital of Sacramento, a 162-bed acute care facility in Sacramento; and Bruceville Terrace, a 171-bed long-term care and skilled nursing facility in Sacramento. Mr. Ivie has additional experience in health care operations and finance at a variety of large health care systems. He is a graduate of California State University, Northridge and earned an MBA from Pepperdine University.
- Paul Ishizuka, MBA, CPA, joined the District in October 2017 as Chief Financial Officer (CFO). He brings 25 years of senior financial leadership in health care and corporate settings. Mr. Ishizuka's experience includes serving as Chief Financial Officer for Samaritan Healthcare, a public district hospital and clinics in Moses Lake, Washington. Prior to Samaritan, he served in a variety of roles for the University of Washington including Medical Center Financial Officer for UW Medicine and Chief Financial Officer for University of Washington Medical Center in Seattle.
- Danny Vera, PharmD, MBA, became the Chief Operating Officer of the District in November 2018. He previously served as Vice President of Operations with Dignity Health Mercy San Juan Medical Center in Carmichael, California, a 370-bed, Level II trauma facility with 2,500 employees. Mr. Vera holds an MBA from the California State University, Fresno Craig School of Business and a Doctor of Pharmacy from the University of California, San Francisco, School of Pharmacy.
- The District board approved the purchase of the \$2 million da Vinci® Xi™ Surgical System, which began operating in September 2018. The system is used in a variety of minimally invasive surgeries and is shown to improve patient outcomes, reduce recovery time and shorten hospital stays. The da Vinci® Xi™ Surgical System was installed at the Skagit Valley Hospital in Mount Vernon and is the first robotic tool system offered by Skagit Regional Health to combine technology and services to improve outcomes for patients.
- The District is making a strategic investment of approximately \$72 million for the five-year span of 2016–2020 to build a new Electronic Health Record (EHR) and selected Epic as the vendor in 2015. The new EHR is a powerful, state-of-the-art tool that provides system interoperability, connectivity with patients, access to information, and data sharing across the District's entire system, including SVH, SRC, and CVH. The EHR became operable across the system in October 2017.

Public Hospital District No. 1 of Skagit County, Washington Management's Discussion and Analysis (continued)

Financial Highlights (continued)

- The District passed a resolution in November 2018 authorizing the sale of the outpatient kidney dialysis operations to Fresenius Medical Care Ventures, LLC. Fresenius offers outpatient dialysis services out of the space previously occupied by the Skagit Valley Kidney Center near Skagit Valley Hospital in Mount Vernon, WA. Fresenius leases the space from the District and has purchased some assets as part of the transaction. Fresenius has employed the majority of Skagit Regional Health's dialysis employees. Moving to a specialty vendor, such as Fresenius, to provide dialysis services is a trend in industry care models for dialysis across the United States. The District looks forward to collaborating with Fresenius, which has outstanding quality scores and is an industry leader offering wrap-around patient services. The sale closed December 17, 2018, with the District recognizing a gain on sale of operations of \$9.2 million, net of associated costs. The District will continue to offer inpatient dialysis services at Skagit Valley Hospital.
- The District approved a letter of intent, dated April 6, 2015, with the University of Washington, acting through UW Medicine, and Public Hospital District No. 3 of Snohomish County (PHD No. 3), d/b/a Cascade Valley Hospital and Clinics in Arlington, Washington. The three parties (the Parties) approved the affiliation agreement (the Agreement) on May 29, 2015. The Agreement establishes the general principles and conditions that will guide the clinical integration between UW Medicine, SVH, and CVH. This Agreement is not a merger, acquisition, corporate restructure, or lease and does not constitute a change in governance or change in mission for any organization. This Agreement defines a process for joint efforts to seek clinical integration to increase efficiency in the delivery of patient care, monitor and utilize health care services to provide quality patient outcomes, and make care more affordable to the extent consistent with applicable law. The Parties are committed to working with each other to seek to increase their level of clinical integration, including but not limited to; standardized clinical protocols, patient safety programs, connectivity of electronic health information, cost and quality benchmarks, collection of quality and cost data, and a commitment to providing continuity of care for patients by remaining within the clinically integrated programs for their entire episode of care.
- Pursuant to this Agreement, UW Medicine will serve as SVH's and CVH's complex tertiary and quaternary health system for specialty care services not available in mutually designated communities and provided by UW Medicine. UW Medicine will be available as a resource for these services and is committed to providing rapid and efficient access to advanced medical care that could not otherwise be provided locally.
- The District and PHD No. 3 also entered into an Affiliation Agreement regarding the lease and operation of Cascade Valley Hospital and Clinics, dated December 4, 2015 (the Affiliation Agreement). Under the terms of the Affiliation Agreement and effective as of the closing date, June 1, 2016, the District began leasing and operating all of PHD No. 3's health care facilities, including its hospital and clinic facilities. Please see the "Affiliation Agreement with Snohomish County PHD No. 3" at the end of this Management Discussion and Analysis for further information on the Affiliation Agreement.

Public Hospital District No. 1 of Skagit County, Washington

Management's Discussion and Analysis (continued)

Financial Highlights (continued)

Following are key operating statistics for the years ended December 31, 2019, 2018, and 2017:

Statistical Volumes and Definitions ⁽¹⁾

VOLUME	2019	2018	2017
Skagit Valley Hospital			
Admissions (excludes Newborns)			
Medical/Surgical	6,711	6,736	6,043
Obstetrics	934	977	1,054
Behavioral Health	383	369	382
Total Admissions	8,028	8,082	7,479
Discharges (excludes Newborns)			
Medical/Surgical	6,653	6,739	6,026
Obstetrics	922	979	1,049
Behavioral Health	401	392	406
Total Discharges	7,976	8,110	7,481
Patient Days (excludes Newborns)			
Medical/Surgical	29,523	28,977	27,156
Obstetrics	1,671	1,797	1,942
Behavioral Health	3,722	4,156	3,836
Total Patient Days	34,916	34,930	32,934
Average Length of Stay (excludes Newborns)			
Medical/Surgical	4.44	4.30	4.51
Obstetrics	1.81	1.84	1.85
Behavioral Health	9.28	10.60	9.45
Total Overall Average Length of Stay	4.38	4.31	4.40
Occupancy (excludes Newborns)	69.8%	69.9%	65.9%
Surgical Cases			
Inpatient Cases	1,521	1,294	1,132
Outpatient Cases	4,576	4,239	3,956
Total Surgical Cases	6,097	5,533	5,088
Endoscopy Cases	6,652	4,700	5,650
Deliveries	864	927	983
Emergency Department Visits ⁽²⁾	33,900	34,324	34,466
Oncology Visits			
Medical Visits	20,339	17,924	18,188
Radiation Therapy Visits	11,236	11,097	11,406
Total Oncology Visits	31,575	29,021	29,594
Diagnostic Imaging Procedures			
CT	20,931	20,688	20,053
MRI	8,841	9,367	8,567
X-Ray	67,708	69,673	69,119
Other Diagnostic Imaging	37,424	36,295	34,101
Total Diagnostic Imaging Procedures	134,904	136,023	131,840
Cath Lab Procedures	3,507	2,961	2,489

⁽¹⁾ Volumes include all patients unless otherwise noted.

⁽²⁾ Includes those patients who are later admitted.

Public Hospital District No. 1 of Skagit County, Washington

Management's Discussion and Analysis (continued)

Financial Highlights (continued)

Statistical Volumes and Definitions ⁽¹⁾

VOLUME	2019	2018	2017
Cascade Valley Hospital			
Admissions (excludes Newborns)			
Medical/Surgical	1,248	1,268	1,130
Obstetrics	160	155	158
Total Admissions	1,408	1,423	1,288
Discharges (excludes Newborns)			
Medical/Surgical	1,241	1,270	1,108
Obstetrics	156	161	169
Total Discharges	1,397	1,431	1,277
Patient Days (excludes Newborns)			
Medical/Surgical	5,402	5,369	4,307
Obstetrics	276	290	263
Total Patient Days	5,678	5,659	4,570
Average Length of Stay (excludes Newborns)			
Medical/Surgical	4.35	4.23	3.89
Obstetrics	1.77	1.80	1.56
Total Overall Average Length of Stay	4.06	3.95	3.58
Occupancy (excludes Newborns)	32.4%	32.3%	26.1%
Surgical Cases			
Inpatient Cases	525	457	454
Outpatient Cases	983	784	1,613
Total Surgical Cases	1,508	1,241	2,067
Endoscopy Cases ⁽³⁾	807	818	
Deliveries	143	135	158
Emergency Department Visits ⁽²⁾	19,779	18,834	19,818
Diagnostic Imaging Procedures			
CT	6,961	5,730	5,252
MRI	1,242	1,096	1,117
X-Ray	13,458	12,461	12,797
Other Diagnostic Imaging	8,696	7,240	5,107
Total Diagnostic Imaging Procedures	30,357	26,527	24,273
Skagit Regional Health - Clinics			
Provider Clinic Visits			
Primary Care Clinic Visits	190,824	190,723	169,949
Specialty Care Clinic Visits	147,873	133,491	115,087
Total Provider Clinic Visits	338,697	324,214	285,036

⁽¹⁾ Volumes include all patients unless otherwise noted.

⁽²⁾ Includes those patients who are later admitted.

⁽³⁾ Cascade Valley Hospital Endoscopy Cases included in Surgical Cases prior to 2018.

Public Hospital District No. 1 of Skagit County, Washington

Management's Discussion and Analysis (continued)

Performance Overview

The following is a comparison of 2019 actual revenues, expenses, and changes in net position results to 2018 and 2017 results (in thousands):

	2019	2018	2017
Operating revenues			
Net patient service revenue	\$ 396,212	\$ 374,835	\$ 349,024
Other operating revenues	28,544	23,813	24,447
Total operating revenues	<u>424,756</u>	<u>398,648</u>	<u>373,471</u>
Operating expenses			
Salaries and wages	191,088	176,382	170,653
Employee benefits	45,272	40,001	40,938
Professional fees	19,080	17,185	22,416
Supplies	69,485	58,817	51,203
Purchased services			
and other	75,453	80,218	83,120
Depreciation	17,754	16,557	14,289
Interest and amortization	6,321	6,038	5,435
Total operating expenses	<u>424,453</u>	<u>395,198</u>	<u>388,054</u>
Operating income (loss)	303	3,450	(14,583)
Net nonoperating income	6,721	5,343	3,333
Gain on disposal of operations	-	9,240	-
Gain on transfer of assets	2,274	2,011	7,827
Capital contributions	2,308	69	287
Increase (decrease) in net position	<u>11,606</u>	<u>20,113</u>	<u>(3,136)</u>
Net position, beginning of year	155,263	135,150	155,332
Cumulative effect of restatement	-	-	(17,046)
Net position, beginning of year, restated	<u>155,263</u>	<u>135,150</u>	<u>138,286</u>
Net position, end of year	<u>\$ 166,869</u>	<u>\$ 155,263</u>	<u>\$ 135,150</u>

Public Hospital District No. 1 of Skagit County, Washington Management's Discussion and Analysis (continued)

Health Care Outlook

Skagit Regional Health is committed to the delivery of safe, quality, and cost effective patient care consistent with the Triple Aim.

SRH believes the market will reward performance for those who effectively shift operations from volume to value. In 2019, SRH continued to partner with the University of Washington's Accountable Care Network (UWACN) while running Cascadia Care Network (CCN), SRH's Medicare Accountable Care Organization. Much of the year was spent enhancing the infrastructure required to support this vision, including an engagement focused on leveraging Epic's Healthy Planet Module to support the initiatives necessary for success.

SRH is shifting its focus away from the acute care hospital business to an ambulatory emphasis. This will allow the District to more efficiently manage the transition from volume to value and cover more lives. The core of that strategy is the expansion and effective operation of the Skagit Regional Clinics, including expansion of virtual care and telehealth capabilities.

Operating Revenue (in thousands)

Net Patient Revenue

Net patient revenue consists of gross patient charges less contractual adjustments, charity care, and a provision for bad debt. Contractual adjustments represent the difference between gross patient charges at established rates and expected contracted payments from third-party payors with which the District has entered into agreements. In addition, the District provides care to patients, at no charge or reduced rates, who meet certain criteria under its charity care policies. The District also estimates the collectability of accounts receivable and records a provision for bad debt. The resulting net patient revenue is highly dependent on the District's payor mix.

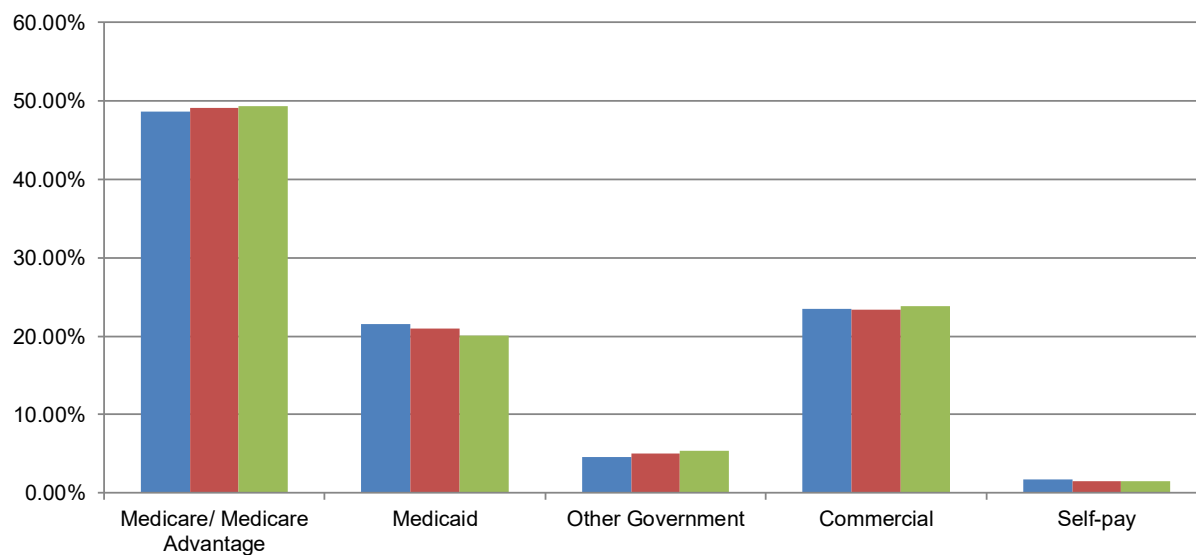
Public Hospital District No. 1 of Skagit County, Washington

Management's Discussion and Analysis (continued)

Operating Revenue (in thousands) (continued)

The table and graph below illustrate the three-year trend in SRH's payor mix, based on gross patient charges, for the years ended December 31, 2017 through 2019.

Payor Mix	Years Ended December 31,		
	2017	2018	2019
Medicare	35.66%	33.85%	32.45%
Medicare Advantage	12.97%	15.21%	16.81%
Subtotal: Medicare	48.63%	49.06%	49.26%
Medicaid	21.51%	20.99%	20.01%
Other Government	4.63%	5.08%	5.35%
Commercial	23.49%	23.39%	23.86%
Self Pay	1.74%	1.48%	1.52%
	100.00%	100.00%	100.00%



Public Hospital District No. 1 of Skagit County, Washington

Management's Discussion and Analysis (continued)

Operating Revenue (in thousands) (continued)

The District continues to see the effects of the aging population in Skagit and northern Snohomish Counties through increased Medicare payor mix. Additionally, the prevalence of high-deductible consumer-directed health plans has increased the patient financial obligation for those with insurance. Management continues to measure and monitor these trends and evaluate the appropriate response and action to mitigate the financial impact while continuing to improve the health of the communities the District serves.

Net patient revenue at SRH grew by \$21,377 from \$374,835 in 2018 to \$396,212 in 2019. Ramp up of recently recruited primary and specialty care providers drove growth in clinic visit volume of 4.5%. Strong growth in surgery, cardiac catheterization, oncology, and endoscopy was the primary drive of the increase in net patient revenue.

In 2018, net patient revenue at SRH grew by \$25,811 from \$349,024 in 2017. Successful recruitment of both primary and specialty care providers drove growth in clinic visit volume of 15%. Strong growth in surgical and special imaging volumes bolstered acute and ancillary services revenue throughout the system. This volume growth combined with rate increases offset volume reductions in oncology and endoscopy associated with provider departures.

Other Operating Revenue

Other operating revenue increased by \$4,731, from \$23,813 in 2018 to \$28,544 in 2019 after seeing a decrease from \$24,447 in 2017. The 340B contracted pharmacy program continued to expand driving revenue up in 2019. The decrease in 2018 is primarily due the closure of the District's three outpatient pharmacies.

Operating Expenses (in thousands)

Total operating expenses in 2019 increased by \$29,255 or 7.4%, from \$395,198 in 2018 to \$424,453 in 2019. Total operating expenses increased by \$7,144 in 2018 from \$388,054 in 2017.

Excluding providers, the District employed 1,908 full time equivalents (FTEs) for the year ending December 31, 2019, which was an increase of 10 FTEs from the 1,898 FTEs employed in the same period in 2018, and a two-year increase of 66 FTEs from the 1,842 FTEs employed in the same period in 2017. This combined growth was partially offset by a reduction in force in early 2018. Overall growth from 2017 to 2019 is related to volume increases within CVH and SVH Hospitals, and Clinics. Provider staff support also increased proportionately with their growth, and leadership FTEs were added to support this growth. Additionally, laboratory services were insourced at the SVH campus in the fall of 2018, which contributed to FTE growth.

At year-end 2019, SRH employed 195 providers, comprised of 108 doctors, 30 residents, and 57 mid-level providers. This is an increase of 5 employed providers from year-end 2018, comprised of 4 doctors and 1 mid-level provider.

Public Hospital District No. 1 of Skagit County, Washington

Management's Discussion and Analysis (continued)

Operating Expenses (in thousands) (continued)

Salaries and benefits increased by \$19,977 or 9.2%, from \$216,383 in 2018 to \$236,360 in 2019. Growth in salaries is related to the FTE increases mentioned above as well as union and non-union staff and provider wage increases. Newly acquired clinics offset by the sale of the outpatient kidney dialysis program in December 2018 account for the remainder of the change. Salaries and benefits increased by \$4,792 or 2.3%, from \$211,591 in 2017. FTE and wage growth were the drivers of this increase. The salary and benefits dollar increases not associated with the added FTEs are accounted for by contracted union and non-contracted staff, and provider annual increases.

Professional fees increased by \$1,895, from \$17,185 in 2018 to \$19,090 in 2019. Increased locums usage in gastroenterology program along with increased informational services professional costs related to upgrades to the Epic EHR and the District's Microsoft windows environment were the main drivers of this increase. Professional fees decreased by \$5,231, from \$22,416 in 2017. Restructuring of the outsourced ER physicians program that coincided with the implementation of the Epic EHR, lower usage of locum providers, and reduced usage of registry nurses and other outsourced personnel account for much of the remaining variance.

The District's supply expense has increased from \$58,817 for the twelve months ended December 31, 2018 to \$69,485 for the same period in 2019. Increased patient volume in oncology, which utilizes high-cost drugs coupled with higher drug prices nationally, has increased drug supply expense. Volume increases in service lines with high supplies costs including, cardiac catheterization, endoscopy, and robotic surgery increased patient-related supply expense. From 2017 to 2018, supply expense increased by \$7,614, from \$51,203 in 2017. This increase was associated with a rise in pharmaceutical spending at SVH related to higher oncology drug usage, inflation, and 340B purchases, and offset partially offset by reductions in retail pharmacy cost of goods sold expenses due to the closure of the Sedro-Woolley, Mount Vernon, and Riverbend retail pharmacies in early 2018.

Purchased services and other expense decreased \$4,765, from \$80,218 in 2018 to \$75,453 in 2019. This decrease is primarily related to the insourcing of laboratory services at the SVH campus, which is partially offset by increased FTEs and salaries mentioned above. Additional variances include a decrease in usage of information technology and technical support services, and increases in software license fees, insurance premiums, and taxes. Purchased services and other expense decreased in 2018 by \$2,902, from \$83,120 in 2017. This variance was primarily attributed to savings in the SVH hospitalist program, and decreases in information systems purchased services related to the Epic EHR.

Depreciation expense of \$17,754 in 2019 was \$1,197 higher than the 2018 depreciation expense of \$16,557. In 2018, depreciation expense increased \$2,268 over the 2017 expense of \$14,289. Major capital purchases in both 2018 and 2019 including the da Vinci® XiTM Surgical System, Drager patient monitoring system, replacement of inpatient beds across the system, and the addition of a third state of the art catheterization lab at Skagit Valley Hospital along with routine replacement and upgrades to major moveable equipment were the chief factor in the increase in depreciation expense. The increase in 2018 is primarily related to the depreciation of Epic EHR, which became operable in the 4th quarter of 2017.

Public Hospital District No. 1 of Skagit County, Washington Management's Discussion and Analysis (continued)

Operating Expenses (in thousands) (continued)

Interest and amortization expense increased by \$283 to \$6,321 in 2019 from \$6,038 in 2018. In 2018, interest and amortization expense increased by \$603 from \$5,435 in 2017. Closing costs related to refinancing of the 2010 Hospital Revenue Bonds, which closed in December of 2019, was the main driver for this increase. Interest on the 2016 Hospital Revenue and Refunding bonds was the main driver of the increase in 2018.

Net Nonoperating Income and Changes in Net Position (in thousands)

Net nonoperating income and other changes in net position decreased by \$5,360, from \$16,663 in 2018 to \$11,303 in 2019 and increased in 2018 by \$5,216, from \$11,447. Improved investment returns drove the increase in nonoperating income in 2018 and 2019. Transfers of assets related to the affiliation agreement with PHD 3 has leveled off in 2018 and 2019 falling from \$7,827 in 2017, down to \$2,011 in 2018, and \$2,274 in 2019. Additional information about this transfer can be found in the "Affiliation Agreement with Snohomish County PUD No. 3" section below. The sale of the outpatient KD operating in December 2018 added \$9,240. Donations received for capital contributions were \$2,308 in 2019, compared with \$69 in 2018, an increase of \$2,239. The majority of the donations were gifts from the hospital foundation for various projects including the Skagit Imaging Pavilion.

Public Hospital District No. 1 of Skagit County, Washington

Management's Discussion and Analysis (continued)

Statements of Net Position (in thousands)

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

	2019	2018	2017
Current assets			
Cash and short-term investments	\$ 49,669	\$ 40,246	\$ 19,112
Accounts receivable, net	57,800	56,207	58,040
Other current assets	19,675	16,820	16,299
Total current assets	127,144	113,273	93,451
Assets whose use is limited, net of current portion	131,444	127,829	126,288
Capital assets, net	149,780	151,991	153,742
Investments in joint ventures	13,031	12,212	12,707
Total assets	421,399	405,305	386,188
Deferred outflows of resources	10,383	5,491	4,434
Total assets and deferred outflows of resources	<u>\$ 431,782</u>	<u>\$ 410,796</u>	<u>\$ 390,622</u>
Current liabilities	\$ 70,596	\$ 59,441	\$ 55,943
Long-term debt, net of current portion	160,115	166,953	175,728
OPEB liability	22,960	23,465	18,992
Estimated professional liability	5,213	4,983	4,037
Total liabilities	258,884	254,842	254,700
Deferred inflows of resources	6,029	691	772
Net position			
Net investment in capital assets	17,407	11,073	5,388
Restricted for debt service	13,075	12,887	12,838
Unrestricted	136,387	131,303	116,924
Total net position	166,869	155,263	135,150
Total liabilities, deferred inflows of resources, and net position	<u>\$ 431,782</u>	<u>\$ 410,796</u>	<u>\$ 390,622</u>

Public Hospital District No. 1 of Skagit County, Washington

Management's Discussion and Analysis (continued)

Statements of Net Position (in thousands) (continued)

Assets and Deferred Outflows of Resources

Total current assets of \$127,144 at December 31, 2019, were \$13,871 higher than at year-end 2018. This increase is comprised of a \$9,423 increase in cash and short-term investments, an increase of \$1,593 in net accounts receivable, and an increase of \$2,855 in other current assets. The increase in cash and short-term assets in 2017 was related to the positive operating results during the year and improvements in AR collections.

Total current assets of \$113,273 at December 31, 2018, were \$19,822 higher than at year-end 2017. This increase is comprised of a \$21,134 increase in cash and short-term investments, a decrease of \$1,832 in net accounts receivable, and an increase of \$521 in other current assets. The increase in cash and short-term assets were related to the positive operating margin, the improvement in AR days outstanding, and the proceeds from the sale of the outpatient kidney dialysis operations.

Net patient accounts receivable average days outstanding at year-end 2019 were 46.2, versus 49.6 days at year end 2018. Net patient accounts receivable average days outstanding at year-end 2017 were 51.6 days. This decrease is due to systematic improvements across the revenue cycle, including consolidation of revenue cycle leadership and consolidation of multiple billing platforms to the Epic EHR.

Assets whose use is limited increased from \$127,829 in 2018 to \$131,444 in 2019, an increase of \$3,615, after increasing by \$1,541 from \$126,288 in 2017. Both the 2019 and 2018 increases were primarily related to investment returns and transfers of assets related to the affiliation agreement with PHD 3.

Net capital assets decreased in 2019 by \$2,211, from \$151,991 to \$149,780. This decrease is made up of \$15,543 of new capital assets, offset by \$16,723 in retirements and a \$17,754 increase in accumulated depreciation. Major capital projects in 2019 include the replacement of inpatient beds and IV pumps across the system, upgrade to the SVH operating room video system, as well as routine replacement of core information technology. Net capital assets decreased in 2018 by \$1,751, from \$153,742 in 2017. This decrease is made up of \$14,806 of new capital assets, offset by \$585 in retirements and a \$15,973 increase in accumulated depreciation. Major capital projects in 2018 were the purchase of the da Vinci® Xi™ Surgical System, the addition of a third state of the art catheterization lab, a patient monitoring system upgrade, and purchases of land around the SVH campus.

Investments in joint ventures increased from \$12,212 in 2018 to \$13,031 in 2019, an increase of \$819. From 2017 to 2018, joint venture investments decreased by \$495. The increase in 2019 reflects the Districts contribution to the joint ventures that participated in the building of the Skagit Imaging Pavilion, offset by distributions from the joint ventures. Distributions from joint ventures accounted for the change in 2017.

Deferred outflows of resources increased from \$4,434 in 2017 to \$5,491 in 2018 and to \$10,383 in 2019. Deferred losses on refunding the 2012 UTGO bonds and the 2010 Revenue bonds were the main driver of the increase in 2019. Increases in both 2018 and 2019 deferred OPEB outflows are related to changes in assumptions used in the actuarial analysis of the OPEB program.

Public Hospital District No. 1 of Skagit County, Washington

Management's Discussion and Analysis (continued)

Statements of Net Position (in thousands) (continued)

Liabilities and Deferred Inflows of Resources

Current liabilities increased \$11,155, from \$59,441 in 2018 to \$70,596 in 2019. This increase is made up of an increase of \$4,210 in payables and accrued salaries and wages, an increase of \$6,201 in payments due to third-party payors, a decrease of \$223 in accrued interest payable, and a decrease in the current portion of long-term debt of \$967. Current liabilities in 2018 increased by \$3,498 over 2017 current liabilities of \$55,943, primarily related to an increase in payments due to third-party payors.

Long-term debt, net of current portion decreased by \$6,838 in 2019 to \$160,115 from \$166,953 in 2018. In 2018, long-term debt, net of current portion decreased by \$8,775 from \$175,728 in 2017. Normal scheduled principal payments offset by the partial refinancing of the 2012 UTGO and full refinancing of the 2010 Revenue bonds account for the decrease in 2019. Scheduled principal payments account for the decrease in 2018.

The Governmental Accounting Standards Board (GASB) issued new standards in 2015 that define how other post-employment benefit (OPEB) liabilities were measured and reported. These standards, GASB 74 and GASB 75, came into effect for plan fiscal years beginning after June 15, 2017. GASB 75, requires a liability to be recognized for OPEB plans that are not pre-funded. Changes in the OPEB liability are recognized as expense in the Statements of Revenue, Expenses, and Changes in Net position or reported as deferred inflows/outflows of resources on the Statements of Net Position, depending on the nature of those changes. The District's OPEB liability was \$18,992 in 2017 and increased to \$23,465 in 2018. OPEB liability decreased to \$22,960 in 2019. Further detail of the District's OPEB liability can be found in Note 10 to the financial statements.

Professional malpractice liability reserve increased by \$230 in 2019, from \$4,983 to \$5,213. This increase is based on an actuarial estimate of the professional malpractice liability, based on historic claims and changes in volume. In 2018, professional liabilities reserves increased by \$946, from \$4,037 in 2017.

Affiliation Agreement with Snohomish County PUD No. 3

In accordance with the Affiliation Agreement, which was dated December 4, 2015, the District began operating Cascade Valley Hospital on June 1, 2016. The Affiliation Agreement is structured as a long-term lease (the Lease) between Snohomish PHD No. 3 d/b/a Cascade Valley Hospital and Clinics and the District. Pursuant to the Affiliation Agreement, Snohomish PHD No. 3 leased substantially all of its assets, including Cascade Valley Hospital, certain other clinic facilities, Snohomish PHD No. 3's interest as lessor in certain land leases, and intangible assets, to the District for a term of 30 years. The District will pay Snohomish PHD No. 3 an annual base rent of \$10.00 and is responsible for all costs and expenses associated with the leased assets, including maintenance and capital improvements.

Public Hospital District No. 1 of Skagit County, Washington Management's Discussion and Analysis (continued)

Affiliation Agreement with Snohomish County PUD No. 3 (continued)

Financial Arrangement

Pursuant to the Affiliation Agreement, Snohomish PHD No. 3 will transfer all of its cash and cash equivalents in excess of a retained amount to the District by June 2017. The retained amount is equal to Snohomish PHD No. 3's known and contingent liabilities and debts plus a minimum cash balance of \$1,000,000. Thereafter, Snohomish PHD No. 3 will continue to levy and collect excess and regular property tax levies, as well as collect revenues from a lease of a medical office building owned by Smokey Point LLC. Smokey Point LLC is owned 50% by the District and 50% by Snohomish PHD No. 3. The Smokey Point LLC building is a two-story, 40,000-square-foot ambulatory center. Approximately one quarter of the space is leased to UW Medicine, which operates a primary care physician practice and a maternal fetal medicine clinic. The rest of the building is leased to the District, which operates an outpatient chemotherapy unit, an urgent care clinic, an occupational medicine clinic, and laboratory and imaging services. Snohomish PHD No. 3's excess property tax levy funds will be used solely for the purpose of paying the debt service on Snohomish PHD No. 3's outstanding unlimited tax general obligation bonds. The proceeds from the Snohomish PHD No. 3 regular property tax levy and the Smokey Point LLC lease will be used to pay Snohomish PHD No. 3's expenses, including the annual debt service on Snohomish PHD No. 3's outstanding limited tax general obligation bonds, and to fund the minimum cash balance of \$1,000,000. To the extent the amount collected by Snohomish PHD No. 3 from its regular property tax levy and the Smokey Point LLC lease exceeds Snohomish PHD No. 3's existing obligations in any year, and the Snohomish PHD No. 3 cash balance is equal to \$1,000,000, the excess funds will be transferred to the District.

In accordance with the Affiliation Agreement, the transferred funds will be deposited in Pool A of the "PHD No. 3 Support Fund." The funds in Pool A will be used by the District to: (1) support the provision of health care services rendered in Snohomish County; (2) pay for capital improvements and equipment located in Snohomish County; (3) pay for health information technology and other capital investments that may be located outside of Snohomish County if it serves both the District facilities and the Cascade Valley Hospital facilities, provided that only that portion of the costs of such improvement and equipment that reasonably relate to Snohomish PHD No. 3's usage of the capital investment shall be allocated to Snohomish PHD No. 3; and (4) to cover any losses incurred by the District in the operation of Cascade Valley Hospital services.

Public Hospital District No. 1 of Skagit County, Washington Management's Discussion and Analysis (continued)

Affiliation Agreement with Snohomish County PUD No. 3 (continued)

At the end of each fiscal year, the District will deposit into a special fund designated as Pool B of the "PHD No. 3 Support Fund" a portion of the District's net cash flow generated from the District's operations, calculated according to a formula set forth in the Affiliation Agreement but in no case less than 1.5% of the annual net revenue generated by the District's operation of the Cascade Valley Hospital services still in operation, which will be calculated based on a three-year rolling average. The funds in Pool B may generally be used and expended by the District in the following order of priority: (1) to cover any Cascade Valley Hospital operating losses, as defined in the Affiliation Agreement, to the extent the loss is not covered by any remaining funds in Pool A; (2) to reimburse the District for expenses incurred in prior years to cover such operating losses that were not reimbursed in prior years because there were insufficient funds in Pool A or Pool B; (3) to reimburse the District for expenses incurred by the District in prior years to fund capital improvements or equipment located at the Cascade Valley Hospital facilities or for health information technology or other capital investments located elsewhere to the extent it serves both the District and Cascade Valley Hospital facilities, but only for such portion that reasonably relate to Snohomish PHD No. 3's usage of the health information technology or other capital investment, to the extent that such expenses were not reimbursed in prior years because there were insufficient funds available in Pool A or Pool B; (4) to reimburse the District for expenses incurred by the District in the current year to fund Cascade Valley Hospital capital improvements, as defined by the Affiliation Agreement; and (5) subject to certain limitations, for other expenditures that support the provision of health care services in Snohomish County.

Required Services

The Affiliation Agreement obligates the District to provide certain required services in North Snohomish County (identified by zip codes 98223, 98241, 98292, 98271, 98270, 98258, and 98252) for five, 10, and 30-year periods. The District has the right to determine the appropriate level of required services to meet the needs of the residents of North Snohomish County, such as the number of medical/surgical beds, ICU beds, observation beds, emergency department bays, operating rooms, procedure rooms, examination and treatment rooms, and staffing levels, provided it does so reasonably after appropriate evaluation and analysis of any impact a reduction in level of service may have on the residents of North Snohomish County.

During the five-year period following affiliation (the Five-Year Period), the District must provide OB/GYN, pediatric physician, and related Cascade Valley Hospital facilities services at any location within North Snohomish County, which the District reasonably believes will appropriately serve the needs of the residents of North Snohomish County. The District must, however, continue to provide or cause to be provided, primary care services at the Darrington and Granite Falls clinics during the Five-Year Period.

Public Hospital District No. 1 of Skagit County, Washington Management's Discussion and Analysis (continued)

Affiliation Agreement with Snohomish County PUD No. 3 (continued)

During the 10-year period following the affiliation (the Ten-Year Period), the District must provide inpatient and outpatient surgery, general inpatient acute services, and orthopedic general surgeons in North Snohomish County. In order to satisfy the Ten-Year Period commitment, the District is required to continuously maintain and operate Cascade Valley Hospital as a general acute care hospital duly licensed by the state of Washington and certified under the Medicare and Medicaid programs, with at least the following services: general inpatient acute services, inpatient surgery, a 24-hour emergency department, observation unit, ancillary medical services to the extent required to maintain state acute care hospital licensure, and an organized medical staff consisting, at a minimum, of primary care physicians, orthopedic surgeons, and general surgeons. The District is granted the right during the Ten-Year Period to modify or reduce the level of service provided at Cascade Valley Hospital provided: (1) it continues to provide an appropriate level of such services in North Snohomish County to meet the needs of residents; and (2) it has given notice to Snohomish PHD No. 3 and allowed Snohomish PHD No. 3 to provide input before said service is eliminated, relocated, modified, or reduced. Nonetheless, if the District elects to discontinue outpatient surgery services at Cascade Valley Hospital during the Ten-Year Period, the District must provide such services during remainder of the Ten-Year Period at an alternative location within North Snohomish County at appropriate levels to meet the needs of residents.

During the Thirty-Year Period following the affiliation, the District must provide a 24-hour emergency department, observation unit, ancillary medical services, and primary care physicians in North Snohomish County. After the Ten-Year Period, the District is entitled to relocate the required services that were subject to the Ten-Year Period commitment and that continue to be subject to the Thirty-Year Period commitment to any location within North Snohomish County that it reasonably believes will appropriately meet the needs of the residents of North Snohomish County.

In the event that the District intends to eliminate, reduce, relocate, or change any required service in a manner not described above, it must give Snohomish PHD No. 3 90 days' advance written notice of such intent (the Change Notice). The Change Notice must include a detailed statement of the reasons for the intended action and must be accompanied by an analysis prepared by a qualified independent health care consultant analyzing the potential impact on the accessibility and availability of health care services for residents of North Snohomish County. Snohomish PHD No. 3 is granted the right to determine, in its sole and absolute discretion, whether it will permit the District to proceed with the requested change. Snohomish PHD No. 3 must notify the District within 90 days of receipt of the Change Notice whether it will permit or deny the requested change. If Snohomish PHD No. 3 fails to respond in writing within 90 days of receipt of the Change Notice, Snohomish PHD No. 3 will be deemed to have approved the proposed service change.

Dispute Resolution

Subject to the parties' right to equitable relief, all controversies, claims, and disputes arising in connection with the Affiliation Agreement must be settled by mutual consultation between the parties, but failing amicable settlement must be settled finally by arbitration, conducted in Seattle, Washington, in accordance with the rules and procedures promulgated by Judicial Dispute Resolution before one arbitrator. The decision of the arbitrator is final and binding on the parties.

Public Hospital District No. 1 of Skagit County, Washington Management's Discussion and Analysis (continued)

Affiliation Agreement with Snohomish County PUD No. 3 (continued)

Termination and Unwinding

The Affiliation Agreement permits termination of the Affiliation Agreement and an unwinding of the affiliation upon the happening of certain conditions. The Affiliation Agreement may be terminated: (1) by mutual written consent of the District and Snohomish PHD No. 3; (2) by either the District or Snohomish PHD No. 3 in the event of an uncured breach of the Affiliation Agreement or the Lease by the other party; (3) by the District in the event that a catastrophic event occurs that was not caused by the District and makes it no longer viable to continue operating Cascade Valley Hospital services as originally contemplated; (4) by either the District or Snohomish PHD No. 3 if Snohomish PHD No. 3 requires the District to purchase the leased facilities and assets as set forth in a certain provision of the Affiliation Agreement governing damages to the facilities related to the District's negligence; and (5) after six years, by the District if the District has incurred sustained operating losses, as defined in the Affiliation Agreement, in the operation of Cascade Valley Hospital services.

To effect an unwind, the District will transfer all of the facilities and assets owned by Snohomish PHD No. 3 back to Snohomish PHD No. 3 following a process consistent with how they were originally transferred. In addition, the District will transfer to Snohomish PHD No. 3 any remaining cash balance in Pool A or Pool B and will assign in part or grant sublicenses under any electronic health records software license, maintenance, and support services agreements in effect at Cascade Valley Hospital facilities immediately prior to termination.

All of the commitments by Snohomish PHD No. 3 to provide any cash or similar support to the District will terminate after the date the District provides written notice of termination of the Affiliation Agreement or concurrent with the termination of the definitive agreements for any other reason, provided that Snohomish PHD No. 3 will remain obligated to provide any cash or similar support on a pro rata basis for the applicable period of time prior to the notice of termination. The Affiliation Agreement provides provisions for certain operating commitments and specific provisions in event the agreement is discontinued.

Unlimited Tax General Obligation Bond, 2019

In September 2019, the District issued a bond in the amount of \$29,040,000 to carry out the advance refunding of a portion of the District's outstanding Unlimited Tax General Obligation Bonds, 2012. The 2019 bond is an unlimited tax general obligation of the District's taxpayers. The principal and interest on this bonds will be paid by a levy on taxable property in the District, authorized by a 2004 super majority vote on the property owners of the District. This advanced refunding issue had a total savings to the taxpayers of the District of \$3,126,813 and a net present value savings of \$2,886,456 at issuance.

Hospital Revenue Refunding Bond, 2019

In December 2019, the District issued a bond in the amount of \$32,775,000 to carry out the advance refunding of the District's outstanding Hospital Revenue Bonds, 2010. The advance refunding will save the District \$8,425,503 over the sixteen-year term of the bond with a net present value savings of \$6,611,503.

Public Hospital District No. 1 of Skagit County, Washington Management's Discussion and Analysis (continued)

Contacting the District's Financial Management

This financial report is designed to provide our patients, suppliers, taxpayers, and creditors with a general overview of Skagit Regional Health's finances and to show the District's accountability for the money it receives. If you have questions about this report or need additional financial information, contact the District's financial management at Skagit Regional Health Business Center, 1415 East Kincaid Street, Mount Vernon, Washington 98273.

Public Hospital District No. 1 of Skagit County, Washington

Statements of Net Position

ASSETS AND DEFERRED OUTFLOWS OF RESOURCES

	December 31,	
	2019	2018
CURRENT ASSETS		
Cash	\$ 1,787,525	\$ 873,722
Short-term investments	47,881,458	39,371,984
Patient accounts receivable, less allowance for uncollectible accounts of \$11,530,743 and \$11,227,726	50,167,058	50,928,913
Other receivables	7,632,775	5,278,577
Assets limited as to use, required for current liabilities	7,967,435	7,320,318
Supplies inventory	5,719,533	4,791,940
Prepaid expenses and other assets	5,121,283	4,120,505
Interest receivable	866,812	587,311
Total current assets	127,143,879	113,273,270
ASSETS LIMITED AS TO USE		
Board-designated for capital improvements	109,082,481	106,601,397
Board-designated for professional liability	1,666,216	1,653,490
Restricted for CVH project funds A & B	15,587,012	14,007,579
Restricted bond reserve funds held by trustee	9,599,080	9,548,782
Restricted for bond redemption fund	3,476,260	3,337,916
	139,411,049	135,149,164
Less amounts required for current liabilities	(7,967,435)	(7,320,318)
	131,443,614	127,828,846
CAPITAL ASSETS		
Land	11,712,330	11,712,330
Construction in progress	681,273	2,278,516
Depreciable capital assets, net of accumulated depreciation	137,386,658	138,000,500
	149,780,261	151,991,346
INVESTMENTS IN JOINT VENTURES	13,031,379	12,211,850
Total assets	421,399,133	405,305,312
DEFERRED OUTFLOWS OF RESOURCES		
Deferred OPEB outflows	3,298,767	1,473,342
Deferred losses on refundings	7,084,730	4,017,164
	10,383,497	5,490,506
Total assets and deferred outflows of resources	\$ 431,782,630	\$ 410,795,818

Public Hospital District No. 1 of Skagit County, Washington

Statements of Net Position

LIABILITIES, DEFERRED INFLOWS OF RESOURCES, AND NET POSITION

	December 31,	
	2019	2018
CURRENT LIABILITIES		
Accounts payable	\$ 20,010,344	\$ 18,385,854
Accrued salaries, wages, and employee benefits	24,038,386	21,452,512
Estimated third-party payor settlements	15,862,321	9,661,148
Accrued interest payable	427,435	650,318
Current portion of long-term debt	10,257,803	9,290,692
	<hr/>	<hr/>
Total current liabilities	70,596,289	59,440,524
 LONG-TERM DEBT, net of current portion	 160,115,233	 166,953,354
 OPEB LIABILITY	 22,960,006	 23,464,988
 ESTIMATED PROFESSIONAL LIABILITY	 5,212,761	 4,983,404
	<hr/>	<hr/>
Total liabilities	258,884,289	254,842,270
	<hr/>	<hr/>
DEFERRED INFLOWS OF RESOURCES		
Deferred OPEB inflows	6,029,159	690,481
 NET POSITION		
Net investment in capital assets	17,406,902	11,072,864
Restricted for debt service	13,075,340	12,886,698
Unrestricted	136,386,940	131,303,505
	<hr/>	<hr/>
Total net position	166,869,182	155,263,067
	<hr/>	<hr/>
Total liabilities, deferred inflows of resources, and net position	\$ 431,782,630	\$ 410,795,818
	<hr/>	<hr/>

Public Hospital District No. 1 of Skagit County, Washington
Statements of Revenues, Expenses, and Changes in Net Position

	Years Ended December 31,	
	2019	2018
OPERATING REVENUES		
Net patient service revenue (net of provision for bad debts of \$18,722,444 and \$21,677,341)	\$ 396,212,369	\$ 374,835,432
Other operating revenues	28,543,982	23,812,302
Total operating revenues	424,756,351	398,647,734
OPERATING EXPENSES		
Salaries and wages	191,088,222	176,381,740
Employee benefits	45,271,792	40,000,808
Professional fees	19,079,925	17,185,235
Supplies	69,484,832	58,816,600
Purchased services	45,683,614	55,246,793
Other	29,769,872	24,971,709
Depreciation and amortization	17,753,617	16,557,366
Interest and amortization	6,320,991	6,038,007
Total operating expenses	424,452,865	395,198,258
Operating income	303,486	3,449,476
NONOPERATING INCOME, net		
Investment income	4,099,725	2,910,619
Revenues from tax levies for general obligation bonds	4,577,499	4,512,981
Interest and amortization expense	(1,824,716)	(2,103,781)
Other income (expense)	(131,560)	22,642
Nonoperating income, net	6,720,948	5,342,461
Excess of revenues over expenses before capital contributions and transfers	7,024,434	8,791,937
CAPITAL CONTRIBUTIONS	2,307,606	69,153
GAIN ON DISPOSAL OF OPERATIONS	-	9,240,364
GAIN ON TRANSFER OF ASSETS	2,274,075	2,011,331
INCREASE IN NET POSITION	11,606,115	20,112,785
NET POSITION, beginning of year	155,263,067	135,150,282
NET POSITION, end of year	\$ 166,869,182	\$ 155,263,067

Public Hospital District No. 1 of Skagit County, Washington

Statements of Cash Flows

Increase (Decrease) in Cash and Cash Equivalents

	Years Ended December 31,	
	2019	2018
CASH FLOWS FROM OPERATING ACTIVITIES		
Cash received from and on behalf of patients	\$ 403,175,397	\$ 376,444,052
Cash paid to suppliers	(164,092,767)	(154,525,884)
Cash paid to employees	(230,765,869)	(212,934,938)
Other cash receipts	23,169,342	23,113,573
Net cash from operating activities	31,486,103	32,096,803
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Purchase of capital assets	(14,746,414)	(13,328,607)
Principal payments on long-term debt	(9,355,006)	(10,091,286)
Escrow payment for refunding of 2012 UTGO and refunding bonds	(29,554,720)	-
Escrow payment for refunding of 2010 revenue bonds	(32,335,093)	-
Interest paid on long-term debt	(7,974,723)	(8,588,025)
Proceeds from issuance of long-term debt	61,815,000	-
Cash paid for financing costs	(698,742)	-
Cash received from tax revenues for general obligation bonds	4,584,310	4,509,087
Cash received from disposal of operations	-	9,240,364
Cash received from transfer of assets	2,274,075	2,011,331
Cash received from capital contributions	2,307,606	69,153
Other	(131,560)	22,642
Net cash from capital and related financing activities	(23,815,267)	(16,155,341)
CASH FLOWS FROM INVESTING ACTIVITIES		
Cash contributions to joint ventures	(2,074,425)	-
Cash distributions from joint ventures	3,734,569	3,849,612
Net change in investments and assets limited as to use	(13,244,602)	(32,313,849)
Investment income	4,877,930	3,383,300
Net cash from investing activities	(6,706,528)	(25,080,937)
NET CHANGE IN CASH AND CASH EQUIVALENTS	964,308	(9,139,475)
CASH AND CASH EQUIVALENTS, beginning of year	3,057,756	12,197,231
CASH AND CASH EQUIVALENTS, end of year	<u>\$ 4,022,064</u>	<u>\$ 3,057,756</u>
RECONCILIATION OF CASH AND CASH EQUIVALENTS TO THE STATEMENTS OF NET POSITION		
Cash	\$ 1,787,525	\$ 873,722
Cash and cash equivalents in assets limited as to use	2,234,539	2,184,034
	<u>\$ 4,022,064</u>	<u>\$ 3,057,756</u>

Public Hospital District No. 1 of Skagit County, Washington

Statements of Cash Flows (continued)

Increase (Decrease) in Cash and Cash Equivalents

	Years Ended December 31,	
	2019	2018
RECONCILIATION OF OPERATING INCOME TO		
NET CASH FROM OPERATING ACTIVITIES		
Operating income	\$ 303,486	\$ 3,449,476
Adjustments to reconcile operating income to net cash		
from operating activities		
Net change in OPEB liability	3,008,271	2,918,632
Investment income considered an investing activity	(540,769)	(679,424)
Interest expense considered a capital financing activity	6,320,991	6,038,007
Depreciation and amortization	17,753,617	16,557,366
Income recognized from joint ventures	(2,479,673)	(3,354,824)
Changes in operating assets and liabilities		
Accounts receivable, net	761,855	(754,726)
Other receivables	(2,354,198)	3,335,519
Supplies inventory	(927,593)	519,780
Prepaid expenses	(1,000,778)	(330,082)
Accounts payable	1,624,490	558,139
Accrued salaries, wages, and employee benefits	2,585,874	528,978
Estimated third-party payor settlements	6,201,173	2,363,346
Reserve for professional liability costs	229,357	946,616
Net cash from operating activities	<u>\$ 31,486,103</u>	<u>\$ 32,096,803</u>
DISCLOSURE OF NONCASH INVESTING ACTIVITIES		
Capital assets financed with capital lease obligation	<u>\$ 796,118</u>	<u>\$ 1,477,648</u>

Public Hospital District No. 1 of Skagit County, Washington

Notes to Financial Statements

Note 1 – Organization

Organization – Public Hospital District No. 1 of Skagit County, Washington (the District), is organized as a municipal corporation pursuant to the laws of the state of Washington. The District is governed by an elected seven (7)-member board. The District, doing business as Skagit Valley Hospital (SVH), added the clinic division on July 1, 2010. The clinic division is known as Skagit Regional Clinics (SRC). On January 1, 2011, the District created the system name Skagit Regional Health (SRH). This name encompasses both SVH's and SRC's operations. SVH is a licensed 137-bed acute care hospital in Mount Vernon, Washington. The District also operates Camano Rural Health Clinic on Camano Island, Washington.

UW Medicine and Public Hospital District No. 3 of Snohomish County (PHD No. 3), which operated Cascade Valley Hospital and Clinics (CVH) in Arlington, Washington, entered into a long-term alliance with UW Medicine with respect to clinical and other ventures and a lease by the District of PHD No. 3's health care facilities (UW Affiliation Agreement).

Pursuant to the UW Affiliation Agreement, UW Medicine serves as SVH's and CVH's complex tertiary and quaternary health system for specialty care services not available in mutually designated communities and provided by UW Medicine. UW Medicine is available as a resource for these services and is committed to providing rapid and efficient access to advanced medical care that could not otherwise be provided locally.

The District and PHD No. 3 also entered into an Affiliation Agreement Regarding the Lease and Operation of CVH, (the Affiliation Agreement). CVH is a 48-bed facility that is approximately 20 miles southeast of SVH's main campus. In accordance with Affiliation Agreement, the District began operating CVH on June 1, 2016. The Affiliation Agreement is structured as a long-term lease (the Lease) between PHD No. 3 and the District. PHD No. 3 leased substantially all of its assets, certain other clinic facilities, PHD No. 3's interest as lessor in certain leases, and intangible assets to the District for a term of 30 years. The District will pay PHD No. 3 an annual base rent of \$10 and is responsible for all costs and expenses associated with the leased assets, including maintenance and capital improvements.

Pursuant to the Affiliation Agreement, PHD No. 3 transferred all of its cash and cash equivalents of a retained amount to the District in 2017. The retained amount is equal to PHD No. 3's known and contingent liabilities and debts plus a minimum cash balance of \$1,000,000. Thereafter, PHD No. 3 will continue to levy and collect excess and regular property tax levies, as well collect revenues from a lease of a medical office building owned by Smokey Point LLC. Smokey Point LLC is owned 50% by the District and 50% by PHD No. 3. The proceeds from PHD No. 3's regular property tax levy and the Smokey Point LLC lease will be used to pay PHD No. 3's expenses, including the annual debt service on outstanding limited tax general obligations, and to fund the minimum cash balance of \$1,000,000. To the extent the amount collected by PHD No. 3 from its regular property tax levy and the Smokey Point LLC lease exceeds PHD No. 3's existing obligations in any year, and the PHD No. 3 cash balance is equal to \$1,000,000, the excess funds will be transferred to the District. Cash transferred by PHD No. 3 to the District resulted in a gain on transfer of assets of \$2,247,075 and \$2,011,331 in 2019 and 2018, respectively.

The Affiliation Agreement provides provisions for certain operating commitments and specific provisions in event the agreement is discontinued.

Public Hospital District No. 1 of Skagit County, Washington

Notes to Financial Statements

Note 2 – Summary of Significant Accounting Policies

Accounting standards – The District reports its financial information in a form that complies with the pronouncements of the Governmental Accounting Standards Board (GASB).

Basis of presentation – The accompanying financial statements have been prepared on the accrual basis of accounting using the economic resources measurement focus. Under this method of accounting, revenues are recognized when earned and expenses are recorded when liabilities are incurred without regard to receipt or disbursement of cash.

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 and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Cash and cash equivalents – Cash and cash equivalents include demand and interest-bearing deposits with an original maturity of three months or less.

Patient accounts receivable – Accounts receivable are reduced by an allowance for doubtful 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 doubtful 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 doubtful 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 doubtful 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' balances (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 doubtful accounts.

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.

Capital assets – Land, buildings, and equipment acquisitions are recorded at cost. Improvements and replacements of land, buildings, and equipment are capitalized. The District's capitalization threshold is \$1,000 per item and a useful life of at least three years. Maintenance and repairs are expensed. The cost of land, buildings, and equipment sold or retired and the related accumulated depreciation are removed from the accounts, and any resulting gain or loss is recorded.

Public Hospital District No. 1 of Skagit County, Washington

Notes to Financial Statements

Note 2 – Summary of Significant Accounting Policies (continued)

Depreciation is recorded over the estimated useful life of each class of depreciable asset using the American Hospital Association's guidelines and is computed using the straight-line method over the shorter period of the lease term or the estimated useful life of the equipment. The estimated useful lives used by the District are as follows:

Land improvements	3 – 40 years
Buildings	26 – 40 years
Fixed equipment	3 – 25 years
Major movable and minor equipment	3 – 20 years

Interest on borrowed funds less any interest earned on temporarily invested funds is capitalized on construction projects as a cost of the related project from the date of borrowing until the construction period ends and the related asset is placed in service. Capitalized interest is depreciated over the estimated useful life of the related asset.

Federal income taxes – The District, as a political subdivision of the state of Washington, is not subject to federal income taxes under Section 115 of the Internal Revenue Code.

Assets limited as to use and short-term investments – Periodically, the Board of Commissioners sets aside cash resources for the funding of future capital improvements and self-insurance reserves. In addition, certain funds are restricted by bond indentures to be used solely for debt service or for the funding of future capital projects. Pool A and Pool B funds are restricted for capital improvements and operations of CVH as defined in the Affiliation Agreement. These funds are invested in bankers' acceptances, obligations of the United States Government, the State Treasurer's Investment Pool, and certificates of deposit with financial institutions in accordance with state guidelines.

All District investments are carried at market value. Investment income earned on self-insurance funds and the revenue bond indenture agreements are reported as other operating revenue. Realized and unrealized investment income or losses on other investments are reported as nonoperating gains and losses.

Investments in joint ventures – The District has investments in several different joint ventures providing health care services and accounts for these investments using the equity method, under which the District's share of net income is reported in other operating revenues.

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 illness; natural disasters; medical malpractice; and employee 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. The District pays certain workers' compensation claims on a self-insured basis. The District has purchased stop-loss insurance to cover workers' compensation claims that exceed stated limits and has recorded an estimated reserve for incurred but not reported claims based on an actuarial estimate, which was \$3,003,000 and \$2,839,000 at December 31, 2019 and 2018, respectively. These amounts are recorded in accrued salaries, wages, and employee benefits on the statements of net position. The District also pays certain professional liability claims on a self-insured basis (Note 11).

Public Hospital District No. 1 of Skagit County, Washington

Notes to Financial Statements

Note 2 – Summary of Significant Accounting Policies (continued)

Postemployment Benefits Other Than Pensions (OPEB) – The net OPEB liability is measured at the actuarial present value of projected benefit payments for the District's covered members. Deferred outflows of resources and deferred inflows of resources related to OPEB, and OPEB expense are recognized as they occur and are based on the changes in the net OPEB liability between measurement dates (Note 10).

Net position – Net position of the District is classified into three components. The net investment in capital assets component of net position consists of capital assets, net of accumulated depreciation, reduced by the outstanding balances of related debt that is attributable to the acquisition, construction, or improvement of those assets. The restricted component of net position represents noncapital assets that must be used for a specific purpose. The unrestricted component of net position is the remaining net amount of the assets and liabilities that are not included in the determination of net investment in capital assets or the restricted components of net position.

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, such as patient service revenue, result from exchange transactions associated with providing health care services—the District's primary business. Nonexchange revenues, such as revenues for tax levies and contributions for other than capital asset acquisition, are reported as nonoperating revenues. Operating expenses are all expenses incurred to provide health care services, other than financing costs related to general obligation bonds. Tax levy income and debt service related to general obligation bonds and peripheral or incidental transactions are reported as nonoperating gains and losses.

Net 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 Medicare and Medicaid are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods, as final settlements are determined.

Reimbursements received from certain third-party payors are 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.

Charity care – The District provides care to patients who meet certain criteria under its charity care policies. Because the District does not pursue collection of amounts determined to qualify as charity care, they are not reported as net patient service revenue. Forgone revenue for charity care provided during 2019 and 2018 measured by the District's standard charges was \$9,999,472 and \$8,171,661, respectively.

Public Hospital District No. 1 of Skagit County, Washington

Notes to Financial Statements

Note 2 – Summary of Significant Accounting Policies (continued)

New accounting pronouncements – In March 2018, the GASB issued Statement No. 88, *Certain Disclosures Related to Debt, including Direct Borrowings and Direct Placements*, to improve the information that is disclosed in notes to government financial statements related to debt. This statement is effective for financial statements for fiscal years beginning after June 15, 2018. Adoption of this statement has added additional debt disclosures to the District's financial statements.

Reclassifications – Certain reclassifications were made to the 2018 Statement of Net Position amounts to make the presentation consistent with the current year.

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

The District has evaluated subsequent events through May 8, 2020, which is the date the financial statements are available to be issued.

Note 3 – Net Patient Service Revenue

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 – 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 Medicare severity diagnosis-related groups (MS-DRGs). Each MS-DRG has a payment weight assigned to it, based on the average resources used to treat Medicare patients in that MS-DRG. The District's classification of MS-DRGs and the appropriateness of their 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). The District's cost reports have been reviewed and/or audited by the Medicare fiscal intermediary through 2015. Net revenue billed under Medicare totaled approximately \$169,972,000 and \$154,489,000 for 2019 and 2018, respectively. Unsecured net patient accounts receivable due from Medicare at December 31, 2019 and 2018, were approximately \$16,478,000 and \$16,500,000, respectively.

Public Hospital District No. 1 of Skagit County, Washington

Notes to Financial Statements

Note 3 – Net Patient Service Revenue (continued)

Medicaid – Beginning 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 District is paid for inpatient Medicaid services based on certain costs as determined by Medicaid. 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 this program, the District will be reimbursed the higher of the 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 District’s allowable operating expenses to total allowable revenue. The District has finalized the Medicaid CPE cost reports through 2014. Net revenue billed under the Medicaid program totaled approximately \$52,803,000 and \$64,791,000 for 2019 and 2018, respectively. Unsecured net patient accounts receivable due from Medicaid at December 31, 2019 and 2018, were approximately \$4,355,000 and \$4,911,000, respectively.

The District’s estimates of final settlements to or from Medicare and Medicaid through 2019 have been recorded in the accompanying statements of net position. Laws and regulations governing the Medicare and Medicaid 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. Differences between the net amounts accrued and subsequent settlements are recorded in operations at the time of settlement.

Other third-party payors – The District has also entered into various payment arrangements with certain commercial insurance carriers, health maintenance organizations, and preferred provider organizations, which provide for payment or reimbursement at amounts different from published rates. Contractual adjustments represent the difference between published rates for services and amounts paid or reimbursed by these third-party payors.

The following are the components of net patient service revenue for the District for the years ended December 31, 2019 and 2018:

	2019	2018
Gross patient service revenue	\$ 1,476,577,763	\$ 1,372,603,213
Less adjustments to gross patient service revenue		
Contractual adjustments	1,051,643,478	967,918,779
Provision for bad debts	18,722,444	21,677,341
Charity care	9,999,472	8,171,661
Total adjustments to gross patient service charges	1,080,365,394	997,767,781
Net patient service revenue	\$ 396,212,369	\$ 374,835,432

Public Hospital District No. 1 of Skagit County, Washington

Notes to Financial Statements

Note 4 – Deposits, Investments, and Assets Limited as to Use

The District makes investments in accordance with Washington State law. Eligible investments include obligations secured by the U.S. Treasury, other obligations of the United States or its agencies, certificates of deposit with approved institutions, insured money market funds, commercial paper, registered warrants of local municipalities, the Washington State Local Government Investment Pool (LGIP), eligible bankers' acceptances, and repurchase agreements.

As a political subdivision of the state, the District categorizes deposits and investments to give an indication of the risk assumed at year-end. Category 1 includes deposits and investments that are insured, registered, or held by the District's agent in the District's name. Category 2 includes uninsured and unregistered investments that are held by the broker's or dealer's trust department or agent in the District's name. Category 3 includes uninsured and unregistered deposits and investments for which the securities are held by the broker or dealer, or its trust department or agent, but not in the District's name.

At December 31, 2019 and 2018, all deposits and investments of the District are categorized as Category 1 and consist of the following:

	2019	2018
Unrestricted cash	\$ 1,787,525	\$ 873,722
Short-term investments		
Government agency securities	14,996,173	-
Investment in State Treasurer's Investment Pool	32,885,285	39,371,984
	<u>47,881,458</u>	<u>39,371,984</u>
Assets limited as to use		
Cash and cash equivalents	2,234,539	2,184,034
Government agency securities	105,549,219	68,938,429
Investment in State Treasurer's Investment Pool	31,627,291	64,026,701
	<u>139,411,049</u>	<u>135,149,164</u>
Total deposits and investments	<u>\$ 189,080,032</u>	<u>\$ 175,394,870</u>

The composition of investments, reported at fair value by investment type at December 31, 2019, and excluding unrestricted cash, short-term investments, and other assets limited as to use balances of \$68,534,640, is as follows:

Investment Type	Quoted Prices in Active Markets for Identical Assets (Level 1)	Percentage of Totals
Government agency securities	<u>\$ 120,545,392</u>	<u>100%</u>

Public Hospital District No. 1 of Skagit County, Washington

Notes to Financial Statements

Note 4 – Deposits, Investments, and Assets Limited as to Use (continued)

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 \$106,456,441, is as follows:

Investment Type	Quoted Prices in Active Markets for Identical Assets (Level 1)	Percentage of Totals
Government agency securities	\$ 68,938,429	100%

The District's deposits and investments had the following maturities as of December 31, 2019:

Deposit/Investment Type	Fair Value	Investment Maturities (in Years)	
		Less Than 1	1–5
Demand deposit	\$ 1,787,525	\$ -	\$ -
Money market	2,234,539	-	-
Government agency securities	120,545,392	79,295,392	41,250,000
Investment in State Treasurer's Investment Pool	64,512,576	-	-
	<u>\$ 189,080,032</u>	<u>\$ 79,295,392</u>	<u>\$ 41,250,000</u>

The District participates in the LGIP. The Office of the State Treasurer of Washington (OST) manages and operates the LGIP. Participation by local governments is voluntary. The investment policies of the LGIP are the responsibility of the OST and any proposed changes are reviewed by the LGIP Advisory Committee. The LGIP is comparable to a Rule 2a-7 money market fund recognized by the Securities and Exchange Commission (17 CFR 270.2a-7). Rule 2a-7 funds are limited to high-quality obligations with limited maximum and average maturities, the effect of which is to minimize both market and credit risk. The objectives of the State Treasurer's investment practices for the LGIP, in priority order, will be safety, liquidity, and return on investment. Separate financial statements for the LGIP are available from the OST. The LGIP is not subject to risk evaluation.

Credit risk – Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. The District'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 not considered to have credit risk.

Deposits – All of the District's deposits are either insured or collateralized. The District's insured deposits are covered by the Federal Deposit Insurance Corporation (FDIC). Collateral protection is provided by the Washington Public Deposit Protection Commission (WPDPC).

Public Hospital District No. 1 of Skagit County, Washington

Notes to Financial Statements

Note 4 – Deposits, Investments, and Assets Limited as to Use (continued)

Custodial credit risk – Custodial credit risk is the risk that in the event of a failure of the counterparty, the District 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 securities are held by the District's safekeeping custodian acting as an independent third party 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 District's investment in a single issuer. The District 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 District manages interest rate risk by having policy limitations on the maximum maturity of any one security to less than 36 months from settlement date to maturity date unless matched to a specific cash flow requirement.

In addition to interest and investment income included in nonoperating income, interest income included in other operating revenues totaled \$540,769 and \$679,287 for the years ended December 31, 2019 and 2018, respectively.

Note 5 – Capital Assets

Capital asset additions, retirements, and balances for the years ended December 31, 2019 and 2018, were as follows:

	Beginning Balance January 1, 2019	Additions	Retirements	Account Transfers	Ending Balance December 31, 2019
NONDEPRECIABLE CAPITAL ASSETS					
Land	\$ 11,712,330	\$ -	\$ -	\$ -	\$ 11,712,330
Construction in progress	2,278,516	3,726,030	-	(5,323,273)	681,273
Total nondepreciable capital assets	13,990,846	3,726,030	-	(5,323,273)	12,393,603
DEPRECIABLE CAPITAL ASSETS					
Land improvements	7,340,456	-	-	-	7,340,456
Buildings and leasehold improvements	140,007,942	1,060,866	-	4,721,337	145,790,145
Fixed equipment	23,143,017	308,541	-	50,062	23,501,620
Movable equipment	145,223,106	10,447,095	(16,722,741)	551,874	139,499,334
LESS ACCUMULATED DEPRECIATION AND AMORTIZATION					
Land improvements	(3,715,709)	(264,288)	-	-	(3,979,997)
Buildings and leasehold improvements	(66,858,189)	(5,552,047)	-	-	(72,410,236)
Fixed equipment	(19,120,592)	(594,589)	-	-	(19,715,181)
Movable equipment	(88,019,531)	(11,342,693)	16,722,741	-	(82,639,483)
Depreciable capital assets, net	138,000,500	(5,937,115)	-	5,323,273	137,386,658
	<u>\$ 151,991,346</u>	<u>\$ (2,211,085)</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 149,780,261</u>

Public Hospital District No. 1 of Skagit County, Washington

Notes to Financial Statements

Note 5 – Capital Assets (continued)

	Beginning Balance January 1, 2018	Additions	Retirements	Account Transfers	Ending Balance December 31, 2018
NONDEPRECIABLE CAPITAL ASSETS					
Land	\$ 10,066,771	\$ 1,645,559	\$ -	\$ -	\$ 11,712,330
Construction in progress	108,520	3,634,068	-	(1,464,072)	2,278,516
Total nondepreciable capital assets	10,175,291	5,279,627	-	(1,464,072)	13,990,846
DEPRECIABLE CAPITAL ASSETS					
Land improvements	7,340,456	-	-	-	7,340,456
Buildings and leasehold improvements	139,327,221	568,287	(4,999)	117,433	140,007,942
Fixed equipment	22,957,049	172,235	(37,142)	50,875	23,143,017
Movable equipment	135,683,676	8,786,106	(542,440)	1,295,764	145,223,106
LESS ACCUMULATED DEPRECIATION AND AMORTIZATION					
Land improvements	(3,451,122)	(264,587)	-	-	(3,715,709)
Buildings and leasehold improvements	(61,539,887)	(5,323,301)	4,999	-	(66,858,189)
Fixed equipment	(18,557,315)	(600,419)	37,142	-	(19,120,592)
Movable equipment	(78,192,912)	(10,369,059)	542,440	-	(88,019,531)
Depreciable capital assets, net	143,567,166	(7,030,738)	-	1,464,072	138,000,500
	<u>\$ 153,742,457</u>	<u>\$ (1,751,111)</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 151,991,346</u>

The District has included equipment under capital lease obligations with a cost of \$9,122,585 and \$8,326,467 in capital assets at December 31, 2019 and 2018, respectively. Amortization expense of \$2,456,683 and \$2,266,436 related to this equipment was recorded in depreciation and amortization expense for the years ended 2019 and 2018, respectively. Accumulated amortization for equipment under capital lease was \$5,458,476 and \$2,992,793 at December 31, 2019 and 2018, respectively.

Depreciation and amortization expense of operating assets for the years ended December 31, 2019 and 2018, was \$17,753,617 and \$16,557,366, respectively.

Note 6 – Investments in Joint Ventures

Cascade Imaging Associates, LLC – Together with a local radiology group, the District formed Cascade Imaging Associates, LLC (CIA), a limited liability company, to provide magnetic resonance imaging and computer-assisted tomography services to the residents of the community. The District has a 50% interest in CIA at December 31, 2019. During the years ended December 31, 2019 and 2018, the District recognized operating income of \$1,565,814 and \$2,450,235, respectively, for its share of the net income realized by CIA. The District's recorded investment in CIA was \$347,013 and \$418,134 at December 31, 2019 and 2018, respectively.

Public Hospital District No. 1 of Skagit County, Washington

Notes to Financial Statements

Note 6 – Investments in Joint Ventures (continued)

Medical Information Network – North Sound, Inc. – Together with area hospitals, the District joined Medical Information Network – North Sound, Inc. (MIN – NS), a Washington nonprofit corporation, to electronically connect patients, providers, and others to a regional electronic health record to improve quality and efficiency of health care services in North Sound communities. The District had a 50% interest in MIN – NS until March 2019. During the years ended December 31, 2019 and 2018, the District recognized operating loss of \$51,123 and \$26,888, respectively, for its share of net loss realized by MIN – NS. The District's recorded investment in MIN – NS was \$0 and \$51,124 at December 31, 2019 and 2018, respectively.

Skagit Digital Imaging, LLC – Together with a local radiology group, the District formed Skagit Digital Imaging, LLC (SDI), a limited liability company, to provide mammography and stereotactic biopsy services to the residents of the community. The District has a 50% interest in SDI at December 31, 2019. During the years ended December 31, 2019 and 2018, the District recognized operating income of \$63,596 and \$21,632, respectively, for its share of the net income realized by SDI. The District's recorded investment in SDI was \$1,736,407 and \$186,451 at December 31, 2019 and 2018, respectively.

Skagit Hospice Services, LLC – Together with Public Hospital District No. 304 of Skagit County, Washington, the District formed Skagit Hospice Services, LLC, dba Hospice of the Northwest (Hospice), a limited liability company, to provide hospice services to the residents of the community. The District has a 50% interest in Hospice at December 31, 2019. During the years ended December 31, 2019 and 2018, the District recognized operating income of \$112,918 and \$211,662, respectively, for its share of the net income realized by Hospice. The District's recorded investment in Hospice was \$1,283,812 and \$1,570,893 at December 31, 2019 and 2018, respectively.

Skagit Valley Real Estate Partnership – As part of the closing of the integration with SRC in 2013, the District purchased a membership interest in Skagit Valley Real Estate Partnership (SVREP), a partnership that invests in and develops real property located mainly in Skagit and Snohomish Counties, Washington. The District has a 30% interest in SVREP at December 31, 2019. During the years ended December 31, 2019 and 2018, the District recognized operating income of \$402,808 and \$275,000, respectively, for its share of the net income realized by SVREP. The District's recorded investment in SVREP was \$4,806,537 and \$4,848,478 at December 31, 2019 and 2018, respectively.

Smokey Point Medical Center, LLC – Together with PHD No. 3, the District formed Smokey Point Medical Center, LLC (SPMC), a limited liability company, which owns the building, land, and equipment leased to the District and PHD no. 3 to operate the Smokey Point clinics. The District has a 50% interest in SPMC at December 31, 2019. During the years ended December 31, 2019 and 2018, the District recognized operating income of \$395,841 and \$375,072, respectively, for its share of the net income realized by SPMC. The District's recorded investment in SPMC was \$4,857,610 and \$5,136,770 at December 31, 2019 and 2018, respectively.

Public Hospital District No. 1 of Skagit County, Washington

Notes to Financial Statements

Note 6 – Investments in Joint Ventures (continued)

Aggregated financial information for all of the District's joint ventures is summarized below:

	2019	2018
Current assets	\$ 6,323,075	\$ 7,462,071
Noncurrent assets, net	<u>29,594,519</u>	<u>25,178,315</u>
	<u>\$ 35,917,594</u>	<u>\$ 32,640,386</u>
Current liabilities	\$ 2,709,702	\$ 1,996,367
Long-term liabilities	12,424,668	11,279,552
Equity	<u>20,783,224</u>	<u>19,364,467</u>
	<u>\$ 35,917,594</u>	<u>\$ 32,640,386</u>
Revenue	\$ 29,804,450	\$ 29,714,151
Expenses	<u>23,711,638</u>	<u>21,991,864</u>
Net income	<u>\$ 6,092,812</u>	<u>\$ 7,722,287</u>

For more information on these joint ventures, including financial statements for the individual joint ventures, please contact the Business Services office of the District.

Public Hospital District No. 1 of Skagit County, Washington

Notes to Financial Statements

Note 7 – Long-Term Debt and Other Noncurrent Liabilities

Interest rates and maturities of long-term debt at December 31, 2019 and 2018, for the District consisted of the following:

	2019	2018
Direct placement revenue refunding bond, 2019, 3.08% to 3.78%, due serially on December 1, in amounts from \$645,000 in 2020 to \$7,105,000 in 2035, maturing in 2035.	\$ 32,775,000	\$ -
Direct placement unlimited tax general obligation refunding bond, 2019, 1.85% to 2.27%, due serially on December 1, in amounts from \$295,000 in 2020 to \$6,130,000 in 2028 maturing in 2028.	29,040,000	-
Revenue and refunding bonds, 2016, 4.00% to 5.00%, due serially on December 1, in amounts from \$1,705,000 in 2020 to \$5,875,000 in 2032, maturing in 2037, net of unamortized premium of \$5,629,401 and \$5,945,069 in 2019 and 2018, respectively.	63,584,401	65,535,069
Unlimited tax general obligation refunding bonds, 2012, 5.00%, due serially on December 1, in amounts from \$3,140,000 in 2020 to \$4,155,000 in 2023, net of unamortized premium of \$2,855,090 and \$4,202,115 in 2019 and 2018, respectively.	17,400,090	48,227,115
Revenue and refunding bonds, 2013A series, 4.00% to 5.00%, due serially on December 1, in amounts from \$1,750,000 in 2020 to \$7,895,000 in 2036, maturing in 2037, net of unamortized premium of \$1,749,999 and \$1,853,959 in 2019 and 2018, respectively.	22,699,999	24,468,959
Note payable to individuals, due in monthly installments from \$4,700 to \$12,400, including interest of 4.50% maturing in 2024.	787,168	954,316
Note payable to bank, due in monthly installments of \$9,900, including interest at 4.25% through January 2021.	112,279	223,554
Capital lease obligations, stated at present value of future minimum lease payments.	3,974,099	5,584,564
Bonds refunded in 2019	-	31,250,469
	170,373,036	176,244,046
Less current portion	(10,257,803)	(9,290,692)
	<u>\$ 160,115,233</u>	<u>\$ 166,953,354</u>

Public Hospital District No. 1 of Skagit County, Washington

Notes to Financial Statements

Note 7 – Long-Term Debt and Other Noncurrent Liabilities (continued)

Under the terms of the revenue and refunding bonds, the District has agreed to maintain certain financial ratios and meet certain covenants. Management is not aware of any violations with its debt covenants.

During 2016, the District issued the 2016 revenue bonds to carry out a tax-exempt refunding of the 2005 and 2007 revenue and refunding bonds. The refunding resulted in the recognition of an accounting loss of \$703,391, which will be deferred and amortized over the life of the 2007 bond, which was set to mature in 2032 and is classified as a deferred outflow of resources on the statement of net position. The refunding decreased the District's aggregate debt service payments by \$8,527,000 over the next 16 years and resulted in an economic gain (difference between the present values of the old and new debt service payments) of \$6,663,000.

During 2019, the District issued the 2019 direct placement revenue bonds to carry out a taxable refunding of the 2010 revenue bonds. The refunding resulted in the recognition of an accounting loss of \$1,593,000, which will be deferred and amortized over the life of the 2010 bond, which was set to mature in 2035 and is classified as a deferred outflow of resources on the statement of net position. The refunding decreased the District's aggregate debt service payments by \$8,426,000 over the next 16 years and resulted in an economic gain (difference between the present values of the old and new debt service payments) of \$6,612,000. If certain conditions are met, on December 1, 2020, the revenue bond, a taxable bond, will convert to a tax-exempt bond bearing an interest at a tax-exempt rate of 3.08% per annum. If conditions are not met, the taxable bond remains outstanding and the interest rate will reset to a fixed-rate of 3.84% until such time that the conversion occurs or until maturity thereof.

During 2019, the District issued the 2019 direct placement unlimited tax general obligation refunding bond to carry out a taxable refunding of a portion of the 2012 unlimited tax general obligation and refunding bonds. The refunding resulted in the recognition of an accounting loss of \$3,731,700, which will be deferred and amortized over the life of the 2012 bond, which was set to mature in 2028 and is classified as a deferred outflow of resources on the statement of net position. The refunding decreased the District's aggregate debt service payments by \$3,127,000 over the next 9 years and resulted in an economic gain (difference between the present values of the old and new debt service payments) of \$2,886,000. If certain conditions are met, on December 1, 2022, the UTGO bond, a taxable bond, will convert to a tax-exempt bond with an interest rate of 1.85%. If conditions are not met, the taxable bond remains outstanding, with an interest rate of 2.27% until such time that the conversion occurs or until maturity thereof.

Public Hospital District No. 1 of Skagit County, Washington

Notes to Financial Statements

Note 7 – Long-Term Debt and Other Noncurrent Liabilities (continued)

Changes in the District's noncurrent liabilities during the years ended December 31, 2019 and 2018, are summarized below:

	Beginning Balance January 1, 2019	Additions	Reductions	Ending Balance December 31, 2019	Amounts Due Within One Year
LONG-TERM DEBT					
2019 Direct placement revenue refunding bond	\$ -	\$ 32,775,000	\$ -	\$ 32,775,000	\$ 645,000
2019 Direct placement UTGO refunding bond	-	29,040,000	-	29,040,000	295,000
2010 Revenue bonds	31,250,469	-	31,250,469	-	-
2012 UTGO refunding bonds	48,227,115	-	30,827,025	17,400,090	3,140,000
2013 Revenue and refunding bonds - series A	24,468,959	-	1,768,960	22,699,999	1,750,000
2016 Revenue and refunding bonds	65,535,069	-	1,950,668	63,584,401	1,705,000
Notes payable to individuals	954,316	-	167,148	787,168	167,945
Note payable to bank	223,554	-	111,275	112,279	112,279
Capital lease obligations	5,584,564	796,118	2,406,583	3,974,099	2,442,579
Total long-term debt	176,244,046	62,611,118	68,482,128	170,373,036	10,257,803
ESTIMATED PROFESSIONAL LIABILITY	4,983,404	229,357	-	5,212,761	-
Total noncurrent liabilities	\$ 181,227,450	\$ 62,840,475	\$ 68,482,128	\$ 175,585,797	\$ 10,257,803

	Beginning Balance January 1, 2018	Additions	Reductions	Ending Balance December 31, 2018	Amounts Due Within One Year
LONG-TERM DEBT					
2010 Revenue bonds	\$ 31,733,863	\$ -	\$ 483,394	\$ 31,250,469	\$ 525,000
2012 UTGO refunding bonds	51,240,857	-	3,013,742	48,227,115	2,845,000
2013 Revenue and refunding bonds - series A	26,157,920	-	1,688,961	24,468,959	1,665,000
2016 Revenue and refunding bonds	67,425,736	-	1,890,667	65,535,069	1,635,000
Notes payable to individuals	1,362,926	-	408,610	954,316	157,394
Note payable to bank	330,399	-	106,845	223,554	111,088
Note payable to Epic	1,136,739	-	1,136,739	-	-
Capital lease obligations	6,296,008	1,477,648	2,189,092	5,584,564	2,352,210
Total long-term debt	185,684,448	1,477,648	10,918,050	176,244,046	9,290,692
ESTIMATED PROFESSIONAL LIABILITY	4,036,788	946,616	-	4,983,404	-
Total noncurrent liabilities	\$ 189,721,236	\$ 2,424,264	\$ 10,918,050	\$ 181,227,450	\$ 9,290,692

Public Hospital District No. 1 of Skagit County, Washington

Notes to Financial Statements

Note 7 – Long-Term Debt and Other Noncurrent Liabilities (continued)

Annual debt service requirements to maturity for long-term debt are as follows:

Year Ending December 31,	Bonds and Notes Payable			Direct Placement Bonds			Capital Leases Payable		
	Principal	Interest	Total	Principal	Interest	Total	Principal	Interest	Total
2020	\$ 6,875,224	\$ 6,303,504	\$ 13,178,728	\$ 940,000	\$ 1,798,303	\$ 2,738,303	\$ 2,442,579	\$ 84,002	\$ 2,526,581
2021	7,228,430	6,068,506	13,296,936	1,100,000	1,642,116	2,742,116	611,722	56,138	667,860
2022	7,730,952	5,687,840	13,418,792	1,140,000	1,610,666	2,750,666	475,825	32,675	508,500
2023	8,268,820	5,163,181	13,432,001	1,290,000	1,459,898	2,749,898	339,004	13,201	352,205
2024	4,232,820	4,729,321	8,962,141	5,850,000	1,425,516	7,275,516	104,969	2,116	107,085
2025–2029	23,335,000	18,878,918	42,213,918	27,540,000	5,220,811	32,760,811	-	-	-
2030–2034	18,265,000	10,600,724	28,865,724	16,850,000	3,183,950	20,033,950	-	-	-
2035–2037	18,413,201	2,531,332	20,944,533	7,105,000	218,834	7,323,834	-	-	-
Total	94,349,447	\$ 59,963,326	\$ 154,312,773	\$ 61,815,000	\$ 16,560,094	\$ 78,375,094	\$ 3,974,099	\$ 188,132	\$ 4,162,231
Net unamortized premiums and discounts	10,234,490								
	<u>\$ 104,583,937</u>								

Annual debt service is calculated assuming conversion of the 2019 Direct placement revenue refunding bond and the 2019 Direct placement UTGO refunding bond to tax-exempt bonds.

Note 8 – Deferred Compensation and Pension Plans

The District has a deferred compensation plan and pension plans created in accordance with Internal Revenue Code §457(b), §401(a), and §414(h). The plans are available to eligible employees and collectively provide for District matching contributions of a maximum of 9% of the employee's gross compensation earned in the prior year. Current District policy is to fund contributions. Plan provisions and contribution requirements are established by the District and may be amended by the District's Board of Commissioners.

Under the §401(a) plan, the District makes contributions on behalf of eligible employees based upon funding levels ranging from 4% to 9% of an employee's gross earnings plus an additional 1/10 of 1% for each year of the first 10 years of credited service. The District contributes up to 9% not to exceed the maximum federal amount for the year. Employees are not allowed to contribute to the §401(a) plan. All employee contributions are made to the §457(b) plan.

The §457(b) 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 an unforeseeable emergency.

The §414(h) plan allows a limited group of employees to make an irrevocable election prior to the beginning of the plan year. The maximum contribution is the §415 limit minus any employer §401(a) contributions. These pick-up contributions are completely voluntary and are in addition to any District contributions made to the §401(a) plan and any contributions that are made to the §457(b) deferred compensation plan. Generally, the benefits may only be distributed at termination of employment or death.

Public Hospital District No. 1 of Skagit County, Washington

Notes to Financial Statements

Note 8 – Deferred Compensation and Pension Plans (continued)

The District has limited administrative involvement and does not perform the investing function for the plans. The District does not hold the assets of the plans in a trustee capacity and does not perform fiduciary accountability for the plans. Therefore, the District employees' deferred compensation plans are not reported on the financial statements of the District.

The District's contributions to the employee benefit plans totaled approximately \$8,834,000 and \$7,872,000 in 2019 and 2018, respectively. Contributions made by employees to the benefit plans totaled approximately \$10,168,000 and \$9,402,000 in 2019 and 2018, respectively. For more information on the retirement plans, contact the District's director of human resources.

Note 9 – Property Taxes

The 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% 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. The Washington State Constitution and Washington State law, RCW 84.55.010, limit the rate. The District may also levy taxes at a lower rate. Further amounts of tax need to be authorized by the vote of the people.

For 2019 and 2018, the District did not have a regular tax levy. There is a voter-approved tax levy for service of the unlimited tax general obligation bonds. For 2019 and 2018, the tax levy for bond service was \$0.79 and \$0.86 per \$1,000 on a total assessed valuation of \$5,299,175,803 and \$4,724,722,380, for a total levy of \$4,206,811 and \$4,076,981, respectively. The District also receives revenue from timber taxes. Timber tax revenue in 2019 and 2018 was \$370,688 and \$436,000, respectively.

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.

Public Hospital District No. 1 of Skagit County, Washington

Notes to Financial Statements

Note 10 – Postemployment Benefits Other Than Pensions (OPEB)

General information about the OPEB Plan

Plan description – Eligible retirees and spouses are entitled to subsidies associated with postemployment medical benefits provided through the Public Employee Benefits Board (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 trust that meets the criteria in paragraph 4 of GASB 75.

Benefits provided – The subsidies provided by PEBB and valued in this report include the following:

- Explicit medical subsidy for post-65 retirees and spouses
- Implicit medical subsidy
- Implicit dental subsidy
- Premium reimbursement for those retired between ages 62 and 65

The explicit subsidies are monthly amounts paid per post-65 retiree and spouse. As of the valuation date, the explicit subsidy for post-65 retirees and spouses is the lesser of \$150 or 50% of the monthly premiums. As of January 1, 2019, the subsidy was increased to \$168 per month, and as of January 1, 2020, the subsidy will be increased to \$183 per month. The retirees and spouses currently pay the premium minus \$150 when the premium is over \$300 per month and pay half the premium when the premium is lower than \$300.

The implicit medical subsidy is the difference between the total cost of medical benefits and the premiums. For pre-65 retirees and spouses, the retiree pays the full premium amount, but that amount is based on a pool that includes active employees. Active employees will tend to be younger and healthier than retirees on average, and therefore can be expected to have lower average health costs. For post-65 retirees and spouses, the retiree does not pay the full premium due to the subsidy discussed above.

GASB 75 requires the projection of the total cost of benefit payments to be based on claims costs or age adjusted premiums approximating claims costs. Because claims costs are expected to vary by age and sex, we have used claims costs that vary by age and sex. The projection of retiree premiums is based on current amounts for the retirees' share of the premium, projected with the medical trend assumption. We also include implicit subsidies for dental coverage.

Employees covered by benefit terms – At December 31, 2019 and 2018, the following employees were covered by the benefit terms:

	2019	2018
Inactive employees or beneficiaries currently receiving benefit payments	97	77
Active plan members	2,067	1,681
	<u>2,164</u>	<u>1,758</u>

Public Hospital District No. 1 of Skagit County, Washington

Notes to Financial Statements

Note 10 – Postemployment Benefits Other Than Pensions (OPEB) (continued)

Contributions – PEBB administrative costs as well as implicit and explicit subsidies are funded by required contributions from participating employers. Contributions are set each biennium as part of the Washington State’s budget process. The benefits are funded on a pay-as you-go basis.

Other information – PEBB does issue a stand-alone financial report, but information about PEBB can be found at <http://leg.wa.gov/osa/additionalservices/Pages/OPEB.aspx>.

Total OPEB liability

The District’s total OPEB liability was \$22,960,006 and \$23,464,988 as of the reporting date of December 31, 2019 and 2018, respectively. The corresponding measurement date was December 31, 2018 and 2017, respectively, and the actuarial valuation date was July 1, 2018 and January 1, 2017, respectively. GASB 75 allows a lag of up to one year between the measurement date and the reporting date. No adjustment is required between the measurement date and the reporting date.

Actuarial assumptions and other inputs – The total OPEB liability in the December 31, 2019, actuarial valuation was determined using the following actuarial assumptions and other inputs, applied to all periods included in the measurement, unless otherwise specified:

Inflation	2.75%
Salary increases	3.5% = 0.75% real wage growth above inflation. The individual’s salary growth is used for use in the actuarial cost method.
Healthcare cost trend rates	Pre-65 ranging from 6.8% to 4.5% and Post-65 ranging from 7.6% to 4.6%
Discount Rate (Liabilities)	4.10% and 3.44% as of December 31, 2019 and 2018, respectively

The discount rate was based on the Bond Buyer General Obligation 20-bond municipal bond index for bonds that mature in 20 years. GASB 75 requires that the discount rate be based on a 20-year high quality (AA/Aa or higher) municipal bond rate.

Demographic assumptions regarding retirement, mortality, turnover, and marriage are based on assumptions used in the 2018 actuarial valuation for Washington State Public Employees’ Retirement System (PERS), and modified for the District.

- The assumed rates of disability under PERS tier 2 and 3 from the 2018 actuarial valuation are less than 0.1% for ages 50 and below and continue to be low after that. An assumption of a 0% disability rate for all ages was used.
- For service retirement, the post-2013, plans 2 and 3, with less than 30 years of service assumptions from the 2018 actuarial valuation for Washington State PERS was used.

Public Hospital District No. 1 of Skagit County, Washington

Notes to Financial Statements

Note 10 – Postemployment Benefits Other Than Pensions (OPEB) (continued)

- For mortality, the assumptions from the 2018 actuarial valuation for Washington State PERS (RP-2000 base mortality table, adjusted by -1 year for both males and females, with generational mortality adjustments using projection scale BB) was used.
- For other termination of employment, we used the assumptions from the 2018 actuarial valuation for Washington State PERS, but no less than 2% per year.

The actuarial assumptions used for the December 31, 2019, reporting were based on a census date of July 1, 2018.

Changes in the total OPEB liability

Balance at January 1, 2018	\$ 18,991,781
Service cost	2,322,431
Interest	800,469
Changes of benefit terms	-
Effects of economic/demographic gains or losses	-
Changes of assumptions or other inputs	1,628,431
Benefit payments	(278,124)
Net Changes	<u>4,473,207</u>
Balance at December 31, 2018	23,464,988
Service cost	2,656,838
Interest	893,888
Changes of benefit terms	-
Effects of economic/demographic gains or losses	2,176,604
Changes of assumptions or other inputs	(5,956,536)
Benefit payments	(275,776)
Net Changes	<u>(504,982)</u>
Balance at December 31, 2019	<u>\$ 22,960,006</u>

Changes of assumptions and other inputs reflect a change in the discount rate from 3.78% in 2017 to 3.44% in 2018 and 4.10% in 2019.

Public Hospital District No. 1 of Skagit County, Washington

Notes to Financial Statements

Note 10 – Postemployment Benefits Other Than Pensions (OPEB) (continued)

Sensitivity of the total OPEB liability to changes in the discount rate – The following presents the total OPEB liability of the County, as well as what the County's total OPEB liability would be if it were calculated using a discount rate that is 1-percentage-point lower or 1-percentage-point higher than the current discount rate:

	1% Decrease (3.10%)	Discount Rate (4.10%)	1% Increase (5.10%)
2019			
Total OPEB liability	<u>\$ 28,035,815</u>	<u>\$ 22,960,006</u>	<u>\$ 19,034,200</u>
2018			
Total OPEB liability	<u>\$ 29,229,663</u>	<u>\$ 23,464,988</u>	<u>\$ 19,067,110</u>

Sensitivity of the total OPEB liability to changes in the healthcare cost trend rates – The following presents the total OPEB liability of the District, as well as what the District's total OPEB liability would be if it were calculated using healthcare cost trend rates that are 1-percentage-point lower or 1-percentage-point higher than the current healthcare cost trend rates:

	1% Decrease	Healthcare Cost Trend Rates	1% Increase
2019			
Total OPEB liability	<u>\$ 18,380,023</u>	<u>\$ 22,960,006</u>	<u>\$ 29,192,932</u>
2018			
Total OPEB liability	<u>\$ 18,276,510</u>	<u>\$ 23,464,988</u>	<u>\$ 30,675,901</u>

The health cost trend assumptions apply to both current and future retirees and generally decrease over time from a high of 6.8% to 4.5% for pre-65 retirees and from a high of 7.6% to 4.6% for post-65 retirees. The dental cost trend assumptions generally increase over time and range from 1.1% to 4.0%.

Public Hospital District No. 1 of Skagit County, Washington

Notes to Financial Statements

Note 10 – Postemployment Benefits Other Than Pensions (OPEB) (continued)

OPEB expense and deferred outflows of resources and deferred inflows of resources related to OPEB

For the years ended December 31, 2019 and 2018, the District recognized OPEB expense of \$3,284,047 and \$2,918,632, respectively, which was included in Employee Benefits in the Statement of Revenues, Expenses, and Changes in Net Position. The District reported deferred outflows of resources and deferred inflows of resources related to OPEB from the following sources as of December 31:

	Deferred Outflows of Resources	Deferred Inflows of Resources
2019		
Differences between expected and actual experience	\$ 1,980,514	\$ -
Changes of assumptions or other inputs	1,318,253	6,029,159
	<u>\$ 3,298,767</u>	<u>\$ 6,029,159</u>
2018		
Differences between expected and actual experience	\$ -	\$ -
Changes of assumptions or other inputs	1,473,342	690,481
	<u>\$ 1,473,342</u>	<u>\$ 690,481</u>

Amounts reported as deferred outflows of resources and deferred inflows of resources related to OPEB will be recognized in OPEB expense as follows:

2020	\$ 266,679
2021	266,679
2022	266,679
2023	266,679
2024	266,679
Thereafter	1,396,997
	<u>\$ 2,730,392</u>

Public Hospital District No. 1 of Skagit County, Washington

Notes to Financial Statements

Note 11 – Professional Liability Insurance

The District has purchased professional liability insurance from Physicians Insurance (PI) on a claims-made basis in the amount of \$1 million per occurrence, with a \$5 million annual aggregate limit. The District has a retention of \$100,000 per claim with an aggregate retention of \$300,000. PI, together with MedPro and AIG, also provides excess coverage on a claims-made basis in the amount of \$45 million per occurrence, with a \$49 million annual aggregate limit. The District accrues an actuarial estimate of the expected value of losses and related expenses for unreported incidents and claims on an occurrence basis, discounted at 4%, which was \$5,213,000 and \$4,983,000 at December 31, 2019 and 2018, respectively.

Note 12 – Joint Venture Transactions

The District provides services, including accounting, management, and ancillary services, to the joint ventures (Note 6). The District was reimbursed approximately \$5,397,000 and \$12,278,000 in expenses related to these services for the years ended December 31, 2019 and 2018, respectively.

As of December 31, 2019 and 2018, the District had a total of approximately \$2,168,000 and \$677,000, respectively, in accounts receivable from joint ventures.

The joint ventures provide various services to the District (Note 6). The District paid approximately \$15,680,000 and \$16,584,000 to the joint ventures for providing these services for the years ended December 31, 2019 and 2018, respectively.

As of December 31, 2019 and 2018, the District had a total of approximately \$789,000 and \$922,000, respectively, in accounts payable to joint ventures.

Note 13 – Concentrations of Credit Risk

The District grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payor agreements. The mix of net receivables from patients and third-party payors at December 31, 2019 and 2018, was as follows:

	2019	2018
Medicare	34%	33%
Medicaid	9%	10%
Group Health	7%	9%
Patient and self-pay	1%	1%
Commercial	34%	36%
Other third-party payors	15%	11%
	<u>100%</u>	<u>100%</u>

Public Hospital District No. 1 of Skagit County, Washington

Notes to Financial Statements

Note 14 – Commitments and Contingencies

Operating leases – The District 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, 2019:

2020	\$ 7,603,068
2021	7,233,919
2022	5,997,275
2023	6,004,329
2024	3,378,322
2025–2029	13,643,588
2030–2031	<u>2,573,080</u>
	<u>\$ 46,433,581</u>

Rent expense on operating leases for 2019 and 2018 was \$8,949,000 and \$8,945,000, respectively.

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

Compliance with laws and regulations – The health care industry is subject to numerous laws and regulations from federal, state, and local governments. These laws and regulations include, but are not necessarily limited to, matters such as licensure, accreditation, government health care program participation requirements, reimbursement for patient services, and Medicare and Medicaid fraud and abuse. 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 substantially. Violations of these laws and regulations could result in expulsion from government health care programs, together with the imposition of significant fines and penalties, as well as significant repayments for patient services previously billed. Management believes that the District is in compliance with the fraud and abuse regulations, as well as other applicable government laws and regulations. Compliance with such laws and regulations can be subject to future government review and interpretation, as well as regulatory actions unknown or unasserted at this time.

Note 15 – Collective Bargaining Agreements

At December 31, 2019, the District had a total of approximately 2,597 employees. Of this total, 1,884 employees are covered by collective bargaining agreements. There are no employees under agreements that expire during 2020 and 176 employees under agreements that expired during 2019 and are under negotiation. The District does not anticipate any significant interruptions as a result of negotiations surrounding the collective bargaining agreement.

Public Hospital District No. 1 of Skagit County, Washington

Notes to Financial Statements

Note 16 – Subsequent Event

Subsequent to December 31, 2019, the World Health Organization declared the novel coronavirus (COVID-19) outbreak a public health emergency. In March 2020, the Governor of the State of Washington, issued a “Stay Home, Stay Healthy” proclamation including an order to halt elective surgeries and dental services to reserve critical equipment for COVID-19 health care workers. As a result of the mandated delay in elective procedures and the “Stay Home, Stay Healthy” proclamation, the District has seen a significant decline in patient volumes at both hospital and clinic locations. Just prior to the end of the first quarter, Congress passed and President Trump signed the Coronavirus Aid, Relief, and Economic Security (CARES) Act. The CARES Act provided funds to be distributed to healthcare providers to address the economic impact of the stoppage of elective procedures as well as the cost incurred in caring for COVID-19 patients. The distribution of these funds began in April. As of April 30, 2020, Skagit Regional Health had received approximately \$7 million. It is not yet known what Skagit Regional Health will receive of the remaining CARES Act funds or any other funding that is or will be made available from federal and/or state sources.

The total financial impact of the pandemic cannot be reasonably estimated at this time, but it is expected to have a material negative impact on the District's financial performance through the end of the year. Management continues to monitor, evaluate, and adjust to the dynamic situation and intends to take appropriate steps to mitigate the financial impact of the crisis and begin the District's recovery.

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. 1 of Skagit County, 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 the District as of and for the year ended December 31, 2019, and the related notes to the financial statements, which collectively comprise the District's financial statements, and have issued our report thereon dated May 8, 2020.

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 opinions 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.

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.

A handwritten signature in black ink that reads "Moss Adams LLP". The signature is written in a cursive, flowing style.

Everett, Washington
May 8, 2020

Required Supplementary Information

Public Hospital District No. 1 of Skagit County, Washington
Schedule of Changes in Total Other Post-Employment Benefits
and Related Ratios

	2019	2018	2017
Total OPEB liability			
Service cost	\$ 2,656,838	\$ 2,322,431	\$ 2,377,362
Interest	893,888	800,469	688,677
Changes of benefit terms	-	-	-
Differences between expected and actual experience	2,176,604	-	-
Changes of assumptions or other inputs	(5,956,536)	1,628,431	(852,947)
Benefit payments	(275,776)	(278,124)	(266,904)
Net change in total OPEB liability	(504,982)	4,473,207	1,946,188
Total OPEB liability - beginning	23,464,988	18,991,781	17,045,593
Total OPEB liability - ending	<u>\$ 22,960,006</u>	<u>\$ 23,464,988</u>	<u>\$ 18,991,781</u>
Plan fiduciary net position	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>
Net OPEB liability	<u>\$ 22,960,006</u>	<u>\$ 23,464,988</u>	<u>\$ 18,991,781</u>
Plan fiduciary net position as a percentage of total OPEB liability	<u>0%</u>	<u>0%</u>	<u>0%</u>
Covered-employee payroll	<u>\$ 154,175,746</u>	<u>\$ 170,215,023</u>	<u>\$ 150,792,481</u>
Total OPEB liability as a percentage of covered-employee payroll	<u>14.89%</u>	<u>13.79%</u>	<u>12.59%</u>

*This schedule is presented to illustrate the requirement to show information for 10 years. However, until a full 10-year trend is compiled, the District will present information for available years.

Changes in benefit terms – There were no applicable changes during the period.

Changes of assumptions – Changes of assumptions and other inputs reflect the effects of changes in the discount rate each period. The discount rate changed from 3.78% in 2017 to 3.44% in 2018 and 4.10% in 2019. As this is a newly adopted standard, a full 10-year trend is not available.

