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

Financial Statements

December 31, 2011

(With Independent Auditors' Report Thereon)

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

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KPMG LLP
Suite 900
801 Second Avenue
Seattle, WA 98104

Independent Auditors' Report

The Board of Trustees
The Board of Commissioners
Public Hospital District No. 1 of King County, Washington
dba Valley Medical Center:

We have audited the accompanying financial statements of the business-type activities of Public Hospital District No. 1 of King County, Washington, dba Valley Medical Center (the Medical Center), a component unit of the University of Washington, and the Medical Center's discretely presented component unit, The Imaging Partners at Valley, as of and for the year ended December 31, 2011, which collectively comprise the Medical Center's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the Medical Center's management. Our responsibility is to express an opinion on these financial statements based on our audit. We did not audit the financial statements of The Imaging Partners at Valley, which represents 100% of the assets and revenues of the discretely presented component unit. Those financial statements were audited by other auditors whose report thereon has been furnished to us, and our opinion, insofar as it relates to the amounts included for The Imaging Partners at Valley, is based on the report of the other auditors.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Medical Center's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements and assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit and the report of other auditors provide a reasonable basis for our opinions.

In our opinion, based on our audit and the report of other auditors, the financial statements referred to previously present fairly, in all material respects, the respective financial position of the business-type activities of Public Hospital District No. 1 of King County, Washington, dba Valley Medical Center, and the Medical Center's discretely presented component unit, The Imaging Partners at Valley, as of December 31, 2011, and the respective changes in financial position and cash flows for the year then ended in conformity with U.S. generally accepted accounting principles.

As described in note 3 to the accompanying financial statements of Public Hospital District No. 1 of King County, Washington, dba Valley Medical Center, net assets as of December 31, 2010 have been restated to correct misstatements from the Medical Center's previously issued financial statements, which were audited by other auditors.

U.S. generally accepted accounting principles require that the management's discussion and analysis on pages 3 through 16 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Our audit was conducted for the purpose of forming an opinion on the financial statements as a whole. The supplementary information included in on pages 55 - 57 is presented for purposes of additional analysis and is not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audits of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.

KPMG LLP

April 27, 2012

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

Management's Discussion and Analysis (Unaudited)

December 31, 2011

The following Management's Discussion and Analysis (MD&A) provides an overview of the financial position and activities of Public Hospital District No. 1 of King County, dba Valley Medical Center (the Medical Center or VMC) for the year ended December 31, 2011. This discussion has been prepared by management and is designed to focus on current activities, resulting changes, and current known facts and should be read in conjunction with the financial statements and accompanying notes that follow this section. All sections are the responsibility of management.

The Medical Center is committed to transparency in financial reporting and effective stewardship of its assets, and believes this discussion provides such information.

The following sections are included within this discussion:

- Introduction
- Recognition
- Results of Operations for the year ending December 31, 2011
- Looking Ahead – Opportunities and Challenges
- Volumes and Statistics
- Overview of Required Financial Statements

Introduction

Public Hospital District No. 1 of King County (the District), doing business as Valley Medical Center, is a full-service, public hospital serving over 400,000 District residents. Licensed for 303 beds, VMC has approximately 2,800 employees, including 127 employed physicians, and is the largest nonprofit healthcare provider between Seattle and Tacoma. In addition to the hospital, the Medical Center operates a network of more than two dozen primary care, urgent care, and specialty clinics throughout Southeast King County.

Located in Renton, Washington, VMC offers medical, surgical, and 24-hour emergency care as a Level III Trauma Center. The Medical Center has recognized medical specialties in joint replacement and orthopedics, neuroscience, stroke and spine, sleep medicine, and childbirth and neonatal care, and provides specialized heart and vascular and cancer treatment. VMC is committed to improving the overall health of its community.

On July 1, 2011, VMC became the eighth member of the University of Washington Medicine Health System (UW Medicine) through an approved Strategic Alliance Agreement executed between the District and the UW Medicine. The District continues to own the hospital, clinic network, and all other assets and liabilities. VMC is managed as a component unit of the University of Washington, subject to the oversight of the Board of Trustees (BOT, otherwise referred to as the Valley Board). The Valley Board oversees the healthcare operations of the District, while a publicly elected Board of Commissioners (BOC, otherwise referred to as the District Board) oversee the District's property taxes and certain nonhealthcare related functions.

In December 2011, the District Board voted to change VMC's fiscal year end from December 31 to June 30 to conform to the UW Medicine fiscal year. The calendar year financial statements ending either on or as of

December 31, 2011 will be the final financial statements issued as of that year-end. Yearly financial statements as of a June 30 year-end will be issued henceforth.

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

Component units are reported as part of the reporting unit under the blended or discrete method of presentation. Discretely presented component units are legally separate from the Medical Center and provide services to entities and individuals outside of the Medical Center. The activities of a discretely presented component unit are presented in a single column in the financial statements.

The Imaging Partners at Valley (IPV) is considered a discretely presented component unit. IPV is a limited liability company formed in 1999 under the laws of Washington State. IPV has two members: the District and Mustang Technology Group, LLC. IPV provides inpatient and outpatient magnetic resonance, positron emission tomography, and computed tomography imaging services to patients. IPV is considered a component unit of the District because IPV's operating budget is subject to the overall approval of the District, even though the District does not have a voting majority on IPV's governing board.

Recognition

VMC received numerous awards and recognitions during 2011:

- Healthgrades, a national healthcare ratings organization, recognized VMC for spine and orthopedic care:
  - The top ranked hospital in Washington state for Joint Replacement,
  - Top 2% nationally for Overall Orthopedic Services,
  - Top 2% nationally for Joint Replacement,
  - Top 5% nationally for Spine Surgery,
  - One of America's 100 Best Hospitals for Overall Orthopedic Services,
  - Orthopedic Surgery Excellence Award (2nd year in a row),
  - Joint Replacement Excellence Award (3rd year in a row)
- VMC received the American Stroke Association *Get with The Guidelines* Silver Performance Award for stroke care as well as the American Heart Association's Gold Performance award for Heart Failure.
- VMC was ranked in the Top 5 in the Seattle area by *U.S. News and World Reports* Best Hospitals Metro rankings.

- *Modern Healthcare* magazine ranked VMC in the Top 10 nationally as a "Best Place to Work in Healthcare" in 2009 and 2010.
- *Seattle Business Monthly* named VMC one of the Puget Sound's "Best Companies to Work For" in 2007, 2008, 2009, and 2010, and named VMC the #1 nonprofit in the state in the extra-large company category.
- The Governmental Financial Officers' Association (GFOA) awarded VMC the Distinguished Budget Presentation Award for VMC's 2011 budget documents, which were comprised of the statutory expenditure budget and management's operating budget.

Results of Operations for the Year Ending December 31, 2011

The Medical Center reported operating income of $5.5 million and a total increase in net assets of $13.0 million for the year ended December 31, 2011. Increasing volumes in both inpatient and outpatient activities were a significant factor in the favorable operating financial performance. More detail is shown in the "Volume and Statistics" section.

Looking Ahead – Opportunities and Challenges

Strategic Alliance with University of Washington Medicine

The Strategic Alliance Agreement between the District's healthcare system and the UW Medicine has established the foundation for clinical growth, increased patient care access for District residents, program development, and potential cost reductions through program integration. In addition, the integration of the two systems will help enhance the patient care and service within such areas as Cardiology, Oncology, Neurosciences, Ophthalmology, Urology and Robotics at a time when the region and nation are preparing for substantial healthcare reform. Discussions between the two systems have already commenced as it relates to strategic planning and programmatic development in several of these areas.

Through the "Patients are First" initiative, VMC participates as a part of UW Medicine on a shared commitment to improving the health of the public through a collaborative system that values patients, quality care and services.

Electronic Health Record Implementation

In December 2010, the District's Board of Commissioners approved the capital project (spanning several years) to implement a healthcare systemwide electronic health record system with the goal on enhancing patient safety and care and providing for seamless integration and transference of patient records throughout the healthcare system, regardless of where the patient is. The expectation is the clinic network will "go live" in July and August 2012, and the hospital will "go live" in October 2012.

Economic Factors Affecting the Future

The state of national healthcare reform remains highly uncertain, with challenges to the legality of the healthcare reform law reaching the U.S. Supreme Court. The potential impact cannot currently be forecasted. In addition, the lingering effects of the recession that began in 2008 continue, with persistently high unemployment and underemployment. That has resulted in continuing downward pressure on hospital revenues and payor mix, as

charity care and bad debt continue to increase as patients find themselves either uninsured or underinsured. The State budget also remains uncertain, with significant impending budgetary shortfalls. The impact to healthcare funding, particularly the state Medicaid program, is currently unknown, but is not likely to be favorable to healthcare providers.

While the economy will ultimately strengthen, and is showing some signs of a mild recovery, the economic outlook for healthcare is unknown. In the face of such ambiguity, the emphasis will need to be on delivering quality and safe patient care while leveraging systemwide efficiencies and strategic collaborations.

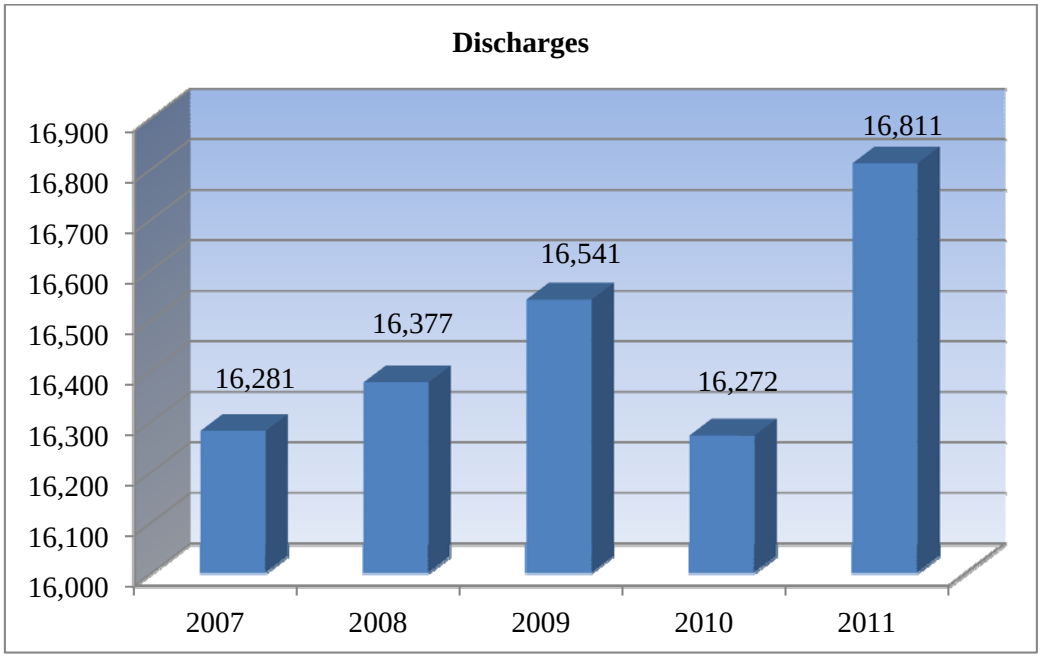
Volume and Statistics

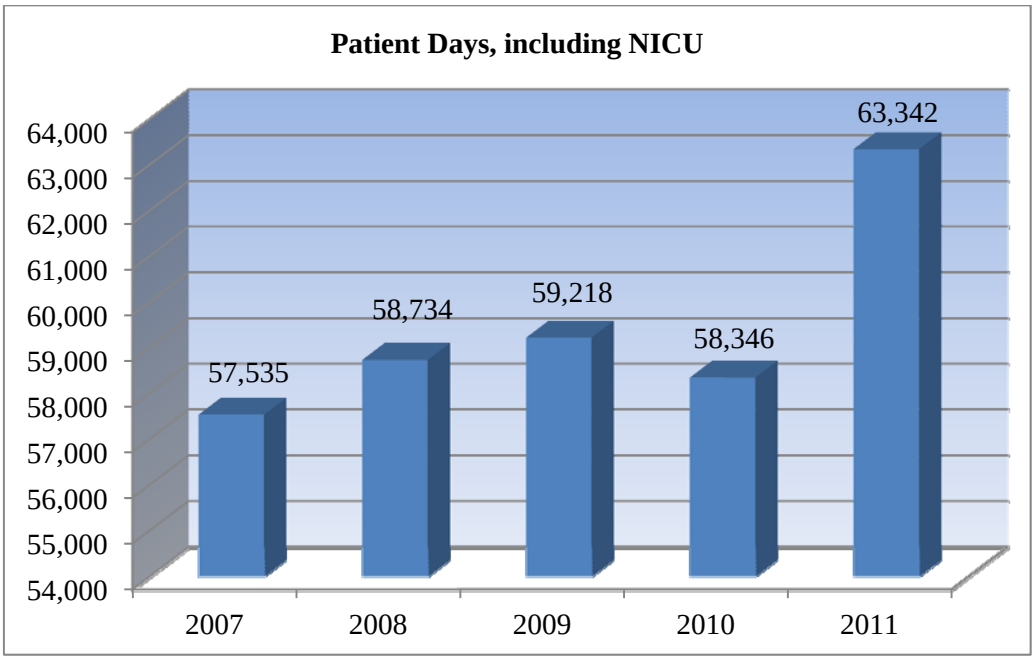
Following are key operating statistics for the year ended December 31, 2011:

Inpatient and operating room activity:	
Available beds	260
Discharges	16,811
Patient days, including NICU	63,342
Length of stay	3.50
Occupancy	67%
Surgery patients	11,157
Births	3,822
Ambulatory and emergency services:	
Outpatient visits, including clinic network	535,225
Emergency department visits	74,622
Medical center staffing:	
Full-time equivalent employees	2,367

Overall, the Medical Center's inpatient and outpatient volumes experienced increases in 2011, comparative to prior years. The increases in volumes are a significant factor in the overall positive financial operating performance of the Medical Center for the year ending December 31, 2011.

The following graphs illustrate trends in some of the Medical Center's key operating statistics, including discharges, patient days (including NICU), surgeries, Emergency Department visits, and outpatient visits (includes hospital outpatient and clinic network).





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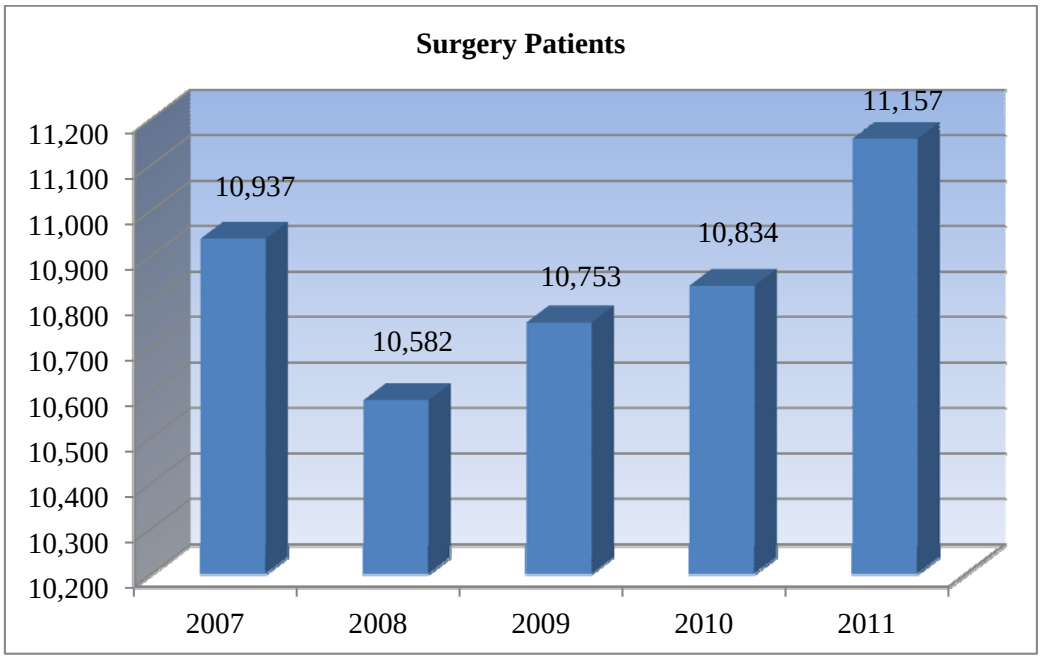
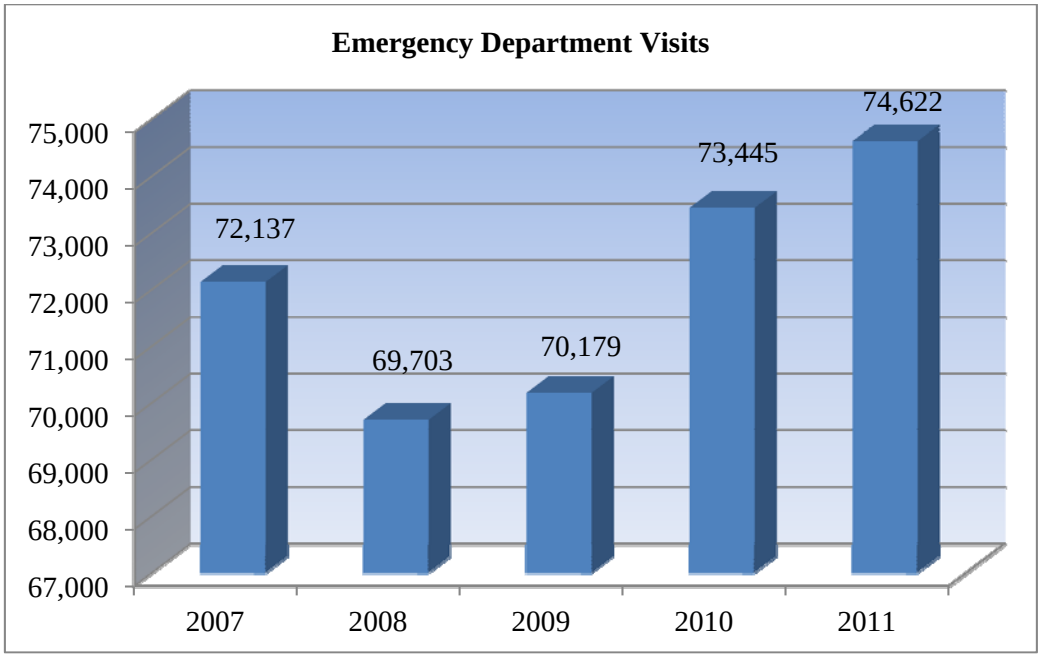

Surgery Patients
11,200
11,100
11,000
10,900
10,800
10,700
10,600
10,500
10,400
10,300
10,200
10,937
10,582
10,753
10,834
11,157
2007
2008
2009
2010
2011


Emergency Department Visits
75,000
74,000
73,000
72,000
71,000
70,000
69,000
68,000
67,000
72,137
69,703
70,179
73,445
74,622
2007
2008
2009
2010
2011

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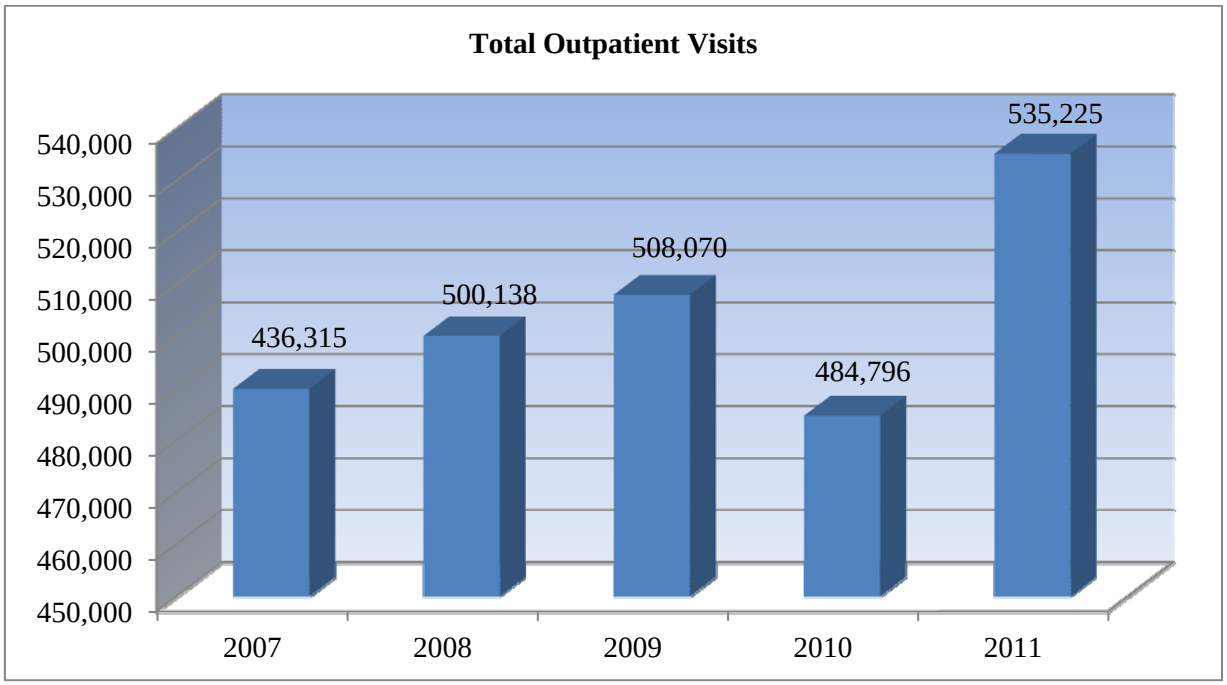


Overview of Required Financial Statements

The Medical Center's financial statements consist of three statements: balance sheet; statement of revenues, expenses, and changes in net assets; and statement of cash flows. These financial statements and related notes provide information about the activities of the Medical Center, including resources held by the Medical Center but restricted for specific purposes by contributors, grantors, or enabling legislation.

The balance sheet includes all of the Medical Center's assets and liabilities, using the accrual basis of accounting, as well as an indication about which assets can be used for general purposes and which are designated for a specific purpose. The balance sheet also includes information to help compute the rate of return on investments, evaluate the capital structure of the Medical Center, and assess the liquidity and financial flexibility of the Medical Center.

The statement of revenues, expenses, and changes in net assets reports all of the revenues and expenses during the time period indicated. Net assets – the difference between assets and liabilities – is one way to measure the financial health of the Medical Center and if the Medical Center has been able to recover all its costs through patient service and other revenue sources.

The statement of cash flows reports the cash provided by the Medical Center's operating activities, as well as other cash sources such as investment income and cash payments for capital additions and improvements. This statement provides meaningful information on where the Medical Center's cash was generated and what it was used for.

Balance Sheet

The following is a presentation of certain condensed financial information derived from the Medical Center's balance sheet (dollars in thousands):

Assets:		
Current assets	$	127,294
Assets limited as to use, net of current amount		115,646
Capital assets, net		364,682
Other noncurrent assets		36,108
Total assets	$	643,730
Liabilities:		
Current liabilities	$	73,983
Noncurrent liabilities		336,886
Total liabilities		410,869
Net assets:		
Invested in capital assets, net of related debt		71,136
Restricted:		
For debt service		7,910
Expendable for specific operating activities		348
Unrestricted		153,467
Total net assets		232,861
Total liabilities and net assets	$	643,730

Financial Analysis

Balance Sheet – Assets

Total Assets were $643.7 million at year-end. Significant events within total assets during 2011 related to the implementation of the electronic health record and the build-out of the 6th and 7th floors of the Emergency Services Tower.

Current Assets consist of cash and cash equivalents, and other assets that are expected to be converted to cash within a year. Current assets also include net patient accounts receivable valued at the estimated net realizable amount due from patients and insurers. As of December 31, 2011, 49% of the net patient accounts receivable balance is due from commercial payors, 35% is due from governmental payors Medicare and Medicaid, and 16% from patients. Due to a variety of factors, including overall economic conditions, employers and insurers have continued to shift responsibility of payment to patients in the form of increased coinsurance and deductibles. Therefore, the patient responsibility component of accounts receivable has increased. Generally speaking, the collection of patient responsibility amounts requires more effort than collection of insurance amounts because patient responsibility balances are typically composed of a high number of smaller dollar accounts.

Net accounts receivable was $48.9 million as of December 31, 2011. Short term investments were $20.7 million at December 31, 2011.

Long-term investments were $26.8 million at December 31, 2011 and are defined as those with over one year to maturity when purchased.

Other current assets include supplies inventory, prepaid expenses, and other assets.

Noncurrent Assets include assets limited as to use, which is comprised of unrestricted and restricted investments held by the Medical Center for general capital improvements and other operations, self-insurance reserves, deferred compensation arrangements, and various revenue and limited general obligation bond agreements. As of December 31, 2011, total investments, limited as to use, net of amounts required for current obligations, were $115.6 million.

Capital Assets were $364.7 million at year-end 2011. Construction in progress included two large initiatives – the design, implementation and build of the information system electronic health record, as well as the physical build-out of the 6th and 7th patient floors of the Emergency Services Tower. Other capital assets funded in 2011 included upgrading and enhancing various hospital-based infrastructure, the acquisition of hospital equipment, and remodeling and expansion of several clinics.

Other Noncurrent Assets consist primarily of the Medical Center's deferred financing costs, as well as goodwill and intangible assets related to the acquisition of a physician practice and the Medical Center's membership interest in First Choice Health Network.

Total Liabilities were $410.9 million as of December 31, 2011.

Current Liabilities include payables to employees, vendors, and other third parties, as well as the current portion of long-term debt. Accounts payable as of December 31, 2011 was $25.6 million. Approximately $16.2 million of the $25.6 million in accounts payable was related to capital projects. The Medical Center also had $28.5 million in accrued salaries, wages, and benefits. Approximately $10.1 million was related to interest payable on outstanding debt issues, accrued taxes and retainage, accrued professional liability expense, and deferred revenue related to the State's Disproportionate Share Program.

The current portion of long-term debt was $8.9 million as of December 31, 2011 and represents upcoming debt payments on various bond issues within the next year.

Noncurrent Liabilities, representing long-term debt and capital lease obligations, net of current portion, were $333.8 million at December 31, 2011. In April 2011, the Medical Center acquired an oncology and infusion center from a private physician group and incurred debt of $3.7 million, of which $2.3 million was outstanding at the end of the year. In September 2011, the District refunded its outstanding 2001 limited tax general obligation bond with a 2011 refunding bond. The District also made approximately $6.9 million in principal payments on long-term debt during the year ended December 31, 2011.

Balance Sheet – Net Assets

The Medical Center reports its net assets in three categories (the Medical Center does not have any assets meeting the criteria of the fourth category, donor-restricted nonexpendable net assets):

Invested in capital assets net of related debt – Total investment in Medical Center property, plant, and equipment net of accumulated depreciation and outstanding debt obligations related to those capital assets.

Restricted for debt service and expendable net assets – Resources the Medical Center is legally or contractually obligated to spend in accordance with restrictions placed by donors and/or external parties that have placed time or purpose restrictions on the use of the asset.

Unrestricted net assets – All other funds available to the Medical Center for the general obligations to meet current expenses for any purpose.

As of December 31, 2011, total net assets were $232.9 million.

Revenues, Expenses, and Changes in Net Assets

The statement of revenues, expenses, and changes in net assets presents the operating results of the Medical Center, as well as the nonoperating revenues and expenses. Activities are reported as either operating or nonoperating. The use of long-lived assets, referred to as capital assets, is reflected in the financial statements as depreciation, which amortizes the cost of an asset over its expected useful life.

A summary of the Medical Center's revenues, expenses, and changes in net assets for the year ended December 31, 2011 is presented below (dollars in thousands):

Summary of Revenue and Expense and Changes in Net Assets
Twelve months ending December 31, 2011

Operating revenues:		
Net patient service revenue (net of Provision for bad debts)	$	399,057
Other operating revenue		18,892
Total operating revenues		417,949
Operating expenses:		
Salaries and wages		184,010
Employee benefits		56,541
Supplies and other expenses		140,128
Depreciation		31,799
Total operating expenses		412,478
Operating income		5,471
Nonoperating income (expense):		
Revenue from taxation		19,553
Interest income		4,942
Interest and amortization expense		(16,975)
Investment income		252
Other, net		(293)
Net nonoperating income		7,479
Increase in net assets		12,950
Net assets, beginning of year, as restated		219,911
Net assets, end of year	$	232,861

Total Operating Revenues

Total Net Operating Revenue consists primarily of net patient revenue and other operating revenues. Net patient revenues are recorded based on standard billing rates less contractual adjustments, charity, and an allowance for uncollectible accounts. The Medical Center has agreements with federal and state agencies, and commercial insurers that provide for payments at amounts different from gross charges. The differences between gross charges and contracted payments are identified as contractual adjustments. The Medical Center, as well as its component unit, provide care at no charge or reduced charges to patients who qualify under the Medical Center's charity policy. The Medical Center also estimates the amount of patient responsibility accounts receivable that will become uncollectible. The difference between gross charges and the estimated net realizable amounts from payors and patients is recorded as an adjustment to charges. The resulting net patient service revenue is shown on the statement of revenues, expenses, and changes in net assets.

(Continued)

Net patient revenue is comprised of inpatient and outpatient revenue. Outpatient revenue consists of both hospital-based and clinic network revenue. Other operating revenue is comprised of hospital-related revenues such as the pharmacies and the cafeteria. The composition of services provided to patients (whether governmental or commercial insured or self-pay) is a key factor in the Medical Center's overall financial operating results. Reimbursement from governmental payors is generally below commercial rates, and reimbursement rules are complex and subject to both interpretation and modification.

For the year ended December 31, 2011, the Medical Center's net operating revenue was $417.9 million, composed of $399.1 million in net patient service revenues and $18.9 in other operating revenues.

Total Operating Expenses

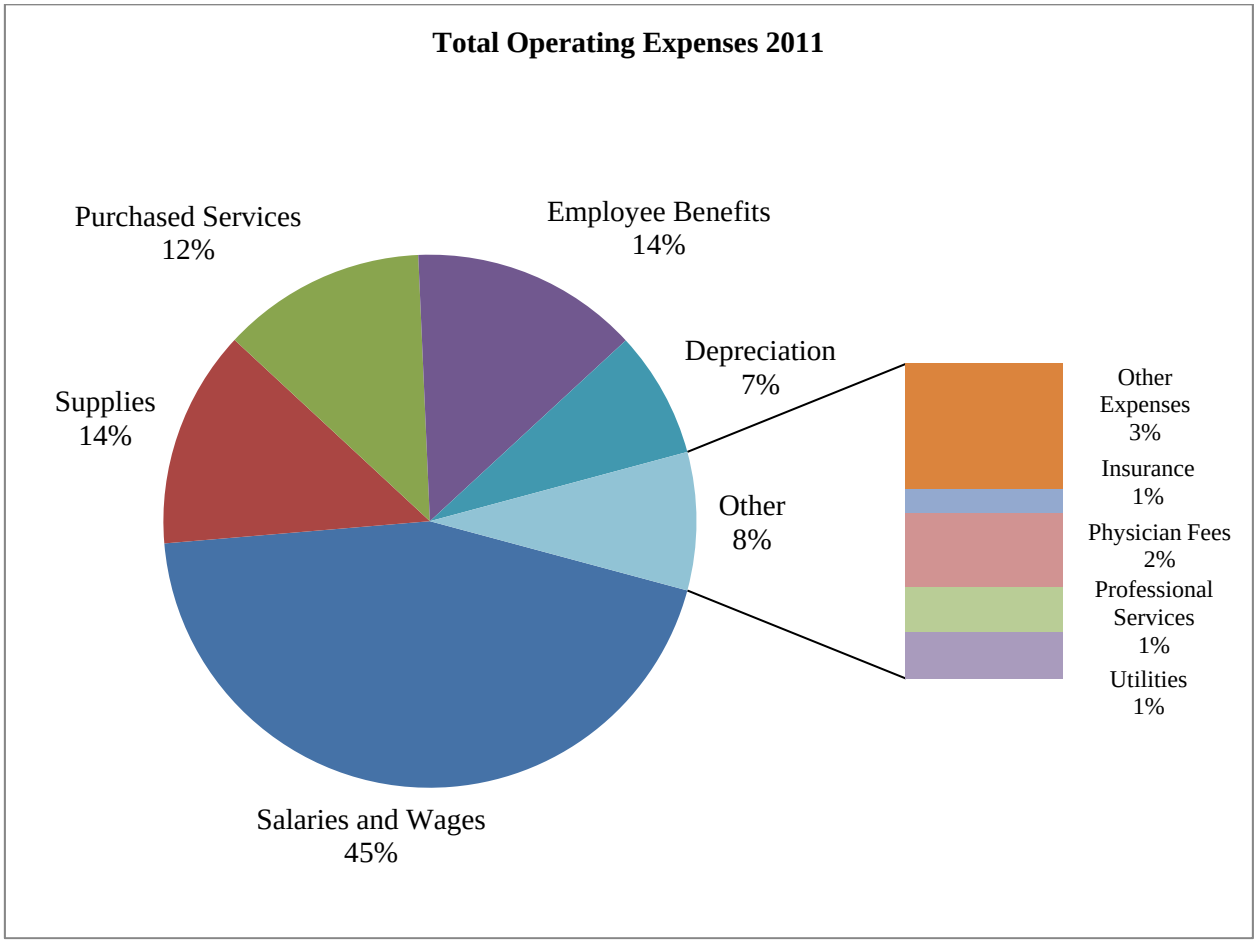
Total Operating Expenses were nearly $412.5 million for the year ending December 31, 2011. Salaries and wages accounted for nearly 45% of operating expenses, while supplies and other expenses were 34%. Employee benefits were approximately 14% of total operating expenses, and depreciation expense was 7%.

The graph below illustrates the various components of operating expenses expressed as percentages of total operating expense for 2011.

Net Assets

Net assets at December 31, 2010 have been restated to reflect a tail liability for professional and general liabilities and to reflect IPV as a discretely presented component unit.

As required by governmental accounting standards, the Medical Center has reflected interest expense as a nonoperating expense and bad debt expense as a component of net patient service revenues. Industry practice for healthcare entities not subject to governmental accounting standards is to reflect interest expense and bad debt expense as operating expenses.



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Contacting the Medical Center's Financial Management

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

If you have questions about this report or need additional financial information, please contact the Medical Center's Finance Department via phone at 425.228.3450 or at Attn: Vice President of Finance, PO Box 50010, Renton, WA 98058.

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

Balance Sheet

December 31, 2011

Assets	VMC	Component Unit – IPV
Current assets:		
Cash and cash equivalents	$ 16,452,503	959,586
Short-term investments	20,707,084	—
Accounts receivable, less allowance for uncollectible accounts	48,863,788	1,369,267
Due from:		
Primary government	—	129,098
Component unit	519,016	—
Assets whose use is limited, required for current obligations	27,130,260	—
Supplies inventory	4,916,857	25,740
Prepaid expenses and other assets	8,704,083	100,380
Total current assets	127,293,591	2,584,071
Long-term investments	26,814,280	—
Assets limited as to use:		
By Board for general capital improvements and operations	81,813,032	—
By Board for self-insurance reserve funds	2,611,453	—
Restricted unspent bond proceeds	46,888,550	—
Restricted under deferred compensation arrangements	3,554,192	—
Restricted under revenue bond indenture agreements	7,341,416	—
Restricted under general and limited general obligation bond agreements	568,541	—
	142,777,184	—
Less amounts required for current obligations	(27,130,260)	—
Total assets limited as to use	115,646,924	—
Capital assets:		
Land	13,299,496	—
Construction in progress	48,225,847	—
Depreciable capital assets, net of accumulated depreciation	303,156,704	1,551,060
Total capital assets	364,682,047	1,551,060
Deferred financing costs	4,551,960	—
Goodwill, intangible assets, and other	4,742,290	—
Total assets	$ 643,731,092	4,135,131

(Continued)

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

Balance Sheet

December 31, 2011

Liabilities and Net Assets	VMC	Component Unit – IPV
Current liabilities:		
Accounts payable	$ 25,625,659	182,447
Accrued salaries, wages, and benefits	28,488,590	—
Due to:		
Primary government	—	519,016
Component unit	129,098	—
Other accrued liabilities, including estimated third-party payor settlements	750,000	—
Interest, patient refunds, and other	10,069,948	486,401
Current portion of long-term debt and capital lease obligations	8,919,220	193,054
Total current liabilities	73,982,515	1,380,918
Deferred compensation	3,040,178	—
Long-term debt and capital lease obligations, net of current portion	333,846,069	577,133
Total liabilities	410,868,762	1,958,051
Net assets		
Invested in capital assets net of related debt	71,135,508	780,873
Restricted:		
For debt service	7,909,957	—
Expendable for specific operating activities	348,589	—
Unrestricted	153,467,276	1,396,207
Total net assets	232,861,330	2,177,080
Total liabilities and net assets	$ 643,730,092	4,135,131

See accompanying notes to financial statements.

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

Statement of Revenues, Expenses, and Changes in Net Assets

Year ended December 31, 2011

	VMC	Component Unit – IPV
Operating revenues:		
Net patient service revenue (net of provision for bad debts of $ 31,437,285)	$ 399,057,031	13,842,667
Other operating revenue	18,891,537	10,666
Total operating revenues	417,948,568	13,853,333
Operating expenses:		
Salaries and wages	184,010,419	2,727,853
Employee benefits	56,541,465	839,410
Supplies and other expenses	140,127,571	4,308,090
Depreciation	31,798,889	431,813
Total operating expenses	412,478,344	8,307,166
Operating income	5,470,224	5,546,167
Nonoperating income (expense):		
Revenue from property taxes	19,553,149	—
Interest income	4,942,219	—
Interest and amortization expense	(16,975,013)	(54,544)
Investment income	251,658	—
Other, net	(292,835)	5,319
Members' cash distributions	—	(5,838,477)
Net nonoperating income (expense)	7,479,178	(5,887,702)
Increase in net assets	12,949,402	(341,535)
Net assets, beginning of year, as restated (note 3)	219,911,928	2,518,615
Net assets, end of year	$ 232,861,330	2,177,080

See accompanying notes to financial statements.

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

Statement of Cash Flows

Year ended December 31, 2011

	Valley Medical Center	Component Unit – IPV
Cash flows from operating activities:		
Receipts from and on behalf of patients	$ 390,061,250	13,806,567
Payments to suppliers and contractors	(144,837,670)	(4,284,204)
Payments to employees	(238,308,440)	(3,813,219)
Other cash receipts	14,595,443	10,666
Net cash from operating activities	21,510,583	5,719,810
Cash flows from noncapital financing activities:		
Cash received from tax levy	19,565,043	—
Other	16,812	—
Net cash from noncapital financing activities	19,581,855	—
Cash flows from capital and related financing activities:		
Proceeds from issuance of refunding bonds	35,636,412	—
Payment to refunding bond escrow agent	(34,630,000)	—
Cash paid for bond issuance	(115,637)	—
Principal payments on long-term debt and capital lease obligations	(7,022,304)	(181,483)
Interest paid, net of amounts capitalized	(17,060,427)	(54,544)
Purchases of capital assets	(33,992,784)	(197,440)
Purchase of VM Oncology	(1,029,970)	—
Other	175,852	—
Net cash used by capital and related financing activities	(58,038,858)	(433,467)
Cash flows from investing activities:		
Distributions from joint venture	4,449,011	—
Distribution to Valley Medical Center	—	(4,273,266)
Distribution to noncontrolling member of Imaging Partners at Valley, LLC	—	(1,078,810)
Sales of investments and assets whose use is limited	48,366,283	—
Purchases of investments and assets whose use is limited	(48,768,840)	—
Investment and interest income, net of amounts capitalized	4,770,358	5,319
Net cash from (used by) investing activities	8,816,812	(5,346,757)
Net decrease in cash and cash equivalents	(8,129,608)	(60,414)
Cash and cash equivalents, beginning of year	33,973,524	1,020,000
Cash and cash equivalents, end of year	$ 25,843,916	959,586

(Continued)

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

Statement of Cash Flows

Year ended December 31, 2011

	Valley Medical Center	Component Unit – IPV
Reconciliation of cash and cash equivalents to the statement of net assets:		
Cash and cash equivalents	$ 16,452,503	959,586
Cash and cash equivalents in assets whose use is limited	9,391,413	—
	$ 25,843,916	959,586
Reconciliation of operating income to net cash from operating activities:		
Operating income	$ 5,470,224	5,546,167
Adjustments to reconcile operating income to net cash from operating activities:		
Depreciation	31,798,889	431,813
Amortization	—	—
Provision for bad debts	31,575,031	228,846
Income recognized from joint venture	(4,226,581)	—
Changes in assets and liabilities:		
Accounts receivable	(40,570,812)	(270,496)
Due from:		
Primary government	—	5,550
Component unit	(17,536)	—
Supplies inventory	(376,057)	(6,526)
Prepaid expenses and other assets	(58,181)	(49,567)
Accounts payable	(2,918,887)	62,443
Due to:		
Primary government	—	17,536
Component unit	(5,550)	—
Accrued salaries, wages, and benefits	2,009,665	(245,956)
Other accrued liabilities and estimated third-party payor settlements	—	—
Other liabilities	(1,403,401)	—
Deferred compensation	233,779	—
Net cash from operating activities	$ 21,510,583	5,719,810
Supplemental disclosures of noncash investing, capital, and financing activities:		
Increase in capital assets included in accounts payable	$ 15,419,883	—
Issuance of note payable for purchase of VM Oncology	3,705,200	—

See accompanying notes to financial statements.

(1) Organization and Mission Statement

(a) Organization

Public Hospital District No. 1 of King County, Washington (the District), a Washington municipal corporation established under Chapter 70.44 Revised Code of the State of Washington (RCW), operates Valley Medical Center (the Medical Center). The District is considered a political subdivision of the state of Washington and is allowed, by law, to be its own treasurer. The District has also been granted 501(c)(3) status by the Internal Revenue Service.

The District includes the majority of the cities of Kent, Renton, and Covington, and portions of Bellevue, Newcastle, Maple Valley, Black Diamond, Auburn, SeaTac, Tukwila, and Federal Way. It is the first and largest of the 56 public hospital districts in the state of Washington.

The District was established in 1948 by resolution of the Board of County Commissioners.

On July 1, 2011, Public Hospital District No. 1 of King County, dba Valley Medical Center, and the University of Washington Medicine (UW Medicine) entered into a Strategic Alliance Agreement, whereby the governance of the Medical Center (the Medical Center) was modified. The Medical Center is managed as a component unit of the University of Washington, subject to the oversight of a Board of Trustees. Because of the Strategic Alliance Agreement, the Medical Center is considered a component unit of the University of Washington. That Board oversees the healthcare operations of the District, while a publicly elected Board of Commissioners oversees the District's taxes and certain nonhealthcare related functions.

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

The Board of Trustees includes all current Public Hospital District Commissioners, as well as five trustees who reside within the District Service Area, at least three of whom also reside within the boundaries of the District. In addition, two current or former trustees of the UW Medicine board or a Board of another component unit within UW Medicine and the Chief Executive Officer of UW Medicine or his designee also serve on the Board of Trustees.

The District owns the hospital, clinic network, and all other assets and liabilities.

The Medical Center comprises a hospital, licensed for 303 beds; eight primary care clinics in the South King County area, including a residency program affiliated with the University of Washington School of Medicine; five urgent care clinics; specialty clinics in neurosurgery, general surgery, vascular surgery, neurology, nephrology, ophthalmology, oncology, rheumatology, diabetes, internal medicine, and ear, nose and throat; an occupational health clinic; and a behavioral health clinic.

(b) Mission Statement and Vision

The mission statement for Public Hospital District No. 1 of King County (also known as Valley Medical Center) is to be "a healthcare network committed to improving the overall health of our community. Governed by publicly elected commissioners, we provide, in collaboration with our medical staff and community agencies, comprehensive quality care and service in a cost-effective and compassionate manner."

The Medical Center's vision is to be a regionally recognized, integrated healthcare delivery system with the best quality, service, access, and people in the Puget Sound region.

(2) Summary of Significant Accounting Policies

(a) Financial Reporting Entity

As defined by generally accepted accounting principles (GAAP), the financial reporting entity consists of Public Hospital District No. 1 of King County, dba Valley Medical Center (the Medical Center), as the Medical Center, and its component unit, which is a legally separate organization for which the Medical Center is financially accountable. Financial accountability is defined as an appointment of the voting majority of the component unit's board, and either (a) the ability to impose will by the Medical Center, or (b) the possibility that the component unit will provide a financial benefit to or impose a financial burden on the Medical Center, or (c) the component unit is financially dependent on the Medical Center.

Based on this criteria, The Imaging Partners at Valley is considered a discretely presented component unit of the Medical Center.

The Imaging Partners at Valley (IPV) is a limited liability company formed in 1999 under the laws of Washington State. IPV has two members: the District and Mustang Technology Group, LLC. IPV provides inpatient and outpatient magnetic resonance, positron emission tomography, and computed tomography imaging services to patients. IPV is considered a component unit of the District because the IPV's operating budget is subject to the overall approval of the District, even though the District does not have a voting majority on the IPV's governing board.

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

During the year ended December 31, 2011, IPV provided radiology services on behalf of the Medical Center, which reimburses IPV for those services. Net patient service revenue for these services was approximately $1,794,000. Complete financial statements for the IPV can be obtained by contacting the IPV's Administrator at www.vrads.com.

Additionally, the Medical Center is a component unit of the University of Washington.

(b) Basis of Accounting

The Medical Center and the component unit report as business-type activities, as defined by Governmental Accounting Standards Board (GASB) Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments*. Business-type activities are those that are financed in whole or in part by fees charged to external parties for goods or services.

The Medical Center recognizes revenue and expenses on the accrual basis of accounting in accordance with the standards established by the Governmental Accounting Standards Board (GASB) and certain provisions in the *Audit and Accounting Guide for Health Care Organizations* published by the American Institute of Certified Public Accountants.

The accrual basis of accounting uses 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.

Pursuant to GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, the Medical Center has elected to apply the provisions of all relevant pronouncements of the Financial Accounting Standards Board (FASB), including those issued after November 30, 1989, that do not conflict with or contradict GASB pronouncements.

In December 2010, GASB issued Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*. That statement supersedes Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*. Statement No. 62 is effective for periods beginning after December 15, 2011. The Medical Center has not yet implemented this statement and management is in the process of evaluating the effect of this guidance on the financial statements.

The following is a summary of the most significant accounting policies.

(c) Use of Estimates

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

(d) Cash and Cash Equivalents

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

(e) Patient Accounts Receivable and Allowance for Uncollectible Accounts

The Medical Center's primary credit risk is patient accounts receivable, which consist of amounts owed by various governmental agencies, insurance companies, and private patients. The Medical Center manages the receivables by regularly reviewing its accounts and contracts and by providing appropriate allowance accounts for uncollectible amounts.

The Medical Center and the component unit provide an allowance for potential uncollectible patient accounts receivable, whereby such receivables are reduced to their estimated net realizable value. The Medical Center and the component unit estimate this allowance based on a variety of relevant factors including the aging of the accounts receivable and historical collection experience by payor. Other factors may also influence the collection trends, including changes in the economy, which in turn may impact employment rates and, consequently, the number of uninsured or underinsured patients, the copayments required by patients with insurance, and collection efforts.

(f) Supplies Inventory

Supplies inventory, consisting of pharmaceutical, medical-surgical, and other medical supplies, is valued at the lower of cost (computed on the first-in, first-out basis), or net realizable value. Obsolete and uninsurable items are written off.

(g) Investments

The Medical Center holds investments, as allowed by State law, in the form of bankers' acceptances, repurchase agreements, obligations secured by the U.S. Treasury, other obligations of the United States or its agencies, and certificates of deposit or money market funds with financial institutions in accordance with state guidelines. Investments are for the funding of future capital improvements, self-insurance reserves, and operational cash. In addition, certain funds are restricted by bond indentures to be used solely for debt service.

All Medical Center marketable investments are reported at fair value in accordance with GASB No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*. Fair value is determined based upon quoted market prices. Investment income, including realized and unrealized investment income or losses, is reported as nonoperating income or expense.

(h) Capital Assets

Land, buildings, and equipment acquisitions are recorded at cost. Improvements and replacements of land, buildings, and equipment are capitalized. The Medical Center's capitalization threshold is $2,500 per item and with 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.

Land, buildings, and equipment donated for Medical Center operations are recorded as additions at fair market value at the date of receipt.

Depreciation is recorded on a straight-line basis over the estimated useful life of each class of depreciable asset. The Medical Center's depreciation and useful life policies utilize several methodologies in assigning depreciable lives to assets. If the construction cost is in excess of $5 million, a composite weighted life is computed utilizing component useful lives provided by external consultants or by facility life analyses performed by external consultants.

Construction projects under $5 million and equipment and information technology systems' useful lives are typically established by using the American Hospital Association guidelines. Depreciation is computed using the straight-line method over the shorter period of the lease term or the estimated useful life of the asset. The estimated useful lives used by the Medical Center are as follows:

Buildings, renovations, and furnishings	5 – 72 years
Fixed equipment	5 – 25 years
Movable equipment	3 – 20 years
Leasehold improvements	Shorter of lease term or useful life

Interest is capitalized on construction projects as a cost of the related project beginning with commencement of construction and ceases when the construction period ends and the related asset is placed in service.

(i) Federal Income Taxes

The District (the Medical Center), as a political subdivision of the state of Washington, is not subject to federal income taxes under Section 115 of the Internal Revenue Code unless unrelated business income is generated during the year.

The component unit is a limited liability company and, therefore, is not a tax-paying entity for federal income tax purposes. Accordingly, no current or deferred income tax expense has been recorded in the component unit's financial statements. Income of the component unit is taxes to the members on their individual tax returns, if applicable. The component unit had no uncertain tax positions at December 31, 2011.

(j) Deferred Financing Costs

Deferred financing costs are amortized over the period the obligation is outstanding using the straight-line method that approximates the effective-interest method.

(k) Intangible Assets, Goodwill, and Other

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

The District also has a membership interest, considered an other asset, in First Choice Health Network, a group purchasing cooperative.

(l) Estimated Third-Party Payor Liabilities

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

The Medicare program's administrative procedures preclude final determination of amounts receivable from or payable to the Medical Center until after the cost reports have been audited or otherwise reviewed and settled by Medicare. The estimated amounts for unsettled Medicare cost reports of $750,000 are included in the other accrued liabilities line of the accompanying Medical Center balance sheet. Additionally, approximately $4.8 million associated with the Medicaid program is included in the Interest, patient refunds and other line of the accompanying balance sheet of the Medical Center.

(m) Insurance

The Medical Center has purchased insurance for professional and general liability. The Medical Center pays certain medical, dental, prescription, and vision claims for its employees, as well as workers' compensation, on a self-insured basis. The Medical Center has purchased stop-loss insurance to cover claims that exceed stated limits and has recorded estimated reserves, based upon actuarial analyses, for the ultimate costs for both reported claims and claims incurred but not reported.

(n) General Accounts

The Medical Center is required to maintain its financial records on an accounting basis that segregates assets, liabilities, revenues, and expenses in conformity with state of Washington municipal corporation laws prescribed by the State Auditor under the authority of Chapter 43.09 RCW and the Department of Health in *Accounting and Reporting Manual for Hospitals*, as well as the Board of Commissioners' resolutions. Certain accounts maintained separately on the books of the Medical Center have been combined for financial statement presentation.

Operating Account

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

Plant and Construction Accounts

These account for land; buildings; equipment; and the proceeds of the 2001, 2004, 2008, and 2011 limited tax general obligation bonds. The District transfers sufficient taxation revenues to the bond redemption fund to make principal payments on the Series 2001, 2004, 2008, and 2011 bonds. Interest payments are also made from the bond redemption fund.

Bond Account

Principal and interest payments on the Series 2001, 2004, 2008, and 2011 bonds are made from this account.

Revenue Bond Account

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

2010 Refundable Credits Account

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

Restricted Accounts

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

(o) Classification of Revenues and Expenses

The Medical Center's statement of revenues, expenses, and changes in net assets distinguishes 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 Medical Center's primary business. Exchange transactions are those in which each party to the transaction receives and gives up essentially equal values. Operating expenses are all expenses incurred to provide health care services.

Tax levy income and debt service related to limited general obligation bonds and other peripheral or coincidental transactions are reported as nonoperating transactions.

(p) 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 governmental agencies, third-party payors, patients, 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 governmental agencies and 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.

(q) Charity Care

The Medical Center and component unit provide care at no charge or reduced charges to indigent patients who meet certain criteria under the Medical Center's approved charity care policies. Because the Medical Center and component unit do 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 2011 measured by the Medical Center's standard charges, was $18,227,017.

(r) Net Assets

Net assets of the Medical Center are classified in three components. *Net assets invested in capital assets, net of related debt* consist of capital assets net of accumulated depreciation and reduced by the outstanding borrowings used to finance the purchase or construction of those assets. *Restricted net assets* (expendable) are noncapital assets that must be used for a specific purpose, as specified by grantors or contributors external to the Medical Center. *Unrestricted net assets* are remaining net assets that do not meet the definition of *invested in capital, net of related debt or restricted.*

(3) Restatement

During a review of professional liability agreements during the year ended December 31, 2011, the Medical Center determined that a tail liability related to claims-made professional liability insurance policies should have been recorded as of December 31, 2010. The actuarially determined amount of the Medical Center's liability as of December 31, 2010 is $1,440,000.

Also during the year ended December 31, 2011, the Medical Center determined that given the rights and relationships related to the IPV as described in note 2(a), IPV should have been considered a discretely presented component unit of the Medical Center. At December 31, 2010, IPV was presented as a joint venture of the Medical Center. The amount of investment in joint venture previously reported by the Medical Center as of December 31, 2010 was approximately $2 million.

In order to correct these errors, the Medical Center restated net assets at December 31, 2010, as follows:

		December 31, 2010
Net assets as previously reported	$	223,319,559
Adjustments:		
Professional liability		(1,440,000)
Investment in joint venture		(1,967,631)
Total correction to net assets		(3,407,631)
Net assets, as restated	$	219,911,928

The restatement does not impact the statement of revenues, expenses and changes in net assets or statement of cash flows.

(4) Net Patient Service Revenue

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

(Continued)

A summary of gross patient charges by payor for the year ended December 31, 2011 is as follows:

Medicare	34%
Medicaid	16
Self pay	5
Other third party payors	45
Total	100%

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

(a) Medicare

Medical Center services rendered to Medicare program beneficiaries are paid at prospectively determined rates, which provide for reimbursement based on Medicare severity adjusted diagnostic related groupings (MS-DRGs). These rates vary according to a patient classification system that is based on clinical, diagnostic, and other factors. The majority of Medicare outpatient services are reimbursed under a prospective payment methodology, the Ambulatory Payment Classification system (APC), or fee schedule. The Medical Center is reimbursed for cost-reimbursable items at a tentative rate, with final settlement determined after submission of annual cost reports by the Medical Center and audits thereof by the Medicare fiscal intermediary. Net revenue under the Medicare program totaled approximately $100.9 million for 2011.

(b) Medicaid

The State of Washington has established an inpatient Medicaid reimbursement methodology for all noncritical access Washington State governmental hospitals called “Certified Public Expenditures” (CPE). Under this program, the Medical Center is paid for inpatient Medicaid services based on allowable costs as determined by Medicaid. The estimated costs for inpatient care are calculated using the ratio of cost to charges from a base year (usually two years before the service year). The Medical Center also receives a monthly disproportionate share payment as determined by Medicaid. Under the program, the Medical Center will be reimbursed the higher of the cost of service or “baseline” reimbursement that would have been received based on the inpatient prospective payment system (IPPS) effective prior to when the CPE program was implemented. For 2011, the payments received under the CPE method are higher than the baseline payment. The program allows the Medical Center to keep the excess until cost settlement. Interim cost settlement occurs two years after the state fiscal year end.

Outpatient services are paid on a fee schedule or a percentage of allowed charges based on a ratio of the Medical Center’s allowable operating expenses to total allowable revenue. The CPE program has been funded by the state Legislature only through the current state biennium (through June 30, 2013).

During the 2009 state legislative session, the state Legislature requested the Washington State Department of Social and Health Services (DSHS) (now part of the Health Care Authority) to create a professional services supplemental payment (PSSP) program for certain public hospitals within the state by no later than June 30, 2010, which DSHS accomplished. The Medical Center participates in the PSSP program. The payments made under the PSSP program are based upon the gap between the average commercial payment rate and the Medicaid rate. Authorization for the PSSP program is through June 30, 2013.

The state legislature, as part of the 2010 state legislative session, enacted a safety net assessment, which is used to augment funding from other sources and obtain additional federal funds to support increased payments to hospitals for Medicaid services. The legislation specifies assessment levels and payment increases. Assessments are based on non-Medicare patient days. As a CPE hospital, the Medical Center is not subject to the safety net assessment; however, the Medical Center receives the restored Medicaid rate.

Net revenue under the Medicaid program totaled approximately $49.0 million for 2011.

The Medical Center's estimates of final settlements to or from Medicare and Medicaid for all years through 2011 have been recorded in the accompanying balance sheet. 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. The Medical Center's Medicare cost reports have been audited by the Medicare fiscal intermediary through December 31, 2006.

(c) Other Third-Party Payors

The Medical Center 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 year ended December 31 for the Medical Center and the component unit:

	Primary government	Component unit
Gross patient service charges	$ 1,137,989,277	30,463,616
Adjustments to patient service charges:		
Contractual discounts	689,130,198	16,109,547
Provision for bad debts	31,575,031	228,846
Charity care	18,227,017	282,556
	738,932,246	16,620,949
Net patient service revenue	$ 399,057,031	13,842,667

(5) Deposits and Investments

(a) General

Chapter 39.59 Revised Code of Washington (RCW) authorizes the Medical Center to make investments in accordance with Washington State law. The Medical Center also has a formalized investment policy that provides the Medical Center may, through formal interlocal agreement, invest funds not immediately required for expenditure with the King County Investment Pool (the Pool) and/or the Washington State Treasurer's Local Government Investment Pool (the LGIP), or may separately invest such funds in either actively managed individual portfolio or mutual fund accounts that meet all statutory investment requirements.

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

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

At December 31, 2011, deposits and investments of the Medical Center consist of the following:

Unrestricted cash and cash equivalents	$	16,452,503
Investments:		
U.S. Treasury securities and bonds		47,521,364
		47,521,364
Assets whose use is limited:		
Cash and cash equivalents		9,391,413
U.S. Treasury securities and bonds		119,966,280
U.S. government mutual funds		8,281,839
Other assets		5,136,652
		142,776,184
	$	206,750,051

Interest income included in other nonoperating revenue totaled just over $4.9 million for the year ended December 31, 2011.

Investments within the other assets category are related to the cash surrender value of life insurance and a deferred compensation plan, the latter of which is self-directed by the participant of the plan which includes money market funds and other eligible investments as authorized by state law. While the investments are currently in the Medical Center's name, the payment of deferred compensation to the participant will be for the resulting value of the self-directed investments. Therefore, the risk of loss has been transferred to the participant.

(b) Investments

Credit Risk

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

Credit risk is measured by the assignment of a rating by a nationally recognized statistical rating organization (NRSRO). The Medical Center follows state statute, which provides that commercial paper, negotiable certificates of deposit, and banker's acceptances must be rated at least A-1 by Standard and Poor's (S&P) and P-1 by Moody's Investor's Services, Inc., and fixed income holdings are limited to securities that are issued by or fully guaranteed by the U.S. Treasury, U.S. government-Sponsored Enterprises, or U.S. government Agencies, including U.S. government

Agency Mortgage-Backed Securities. Money market funds are limited to those with an average credit quality of AAA by S&P.

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

As of December 31, 2011, the Medical Center's investment in the Pool was not rated by a NRSRO. In compliance with state statutes, Pool policies authorize investments in U.S. Treasury securities, U.S. agency and mortgage-backed securities, municipal securities (rated at least A by two NRSROs), commercial paper (rated at least the equivalent of A-1 by two NRSROs), certificates of deposit issued by qualified public depositories, repurchase agreements, and the LGIP managed by the Washington State Treasurer's office.

As of December 31, 2011, all impaired commercial paper investments have completed enforcement events. The King County Impaired Investment Pool (Impaired Pool) held one commercial paper asset where the Impaired Pool accepted an exchange offer and is receiving the cash flows from the investment's underlying securities, and the residual investments in four commercial paper assets that were part of completed enforcement events where the Impaired Pool accepted the cash out option. The Medical Center's share of the Impaired Pool principal is $312,823 and the Medical Center's fair value of these investments is $136,980.

The composition of investments, reported at fair value by investment type and rating at December 31, 2011 and excluding cash balances of $3,627,520, is as follows:

Investment type		Fair value	Ratings	Percentage of totals
Money market mutual fund	$	13,961,980	AAA	6.9%
U.S. Treasuries		71,462,056	Not Rated	35.2
U.S. agencies		65,461,082	AAA	32.2
U.S. agency mortgages		28,832,699	AAA	14.2
Tax exempt issues		1,012,089	AAA	0.5
U.S. government mutual fund		8,499,184	AAA	4.2
King County investment pool		8,733,014	Not Rated	4.3
State (LGIP) investment pool		23,774	Not Rated	—
Other assets		5,136,652	Not Rated	2.5
Total	$	203,122,530		100.0%

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

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

There are no investments exceeding 5% of total investments that are with any one issuer other than the U.S. Treasury, U.S. Agency, or U.S. government-sponsored entities. As of December 31, 2011, for those investments that require composition disclosure, the Medical Center holds investments in U.S. government-sponsored entities totaling 20% of its total investments in Federal National Mortgage Association securities, 12% of its total investments in Federal Home Loan Mortgage Corporation securities, and 7% of its total investments in Federal Home Loan Bank securities.

Custodial credit risk is the risk that, in the event of a failure of the counterparty, the Medical Center will not be able to recover the value of the investment or collateral securities that are in possession of the Medical Center.

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

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

Interest Rate Risk

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

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

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

Issuer/instrument	Maximum length of maturity
U.S. Treasury bonds, certificates, bills	10 years
Other obligations of the U.S. or its agencies	10 years
Mutual funds consisting of only U.S. government bonds or U.S. guaranteed bonds	Average maturity < 4 years
Statutorily allowed certificates of deposit	24 months
Commercial paper	180 days
General obligation bonds of any state/local government	10 years

The Medical Center's investments in a U.S. government mutual fund had a weighted average duration of 2.3 years at December 31, 2011.

As of December 31, 2011, the Pool's average duration was 0.72 years. As a means of limiting its exposure to rising interest rates, securities purchased in the Pool must have a final maturity, or weighted average life, of no longer than five years. Although the Pool's market value is calculated on a monthly basis, unrealized gains or losses are not distributed to participants. The Pool distributes earnings monthly using an amortized cost methodology.

The LGIP is an unrated 2a-7 pool, as defined by GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*. Accordingly, the Medical Center's balances in the LGIP are not subject to material interest rate risk, as the weighted average maturity of the portfolio will not exceed 90 days. At December 31, 2011, the weighted average maturity was 32 days.

(Continued)

Information about the sensitivity of the fair values of the Medical Center's investments (including investments held by the bond trustee) to market interest rate fluctuations is provided by the following table, which shows the distribution of the Medical Center's investments by maturity:

		Remaining maturity (in months)			
Investment type	**Fair value**	**12 months or less**	**13 to 24 months**	**25 to 48 months**	**More than 48 months**
Money market mutual fund	$ 13,961,980	13,961,980	—	—	—
U.S. Treasuries	71,462,056	26,076,366	17,672,304	20,804,618	6,908,768
U.S. agencies	65,461,082	24,196,824	19,534,696	13,919,498	7,810,064
U.S. agency mortgages	28,832,699	—	1,412,005	1,158,020	26,262,674
Tax exempt issues	1,012,089	—	1,012,089	—	—
U.S. government mutual fund	8,499,184	—	—	8,499,184	—
King county investment pool	8,733,014	8,733,014	—	—	—
State investment pool	23,774	23,774	—	—	—
Other Assets	5,136,652	—	—	—	5,136,652
	$ 203,122,530	72,991,958	39,631,094	44,381,320	46,118,158

(6) Property Tax Revenues

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

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

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

The actual levy rate for 2011 was $0.56 per $1,000 for a total regular levy of $19,681,672.

Property taxes are recorded as receivables when levied. Because State law allows for the sale of property for failure to pay taxes, no estimate of uncollectible taxes is made. Given property taxes are recorded on a calendar year basis, there is not a material property tax receivable balance at December 31, 2011.

(Continued)

(7) Capital Assets

Medical Center's Capital Assets

The activity in the Medical Center's capital asset accounts and related accumulated depreciation for year ended December 31, 2011 was as follows:

	Balance January 1, 2011	Additions	Retirements	Account transfers	Balance December 31, 2011
Nondepreciable capital assets:					
Land	$ 13,299,496	—	—	—	13,299,496
Construction in progress	13,120,129	48,560,574	—	(13,454,856)	48,225,847
Total nondepreciable capital assets	26,419,625	48,560,574	—	(13,454,856)	61,525,343
Depreciable capital assets:					
Land improvements	18,158,078	—	—	92,257	18,250,335
Buildings and leasehold improvements	361,538,407	12,010	(331,245)	5,596,881	366,816,053
Equipment:					
Fixed	27,514,056	—	(691,538)	95,797	26,918,315
Major movable	135,892,060	822,671	(15,525,421)	6,583,338	127,772,648
Minor	12,063,321	654,779	(729,040)	1,086,583	13,075,643
Total depreciable capital assets	555,165,922	1,489,460	(17,277,244)	13,454,856	552,832,994
Less accumulated depreciation:					
Land improvements	(9,681,806)	(342,406)	—	—	(10,024,212)
Buildings and leasehold improvements	(104,251,446)	(13,869,372)	296,743	—	(117,824,075)
Equipment:					
Fixed	(20,897,033)	(1,032,353)	614,275	—	(21,315,111)
Major movable	(92,820,705)	(15,731,887)	15,068,661	—	(93,483,931)
Minor	(6,380,790)	(1,308,369)	660,198	—	(7,028,961)
Total accumulated depreciation	(234,031,780)	(32,284,387)	16,639,877	—	(249,676,290)
Depreciable capital assets, net	321,134,142	(30,794,927)	(637,367)	13,454,856	303,156,704
Capital assets, net	$ 347,553,767	17,765,647	(637,367)	—	364,682,047

Total additions to accumulated depreciation of $32,284,387 include $485,498 of nonoperating depreciation expense. These assets are medical office buildings rented or leased to physician practices and others, and, therefore, are not considered within the operations of the Medical Center. Therefore, $31,798,889 in

depreciation expense is reflected in the operating expenses section of the Statement of Revenues, Expenses, and Changes in Net Assets.

Interest expense on borrowed funds during construction is a component of the cost of assets. The amount capitalized represents interest on funds expended for construction. Capitalization of interest ceases when the asset is substantially complete or placed in service.

The Medical Center capitalized interest costs of $1,369,433 during the year ended December 31, 2011.

Property and equipment also includes certain capitalized labor incurred to ready such property and equipment for use. Capitalized labor related to information technology and internally generated computer software is capitalized only during the application development stage. Management has explicitly authorized and committed the funding for such capitalized labor in its annual capital and operating budgets. Total capitalized labor and associated benefits were approximately $3,100,000 for the year ended December 31, 2011.

Included in major movable equipment at December 31, 2011 is $4,619,239 of equipment under capital lease. Accumulated amortization of the equipment under capital lease totaling $4,330,066 is included in accumulated depreciation at December 31, 2011.

Approximately $16,200,000 of the Medical Center's accounts payable as of December 31, 2011 relate to capital assets.

Component Unit's Capital Assets

The activity in the component unit's capital asset accounts and the related accumulated depreciation accounts for the year ended December 31, 2011 was as follows:

	Beginning balance January 1, 2011	Additions	Retirements	Account transfers	Ending balance December 31, 2011
Depreciable capital assets:					
Buildings and leasehold improvements	$ 88,347	—	—	—	88,347
Equipment:					
Major movable	6,394,139	165,132	—	—	6,559,271
Minor	356,764	32,308	—	—	389,072
Total depreciable assets	6,839,250	197,440	—	—	7,036,690
Less accumulated depreciation:					
Buildings and leasehold improvements	(33,967)	(9,657)	—	—	(43,624)
Equipment:			—		
Major movable	(4,742,115)	(379,042)	—	—	(5,121,157)
Minor	(277,735)	(43,114)	—	—	(320,849)
Total accumulated depreciation	(5,053,817)	(431,813)	—	—	(5,485,630)
Depreciable capital assets, net	$ 1,785,433	(234,373)	—	—	1,551,060

(Continued)

(8) Long-Term Debt and Capital Lease Obligations

Medical Center's Long-Term Debt and Capital Leases

Long-term debt for the District (Medical Center) consisted of the following as of December 31, 2011:

Limited tax general obligation bonds:		
2011 term bond, 2.19%, due in June and December, in yearly amounts from $705,000 in 2011 to $4,071,034 in 2021, plus interest due semi-annually.	$	33,911,953
2008 series A and B, 4.0% to 5.25%, due serially in December, in amounts from $1,185,000 in 2011 to $17,365,000 in 2037, plus interest due semi-annually, net of unamortized premium of $1,542,521 and and unamortized loss on refinancing of $2,815,601.		215,762,920
2001 series, 4.25% to 5.5%, due serially in December, in amounts from $2,625,000 in 2011 to $5,995,000 in 2021, plus interest due semi-annually, net of unamortized premium of $172,510. Refunded in September 2011.		—
2004 series, 3.75% to 4.25%, due serially in December, in amounts from $1,000,000 in 2011 to $1,260,000 in 2017, plus interest due semi-annually, net of unamortized premiums of $122,552 and unamortized loss on refinance of $369,260.		6,709,622
Revenue bonds:		
2010 series A, 3.00% to 5.00%, due serially in June, in amounts from $1,335,000 in 2011 to $2,395,000 in 2024, plus interest due semi-annually, net of unamortized premium of $251,086 and unamortized discount of $214,065.		22,583,564
Build America bonds:		
2010 series B, 7.90% to 8.00%, due serially in June, in amounts from $2,520,000 in 2025 to $5,485,000 in 2040, plus interest due semi-annually.		61,155,000
Long-term debt		340,123,059
Capital lease obligations, stated at present value of future minimum lease payments		312,030
Note Payable:		
2011 note payable, 2.25%, due in three payments 2012 to 2014, plus interest due annually.		2,330,200
		342,765,289
Less current portion		(8,919,220)
Long-term portion of debt and capital lease obligations	$	333,846,069

Under the terms of its financing agreements, the District has agreed to meet certain covenants. Bond covenants related to the Limited Tax General Obligation (LTGO) bonds require including in the Medical Center's budgets and making annual levies of taxes, within constitutional and statutory tax limitations

provided by law upon on all property within the District subject to taxation, together with any other money legally available, to be sufficient to pay the principal and interest of the LTGO bonds.

Financing covenants associated with the District's revenue bonds require maintaining an amount within the Reserve Account (a subaccount within the Revenue Bond Fund) equal to the Reserve Requirement for all covered revenue bonds (the 2010 series only). That amount is equal to the lesser of the Maximum Annual Debt Service with respect to the 2010 bond series, an aggregate of the sum of 10% of the initial principal amount of the 2010 bond series, or 125% of the Average Annual Debt Service on the 2010 bond series.

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

Management is not aware of any violations with its debt covenants for the year ending December 31, 2011.

Series 2011 Bond Issue

The 2011 Limited Tax General Obligation Refunding Bond was issued on September 7, 2011 for $35,636,412. The Bond was issued for the purpose of refunding, on a current basis, and defeasing the Limited Tax General Obligation Refunding Bonds, 2001, maturing on and after December 1, 2012. The Series 2011 proceeds were irrevocably deposited, on September 7, 2011, into an escrow fund held by an escrow agent. Upon such deposit, the Series 2001 bonds were deemed defeased and are no longer outstanding.

The Series 2011 Term Bond was issued with a fixed interest rate of 2.19%, and has ten annual maturities of varying amounts between 2011 and 2021. The refunding resulted in a difference between the reacquisition price and the net carrying amount of the old debt of $1,052,279 for the year ended December 31, 2011, which will be deferred and amortized over the life of the new bonds. The refunding resulted in an economic gain (difference between the present values of the old and new debt service payments) of $5,000,704.

The District has pledged tax revenues to secure the bonds.

2011 Note Payable

In March 2011, the District purchased an infusion center and medical oncology practice from a private physician group. The purchase price for the assets was $3,705,200. As of December 31, 2011, the outstanding note payable was $2,330,200, which has payments in years 2012 - 2014, with a fixed interest rate of 2.25%.

Series 2010 Revenue Bond Issue

The Series 2010 Bonds were issued in two subseries. On June 23, 2010, the District issued $25,145,000 in federally tax-exempt revenue bonds (Series 2010A) and $61,155,000 in Federally taxable revenue Build America Bonds (BABs) (Series 2010B). Both series are fixed rate.

The Series 2010A Bonds were used to refund and defease all of the Series 1997 Bonds and the eligible portion of the Series 1998 Bonds, as well as acquire District Hospital facilities and land. Of the total, $9,240,000 of the Series 1998 Bonds could not be legally advance refunded with tax-exempt obligations proceeds. Consequently, the District used its own operational funds to cash defease that portion of the Series 1998 Bonds.

To refund and defease the Series 1997 Bonds and the Eligible Series 1998 Bonds, the District irrevocably deposited a portion of the Series 2010A Bond proceeds, along with District funds, into an escrow fund held by an escrow agent. Upon such deposit, on June 23, 2010, the Series 1997 Bonds and Eligible Series 1998 bonds were deemed defeased and are no longer outstanding.

The Series 2010A consists of serial bonds of $16,255,000, which were issued with interest rates ranging from 3.00% to 5.00% at yields of 1.88% to 4.85%, maturing between 2011 - 2020, and an $8,890,000 5.125% term bond is due in 2024.

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

Under the BAB bonds, the District receives a direct cash subsidy payment from the United States Department of the Treasury equal to 35% of the interest payable on the Series 2010B Bonds as of each Interest Payment Date. For the year ending December 31, 2011, the District received $1,706,294 in subsidy payments, which are recorded in other nonoperating revenues in the Statement of Revenues, Expenses, and Changes in Net Assets.

Although the refunding of the 1997 and 1998 series resulted in a difference in cash flow requirements of $5.2 million between the defeased debt and the newly issued debt, the Medical Center obtained an economic gain (difference between the present values of the old and new debt service payments) of approximately $3.6 million in 2010.

Series 2008 Bond Issue

The District issued $218,220,000 in limited tax general obligation and refunding bonds, Series 2008A and 2008B, in March 2008. The 2008 series refunded two prior bond series, the 2005 revenue bonds and the 2006 limited tax general obligation Series A and B bonds.

Series 2008A is for $113,315,000 and comprises $97,745,000 of 5.0% - 5.25% term bonds maturing beginning with $14,730,000 maturing in 2023 to $59,725,000 5.0% bonds maturing in 2037. Within this subseries, $15,570,000 of this subseries is in 4.0%-5.0% serial bonds, which mature for eight consecutive years beginning in 2011. Series 2008A is insured by a rated bond insurer.

Series 2008B is for $104,905,000 5.25% term bonds, beginning with $8,920,000 maturing in 2023 to $69,260,000 maturing in 2037. Series 2008B is uninsured.

The District has pledged tax revenues to secure the bonds.

Long-term debt, capital lease obligations, and deferred compensation activity summary for 2011 is as follows:

	Beginning balance January 1, 2011	Additions	Reductions	Ending balance December 31, 2011	Amounts due within one year
Limited tax general obligation bonds:					
2011 series	$ —	35,636,412	1,724,459	33,911,953	4,130,000
2008 series	216,890,316	—	1,127,396	215,762,920	880,000
2004 series	7,682,168	—	972,546	6,709,622	1,030,000
2001 series	37,413,033	—	37,413,033	—	—
Revenue bonds:					
2010 Series A	23,671,135	—	1,087,571	22,583,564	1,380,000
Build America bonds:					
2010 Series B	61,155,000	—	—	61,155,000	—
Note payable	—	3,705,200	1,375,000	2,330,200	1,370,000
Capital lease obligations	484,334	—	172,304	312,030	129,220
Total long-term debt and capital lease obligations	347,295,986	39,341,612	43,872,309	342,765,289	8,919,220
Deferred compensation	2,806,399	501,693	267,914	3,040,178	—
Total noncurrent liabilities	$ 350,102,385	39,843,305	44,140,223	345,805,467	8,919,220

(Continued)

A summary of future maturities on long-term debt, excluding capital leases, for the next five years and thereafter, as of December 31, 2011, using the fixed interest rates, for both principal and interest, is presented below:

	Principal	Interest
2012	$ 8,790,000	18,172,864
2013	8,120,100	17,942,785
2014	8,365,100	17,702,030
2015	8,130,000	17,449,167
2016	8,450,000	17,133,694
2017 – 2021	40,586,413	80,886,963
2022 – 2026	57,165,000	70,632,700
2027 – 2031	73,810,000	52,388,688
2032 – 2036	95,020,000	28,700,190
2037 – 2041	37,685,000	4,248,850
	346,121,613	$ 325,257,931
Plus amount representing net unamortized bond discounts and premiums	1,703,094	
Less amount representing unamortized deferred losses on refinancings	(5,371,448)	
	$ 342,453,259	

(a) Capital Leases

The Medical Center acquired certain equipment under capital lease obligations. The imputed interest rate on the equipment under capital lease is 3.5%. These leases are collateralized by the related equipment. Future minimum lease payments and the present value of net minimum lease payments are as follows:

2012	$	140,654
2013		84,924
2014		84,816
2015		22,083
Total minimum lease payments		332,477
Less amount representing interest		20,447
		312,030
Present value of capital lease payments:		
Less current portion		129,220
	$	182,810

(b) Line of Credit

The Medical Center has an unsecured $2.0 million line of credit with its banking institution, with an interest rate set at 1.75% above the daily 3-month LIBOR (London Interbank Offered Rate) in effect at the time the line of credit is utilized. The line of credit was unused during 2011, and there was no outstanding balance as of December 31, 2011. This line of credit is in effect until September 2012.

Component Unit's Long-Term Debt and Capital Leases

The component unit has no outstanding long-term debt. The capital lease obligation as of December 31, 2011 consists of an equipment lease with a present value of $770,187, with total monthly payments of $19,613, including imputed interest of 6.20%, maturing in 2015.

The schedule of capital leases follows:

	Beginning balance January 1, 2011	Additions	Reductions	Ending balance December 31, 2011	Amounts due within one year
Capital lease obligations	$ 951,670	—	181,483	770,187	193,054

(Continued)

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

2011	$	235,356
2012		235,356
2013		235,356
2014		156,904
Total minimum lease payments		862,972
Less amount representing interest		(92,785)
		770,187
Present value of capital lease payments:		
Less current portion		(193,054)
	$	577,133

(9) Purchased and Self Insurance

The Medical Center is exposed to risk of loss related to professional and general liability, employee medical, dental, and pharmaceutical claims, and injuries to employees. The Medical Center maintains a program of purchased insurance and excess insurance coverage for professional and general liability, as well as self-insurance reserves.

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

Management believes that these estimated liabilities are adequate, however the establishment of reserves is an inherently uncertain process and there can be no assurance that currently established liabilities will provide adequate to cover actual ultimate expenses. Subsequent actual experience could result in liabilities being too high or too low, which could positively or negatively impact the Medical Center's reported operations in future periods.

(a) Professional and General Liability

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

Settlement amounts have not exceeded insurance coverage in the last three years.

(b) Employee Medical

The Medical Center is self-insured for medical and dental benefits. The accrued liabilities for the self-insured component of the plan include the unpaid portion of claims that have been reported and estimates for claims that have been incurred but not reported. The Medical Center also carries stop-loss coverage for claims subject to a specific benefit deductible of $225,000 in 2011. The Medical Center has recorded an actuarially estimated liability for health claims of $3,774,976 as of December 31, 2011, which is included in accrued salaries, wages, and benefits in the accompanying Medical Center balance sheet. The health benefit claims reserve at December 31, 2011 is based on undiscounted calculations.

(c) Workers' Compensation

The Medical Center is self-insured for the first $500,000 of each worker's compensation claims in 2011. The accrued liabilities for the self-insured components of this plan include the unpaid portion of claims that have been reported and estimates for claims that have been incurred but not reported. The Medical Center has recorded an actuarially determined estimated liability for workers' compensation claims of $3,102,225 at December 31, 2011, which is included in accrued salaries, wages, and benefits in the accompanying Medical Center balance sheet. The workers' compensation reserve at December 31, 2011 is based on undiscounted calculations.

(d) Changes in the Self-Insurance Reserve – Tail Liability

The Medical Center has established a reserve based on the requirement of GASB No. 10, *Accounting and Financial Reporting for Risk Financing and Related Insurance Issues*, which requires that a liability for claims be reported if information prior to the issuance of the financial statements indicates that it is probably that a liability has been incurred at the date of the financial statements and the amount of the loss can be reasonably estimated. The reserve includes the amount that will be required for future payments of claims that have been reported and claims related to events that have occurred but have not been reported and an estimated tail liability for any claims in excess of coverage with the excess insurance policies on a claims-made basis.

Changes in the self-insurance reserve as it relates to the tail liability for professional liability insurance as of December 31, 2011 are noted below:

Reserve at December 31, 2010	$	1,440,000
Incurred claims and changes to estimate		60,000
Required reserve at December 31, 2011	$	1,500,000

(Continued)

(10) Vacation and Sick Leave

(a) Vacation

All bi-weekly paid employees of the Medical Center and component unit who are in regularly scheduled full or part-time positions, except for employees who have elected a wage premium in lieu of benefits or as otherwise specified in individual employment contracts or relevant labor contracts, earn annual vacation hours based on actual hours worked/paid. Employees become eligible to use accrued annual vacation hours the first full pay period following the completion of six consecutive months (180 days) or 1,040 hours worked of employment. The biweekly annual vacation accrual rates vary depending on the employee's level of employment, applicable labor agreements, and length of service. The maximum accrual of annual leave is two times the annual accrual rate.

After six months or 1,040 hours of continuous service, upon termination in good standing and with appropriate notice given to the Medical Center, payment of unused but accrued annual leave will be made. At December 31, 2011, the Medical Center's liability was approximately $9,500,000 and is included in accrued salaries, wages, and benefits in the accompanying balance sheet.

(b) Accrued Sick Leave

All bi-weekly paid employees of the Medical Center and component unit who are in regularly scheduled full or part-time positions, except for employees who have elected a wage premium in lieu of benefits or as otherwise specific in individual employment contracts or relevant labor contracts, earn sick leave hours based upon actual hours worked/paid. Nearly all employees become eligible to use vested sick leave the full pay period following the completion of three consecutive months (90 days) of employment.

Depending on the labor contract, employee's level of employment and appropriate notice and standing to the Medical Center upon termination, vested sick leave may be paid out. At December 31, 2011, the Medical Center's liability for unused vested sick leave was approximately $3,600,000 and is included in accrued salaries, wages, and benefits in the accompanying balance sheet.

(11) Retirement Plans

The Medical Center maintains a defined contribution plan, the Money Purchase Pension Plan, that covers substantially all of its employees. The plan is administered by the Medical Center. The Medical Center's contribution is based on the salaries of active participants in accordance with formulas specified in the plan. Plan provisions and contribution requirements are established by the Medical Center and may be amended by the Medical Center's Board of Commissioners. Actuarial assumptions are not used in the determination of costs because benefits are payable only to the extent of available assets derived from contributions and plan earnings.

Employer contributions to the plan were $12,921,978 for the year ended December 31, 2011. Employee contributions are permitted within the plan in an amount up to 10% of pay period earnings, capped at the annual amount allowed by federal law, and totaled $682,506 for the year ended December 31, 2011.

The Medical Center offers its employees two deferred compensation plans created in accordance with Internal Revenue Code (IRC) Sections 403(b) and 457. The plans, available to all employees, permit them to defer a portion of their salary until future years. Employee contributions to the plans totaled $6,333,343 for the year ended December 31, 2011. The deferred compensation is payable to employees upon termination, retirement, death, or unforeseen emergency.

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

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

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

(12) Concentrations of Credit Risk

The Medical Center grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payor agreements.

The mix of receivables from patients and third-party payors at December 31, 2011 for the Medical Center and the component unit were as follows:

	Primary government	Component unit
Medicare	24%	25%
Medicaid	11	5
Blue Shield/Regence	13	18
PPO/First Choice	7	—
Blue Cross/Premera	7	14
Patient	16	4
Commercial	15	20
Other third-party payors	7	14
	100%	100%

(Continued)

(13) Commitments and Contingencies

(a) Operating Leases

The Medical Center leases certain facilities and equipment under operating lease arrangements with its component unit and third parties, some of which contain renewal options. Likewise, the component unit leases certain medical office space and other equipment under operating leases with the Medical Center and third parties.

The following is a schedule by year of future minimum lease payments by year for the Medical Center and the component unit as of December 31, 2011:

		Primary	Component
2012	$	9,947,010	1,076,000
2013		8,614,345	945,000
2014		5,879,786	901,000
2015		5,096,311	267,000
2016		4,694,120	257,000
Thereafter		19,341,778	343,000
Total minimum lease payments	$	53,573,350	3,789,000

Rent expense on operating leases for the Medical Center for 2011 was $10,166,731.

The component unit has several lease agreements with the Medical Center. Office space for two different locations is leased from the Medical Center for approximately $875,000 for the year ending December 31, 2011. The leases expire in December 2014 and May 2018, respectively. Of the component unit's $3,789,000 in total outstanding minimum lease payments, $3,570,000 is due to the Medical Center.

(b) Litigation

The Medical Center 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 Medical Center's future financial position or results from operations.

(c) 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

(Continued)

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, to the best of their knowledge, believes that the Medical Center is in compliance with the fraud and abuse regulations as well as other applicable government laws and regulations. Compliance with such laws and regulations can be subject to future government review and interpretation as well as regulatory actions unknown or unasserted at this time.

(d) Risk Management

The Medical Center is exposed to various risks of loss from torts; theft of, damage to, and destruction of assets; business interruption; errors and omissions; employee injuries and illnesses; and natural disasters. Commercial insurance coverage is purchased for claims arising from such matters and no claims have exceeded such coverage.

(e) Construction and Information Technology Commitments

The Medical Center has committed to various construction and equipment projects, as well as significant information technology implementations, including a new electronic medical record system, which includes both billing and clinical components, in 2011 and beyond. As of December 31, 2011, the future commitments for these projects total $54.4 million.

(f) Collective Bargaining Agreements

The Medical Center has a total of approximately 2,800 employees. Of this total, approximately 72% are covered under one of the Medical Center's collective bargaining agreements as of December 31, 2011. There were no bargaining agreements expiring as of December 31, 2011. Two bargaining units' contracts expire during 2012. Management anticipates both contracts will be successfully negotiated.

(14) Pledged Tax Revenues

The District has pledged its future tax revenues, as well as operating revenues, to repay its limited tax general obligation and revenue bonds issued in 2001, 2004, 2008, and 2011 to finance construction, other capital improvements, medical equipment and technology, and information technology systems.

(15) Meaningful Use

Beginning in 2011, the Medicaid Electronic Health Records incentive program was developed as part of a federally funded stimulus plan designed to help to eligible professionals and hospitals adopt and meaningfully use electronic health record technology. For the year ended December 31, 2011, the Medical Center recorded $1,348,873 of other operating revenue related to Medicaid compensation for meaningful use of electronic health records. This amount may be subject to future audits.

(16) Related Party Transactions

A total of $239,838 was paid by the Medical Center to the University of Washington Medicine for the time period July 1, 2011 (when the Strategic Alliance Agreement went into effect) through December 31, 2011 (year-end) for transactions primarily related to reference laboratory work, providing contracted nursing assistance with the Valley Nurse Line, and management assistance with the various pharmacies.

(17) Subsequent Events

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

The following subsequent events occurred after December 31, 2011 but prior to the issuance of the audit report:

1. In late January 2012, the Medical Center received notification from the King County Assessor's Office that the overall statutory aggregate limit (which is $5.90 per assessed $1,000 in property value) has been exceeded in certain District tax levy codes for the calendar year ended December 31, 2012. Under Washington state statute, the Assessor's Office must recalculate the property tax levy rates when it is found the aggregate rate of certain senior and junior taxing districts within a given levy code area exceeds the $5.90 limit established by RCW 84.52.043. Any required rate recalculations are performed in a specific order specified within RCW 84.52.010(2). In summary, within these priorities, a hospital district receives the first $0.50 of its levy. Consequently, as a result of this required rate recalculation, the District's tax levy rate has been decreased from $0.59 per assessed $1,000 in property value pursuant to the District's authorized tax levy, to $0.50 per assessed $1,000 in property value, resulting in a revised tax levy of $16,782,333. That is a reduction of $3,298,022, or 16%, from the original tax levy, in property tax revenues during calendar year 2012.

2. On January 4, 2012, the Medical Center purchased an obstetrics and gynecological practice from a private physician organization for approximately $865,000.

3. On March 19, 2012, the District's Board of Commissioners passed Resolution 992, authorizing the President and Vice President of the Board of Commissioners to undertake negotiations with the UW Medicine to revise the parties' Strategic Alliance Agreement in order to bring the agreement into conformity with applicable law and public policy. The passage of this resolution by itself does not necessarily mean any changes between the two parties are forthcoming. It does, however, express the Board of Commissioners' desire to have certain aspects of the Alliance Agreement revisited.

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

Supplementary Information Aggregating Balance Sheet

December 31, 2011

Assets	VMC	Component Unit – IPV	Eliminations	Aggregated
Current assets:				
Cash and cash equivalents	$ 16,452,503	959,586	—	17,412,089
Short-term investments	20,707,084	—	—	20,707,084
Accounts receivable, less allowance for uncollectible accounts	48,863,788	1,369,267	—	50,233,055
Due from:				
Primary government	—	129,098	(129,098)	—
Component unit	519,016	—	(519,016)	—
Assets whose use is limited, required for current obligations	27,130,260	—	—	27,130,260
Supplies inventory	4,916,857	25,740	—	4,942,597
Prepaid expenses and other assets	8,704,083	100,380	—	8,804,463
Total current assets	127,293,591	2,584,071	(648,114)	129,229,548
Long-term investments	26,814,280	—	—	26,814,280
Assets limited as to use:				
By Board for general capital improvements and operations	81,813,032	—	—	81,813,032
By Board for self-insurance reserve funds	2,611,453	—	—	2,611,453
Restricted unspent bond proceeds	46,888,550	—	—	46,888,550
Under deferred compensation arrangements	3,554,192	—	—	3,554,192
Under revenue bond indenture agreements	7,341,416	—	—	7,341,416
Under general and limited general obligation bond agreements	568,541	—	—	568,541
	142,777,184	—	—	142,777,184
Less amounts required for current obligations	(27,130,260)	—	—	(27,130,260)
Total assets limited as to use	115,646,924	—	—	115,646,924
Capital assets:				
Land	13,299,496	—	—	13,299,496
Construction in progress	48,225,847	—	—	48,225,847
Depreciable capital assets, net of accumulated depreciation	303,156,704	1,551,060	—	304,707,764
Total capital assets	364,682,047	1,551,060	—	366,233,107
Deferred financing costs	4,551,960	—	—	4,551,960
Goodwill and intangible assets	4,742,290	—	—	4,742,290
Total assets	$ 643,731,092	4,135,131	(648,114)	647,218,109

(Continued)

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

Supplementary Information Aggregating Balance Sheet

December 31, 2011

Liabilities and Net Assets	VMC	Component Unit – IPV	Eliminations	Aggregated
Current liabilities:				
Accounts payable	$ 25,625,659	182,447	—	25,808,106
Accrued salaries, wages and benefits	28,488,590	—	—	28,488,590
Due to:				
Primary government	—	519,016	(519,016)	—
Component unit	129,098	—	(129,098)	—
Other accrued liabilities, including estimated third-party payor settlements	750,000	—	—	750,000
Interest, patient refunds and other	10,069,948	486,401	—	10,556,349
Current portion of long-term debt and capital lease obligations	8,919,220	193,054	—	9,112,274
Total current liabilities	73,982,515	1,380,918	(648,114)	74,715,319
Deferred compensation	3,040,178	—	—	3,040,178
Long-term debt and capital lease obligations, net of current portion	333,846,069	577,133	—	334,423,202
Total liabilities	410,868,762	1,958,051	(648,114)	412,178,699
Net assets:				
Invested in capital assets net of related debt	71,135,508	780,873	—	71,916,381
Restricted:				
For debt service	7,909,957	—	—	7,909,957
Expendable for specific operating activities	348,589	—	—	348,589
Unrestricted	153,467,276	1,396,207	—	154,863,483
Total net assets	232,861,330	2,177,080	—	235,038,410
Total liabilities and net assets	$ 643,730,092	4,135,131	(648,114)	647,217,109

See accompanying independent auditors’ report.

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

Aggregating Statement of Revenue and Expense and Changes in Net Assets

Year ended December 31, 2011

	VMC	Component Unit – IPV	Eliminations	Aggregated
Operating revenues:				
Net patient service revenue (net of provision for bad debts)	$ 399,057,031	13,842,667	—	412,899,698
Other operating revenue	18,891,537	10,666	(5,265,518)	13,636,685
Total operating revenues	417,948,568	13,853,333	(5,265,518)	426,536,383
Operating expenses:				
Salaries and wages	184,010,419	2,727,853	—	186,738,272
Employee benefits	56,541,465	839,410	—	57,380,875
Supplies and other expenses	140,127,571	4,308,090	(1,796,327)	142,639,334
Depreciation	31,798,889	431,813	—	32,230,702
Total operating expenses	412,478,344	8,307,166	(1,796,327)	418,989,183
Operating income	5,470,224	5,546,167	(3,469,191)	7,547,200
Nonoperating income (expense):				
Revenue from taxation	19,553,149	—	—	19,553,149
Interest income	4,942,219	—	—	4,942,219
Interest and amortization expense	(16,975,013)	(54,544)	—	(17,029,557)
Investment income (loss)	251,658	—	—	251,658
Other, net	(292,835)	5,319	(30,427)	(317,943)
Members' cash distributions	—	(5,838,477)	—	(5,838,477)
Net nonoperating income (expense)	7,479,178	(5,887,702)	(30,427)	1,561,049
Increase in net assets	12,949,402	(341,535)	(3,499,618)	9,108,249
Net assets, beginning of year, as restated	219,911,928	2,518,615	—	222,430,543
Net assets, end of year	$ 232,861,330	2,177,080	(3,499,618)	231,538,792

See accompanying independent auditors' report.