KPMG

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

(A Component Unit of the University of Washington)

Financial Statements

June 30, 2019 and 2018

(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 2900
1918 Eighth Avenue
Seattle, WA 98101

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, and the discretely presented component unit of Public Hospital District No. 1 of King County, Washington dba Valley Medical Center (the Medical Center), as of and for the years ended June 30, 2019 and 2018, and the related notes to the financial statements, which collectively comprise the Medical Center's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the business-type activities and the discretely presented component unit of Public Hospital District No. 1 of King County, Washington dba Valley Medical Center, as of June 30, 2019 and 2018, and the respective changes in financial position and cash flows thereof for the years then ended in accordance with U.S. generally accepted accounting principles.

Other Matters

Required Supplementary Information

U.S. generally accepted accounting principles require that the management's discussion and analysis on pages 5–21 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Supplementary and Other Information

Our audits were conducted for the purpose of forming opinions on the financial statements that collectively comprise the Medical Center's basic financial statements. The accompanying aggregating schedules are presented for purposes of additional analysis and are not a required part of the basic financial statements.

The aggregating schedules are the responsibility of management and were derived from and relate directly to the underlying accounting and other records used to prepare the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the aggregating schedules are fairly stated, in all material respects, in relation to the basic financial statements as a whole.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated September 23, 2019 on our consideration of the Medical Center's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is solely to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the Medical Center's internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Medical Center's internal control over financial reporting and compliance.

KPMG LLP

Seattle, Washington
September 23, 2019

KPMG LLP
Suite 2900
1918 Eighth Avenue
Seattle, WA 98101

Independent Auditors' Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance With *Government Auditing Standards*

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

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the business-type activities, and the discretely presented component unit of Public Hospital District No. 1 of King County, Washington dba Valley Medical (the Medical Center) as of and for the year ended June 30, 2019, and the related notes to the financial statements, which collectively comprise Medical Center's basic financial statements, and have issued our report thereon dated September 23, 2019.

Internal Control Over Financial Reporting

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

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

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Medical Center's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the Medical Center's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Medical Center's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

KPMG LLP

Seattle, Washington
September 23, 2019

The following discussion and analysis provides an overview of the financial position and activities of Public Hospital District No. 1 of King County, Washington, dba Valley Medical Center (VMC), for the years ended June 30, 2019, 2018 and 2017. This discussion has been prepared by management and is designed to focus on current activities, resulting changes, and current known facts and should be read in conjunction with the financial statements and accompanying notes that follow this section.

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

Using the Financial Statements

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

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

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

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

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

Results of Operations for Fiscal Year 2019

VMC recorded a $5.0 million net operating loss for fiscal year 2019; this is a change of $16.8 million from the net operating income of $11.8 million in 2018. In 2019, VMC's net position increased by $12.2 million to $269.7 million from $257.6 million. The net operating loss in 2019 primarily resulted from additional

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infrastructure costs related to growth in the ambulatory areas and specialty clinics and decreased reimbursement from government payers.

	2019	2018	2017
		(In thousands)	
Total operating revenues	$ 684,884	643,835	582,978
Total operating expenses	689,894	632,006	610,809
Operating (loss) income	(5,010)	11,829	(27,831)
Property tax revenue	23,258	22,722	21,490
Interest income	4,001	4,277	4,417
Interest and amortization expense	(14,853)	(14,253)	(17,696)
Investment income (loss)	3,785	(1,809)	(2,868)
Other, net	980	17,414	290
Nonoperating income	17,171	28,351	5,633
Change in net position	12,161	40,180	(22,198)
Net position, beginning of year	257,580	217,400	239,598
Net position, end of year	$ 269,741	257,580	217,400

- Inpatient days increased 4% from 2018 to 2019 and 1% from 2017 to 2018.
- VMC experienced significant growth in outpatient volumes, particularly in the primary and specialty care clinics with the full year impact of expansion of the multi-specialty clinics in October 2017. The other area of growth is in special procedure cases with the remodel of the Special Procedures Care Unit (SPCU), formerly called Interventional Radiology (IRCU).
- VMC experienced significant growth in the contract pharmacies program. Revenue increased 123% over 2018 by $14.4 million to $32.2 million.
- VMC management implemented significant cost saving initiatives in the second half of the fiscal year 2018 and continued into fiscal year 2019, focusing on labor productivity, detailed revenue cycle process improvement initiatives, continued standardization of high dollar medical supplies and equipment, and reductions in purchased services.
- VMC continued to invest in information technology.

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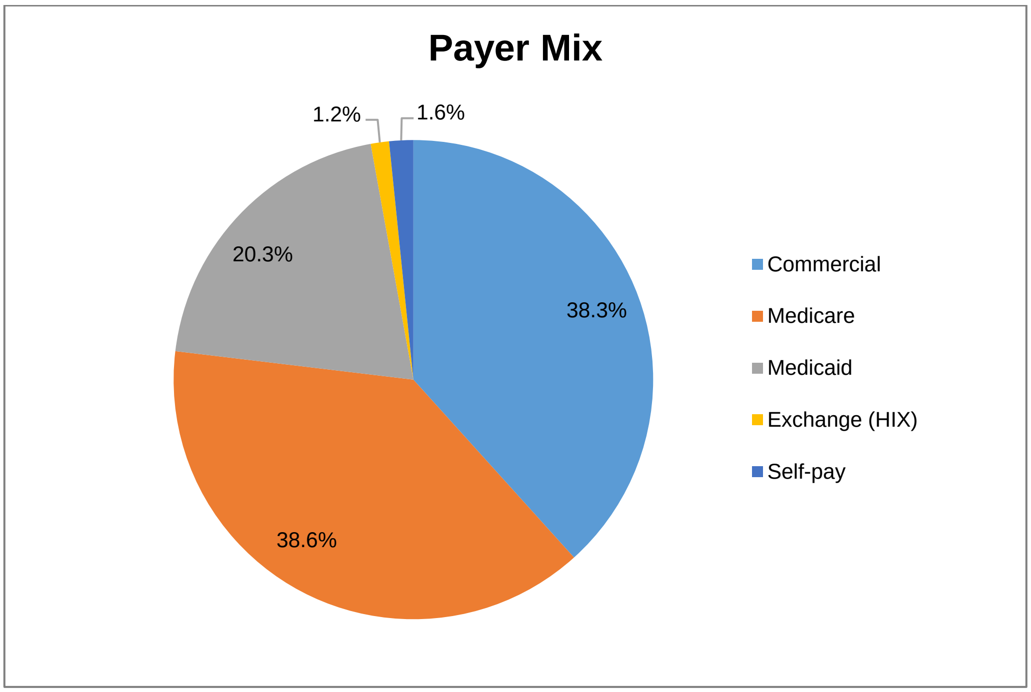
The chart below represents the key performance statistics for the last three years.

	2019	2018	2017
Available beds	311	311	295
Discharges	18,271	18,409	18,153
Patient days	75,824	73,102	72,541
Average length of stay	4.15	3.97	4.00
Occupancy	68 %	64 %	67 %
Case mix index (CMI)	1.59	1.54	1.55
Surgery cases	12,878	12,767	12,617
Emergency room visits	85,305	85,098	83,871
Primary care clinic visits	228,591	216,522	193,596
Specialty/urgent care clinic visits	441,541	408,280	333,904
Full time equivalents (FTEs)	3,296	3,134	3,051
Births	3,180	3,536	3,742

Total Operating Revenues

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

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



VMC's payer mix is a key factor in the overall financial operating results. The chart above illustrates gross payer mix for 2019. For the years ended June 30, 2019, 2018, and 2017, Medicaid revenue represented 20%, 21%, and 23%, respectively. The high percentage in Medicaid revenue in 2017 was a direct result of the expansion of the Medicaid program in Washington State as part of the Affordable Care Act. There was a decrease in Medicaid revenue in 2019 and 2018 that shifted to Medicare and self-pay. For the years ended June 30, 2019, 2018, and 2017, Medicare revenue represented 39%, 37%, and 36%, respectively. The shift in payer mix was from Medicaid to Medicare and primarily due to the aging population within the district, as well as likely migration into the district.

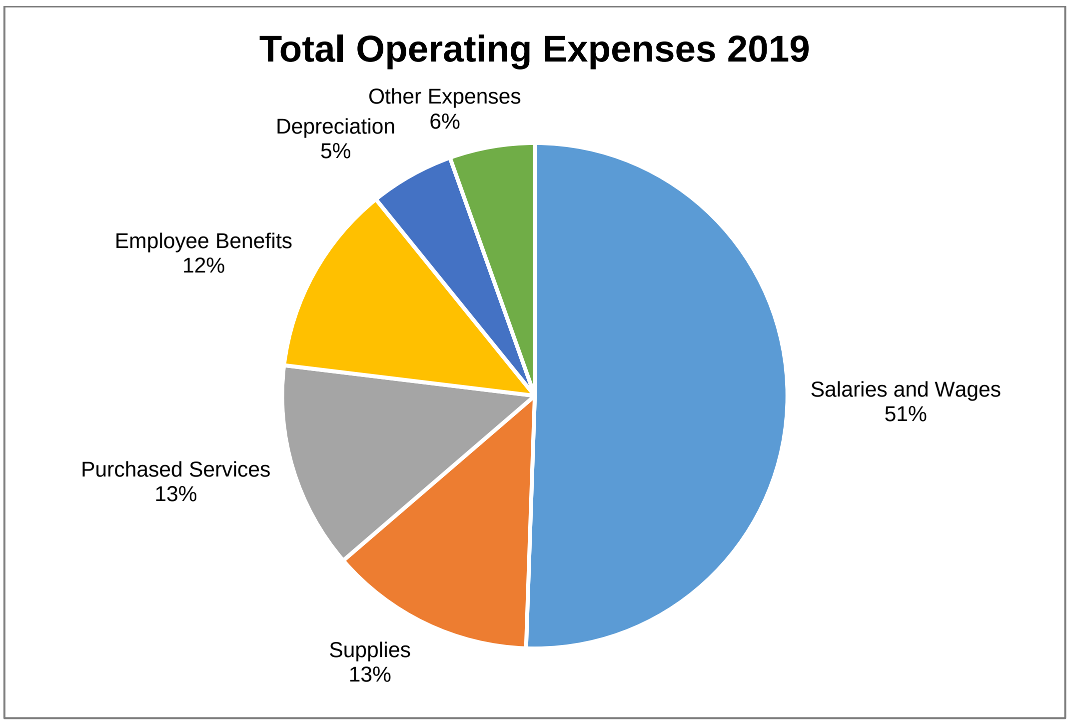
Reimbursement from governmental payers is generally below commercial rates and reimbursement rules are complex and subject to both interpretation and settlements.

For the years ended June 30, 2019, 2018, and 2017, VMC's total operating revenues were $684.9 million, $643.8 million, and $583.0 million composed of $622.8 million, $598.6 million, and $544.7 million in net patient service revenue and $62.1 million, $45.2 million, and $38.3 million in other operating revenue, respectively.

In 2019 and 2018, the increase in operating revenue is due to growth in inpatient volumes, growth in outpatient volumes across the clinic network (primary and specialty, and urgent care), and continued increases in outpatient surgical procedures. The increase in other operating revenue is attributed to increases in the radiology imaging service line, and in outpatient and contract pharmaceutical volumes.

Total Operating Expenses

Total operating expenses were $689.9 million for the year ended June 30, 2019 compared to $632.0 million for the year ended June 30, 2018. The composition of fiscal year 2019 operating expenses is illustrated in the pie chart below.



Salaries and wages increased $31.9 million from $315.9 million in fiscal year 2018 to $347.8 million in fiscal year 2019. The increase was primarily related to contractually agreed upon wage increases; continued addition of providers in the clinic network's services in primary, urgent and specialty care, growth in certain hospital inpatient and outpatient departments, and the addition of support staff in overhead departments with the growth.

Salaries and wages increased $21.4 million from $294.5 million in fiscal year 2017 to $315.9 million in fiscal year 2018. The increase was primarily related to contractually agreed upon wage increases; continued addition of providers in the clinic network's services in primary, urgent and specialty care – specifically the

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multi-specialty expansion project in October 2017 that opened six specialty clinics, and growth in certain hospital inpatient and outpatient departments.

Employee benefits increased $8.3 million from $75.9 million in fiscal year 2018 to $84.2 million in fiscal year 2019 and decreased $3.8 million from $79.7 million in fiscal year 2017 to $75.9 million in fiscal year 2018. Employee benefit costs are a function of employment. In fiscal year 2019, benefits increased by 11% while salaries and wages increased by 10%. In fiscal year 2018, benefits decreased by 5%, while salaries and wages increased by 7%. The lower benefit cost in fiscal year 2018 was a result of the voluntary one-time early retirement and early separation programs implemented in June 2017 when $4.1 million COBRA benefits were expensed in fiscal year 2017 and much lower medical & pharmaceutical claims in fiscal year 2018 after the retirees left VMC's self-insured program.

Purchased services expense, which consists of professional and consulting fees, increased $8.1 million from $82.9 million in fiscal year 2018 to $91.0 million in fiscal year 2019 and decreased $9.9 million from $92.8 million in fiscal year 2017 to $82.9 million in fiscal year 2018. The increase between fiscal year 2018 and 2019 is attributed to additional consulting fees, additional rental expenses from new clinics and contracted services agreements from volume growth. The decrease between fiscal year 2017 and 2018 is attributed to lower physician fees as VMC continues to employ more specialty physicians – specifically VMC opened six specialty clinics in October 2017, and cost savings initiatives implemented in fiscal year 2018.

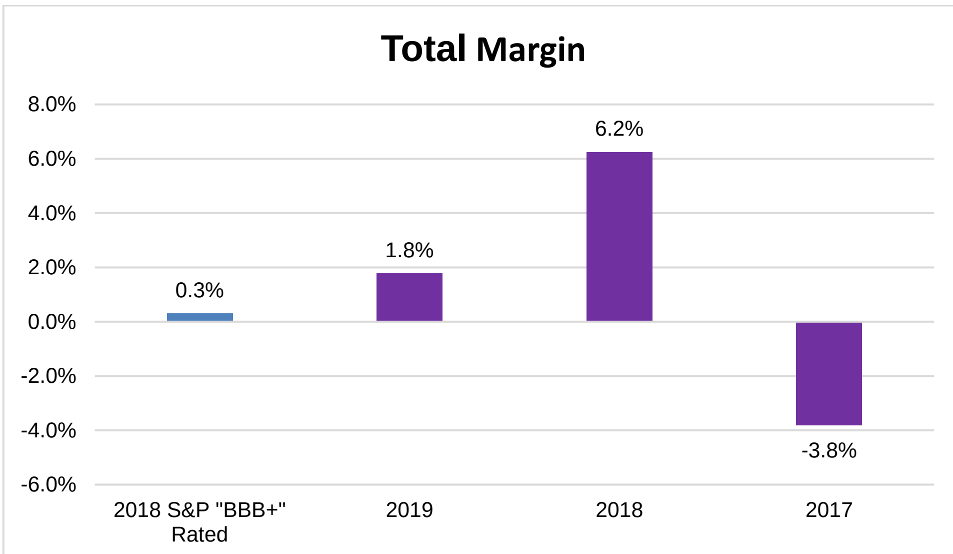
Supplies and other expense include medical and surgical supplies, pharmaceutical supplies, insurance, taxes, and other expenses. In total, these expenses increased $5.6 million from $124.3 million in fiscal year 2018 to $129.9 million in fiscal year 2019. Considering the increased volume in both inpatient and outpatient areas, the slight increase is primarily as a result of price inflation with medical and pharmaceutical supplies. Supplies and other expenses increased $11.9 million from $112.4 million in fiscal year 2017 to $124.3 million in fiscal year 2018. The increase is primarily due to increased volume in both inpatient and outpatient areas, particularly in ambulatory outpatient surgery volumes, and price increases with pharmaceutical supplies.

Depreciation expense increased $4.0 million from $33.0 million in fiscal year 2018 to $37.0 million in fiscal year 2019 and increased $1.6 million from $31.4 million in fiscal year 2017 to $33.0 million in fiscal year 2018. The increases in both years were due to various projects being placed in service and depreciated.

Nonoperating revenue consists of revenue from property taxes, interest and investment income offset by interest and amortization expense and other activities not directly related to patient care. Net nonoperating revenue decreased $11.2 million between fiscal years 2019 and 2018, primarily due to a $16.5 million gain recognized from the sale of a joint venture lab in 2018 partially offset by an increase in revenue from taxation and an increase in investment income Net nonoperating revenue increased $22.7 million between fiscal years 2018 and 2017, primarily due to an increase in revenue from taxation, a decrease in interest expenses and investment losses, and a $16.5 million gain recognized from the sale of a joint venture lab in 2018.

Total Margin

Total margin or excess margin is a ratio that defines the percentage of total revenue that has been realized in the form of change in net position and is a common measure of total hospital profitability. Total margin for the fiscal years 2019, 2018 and 2017 compared to the industry median for Standard & Poor's (S&P's) BBB+ rated health care systems is illustrated in the bar chart below.



Financial Health

Statements of Net Position

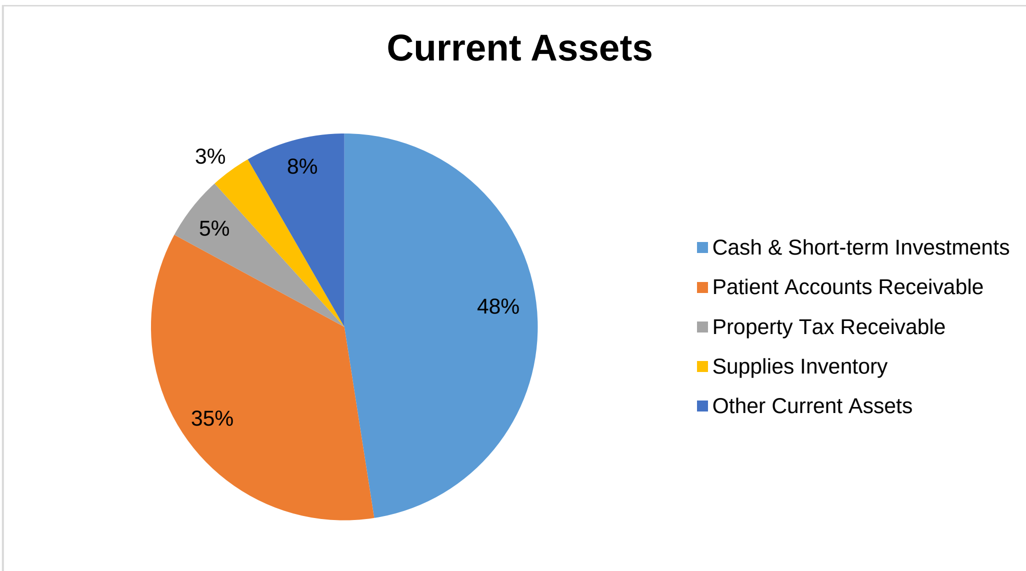
The table below is a presentation of certain condensed financial information derived from VMC's statements of net position as of June 30, 2019, 2018 and 2017.

	2019	2018	2017
		(In thousands)	
Current assets	$ 213,241	226,526	219,753
Noncurrent assets:			
Capital assets, net	385,131	379,540	362,569
Other noncurrent assets	149,240	78,603	93,658
Long-term investments	545	1,378	2,053
Goodwill, intangible assets and other	3,519	2,796	3,163
Total assets	751,676	688,843	681,196
Deferred outflow of resources	16,119	12,491	13,242
Total assets and deferred outflows	767,795	701,334	694,438
Current liabilities	135,831	119,460	124,067
Noncurrent liabilities	338,374	299,263	310,254
Total liabilities	474,205	418,723	434,321
Total deferred inflows of resources	23,849	25,031	42,717
Net position	$ 269,741	257,580	217,400

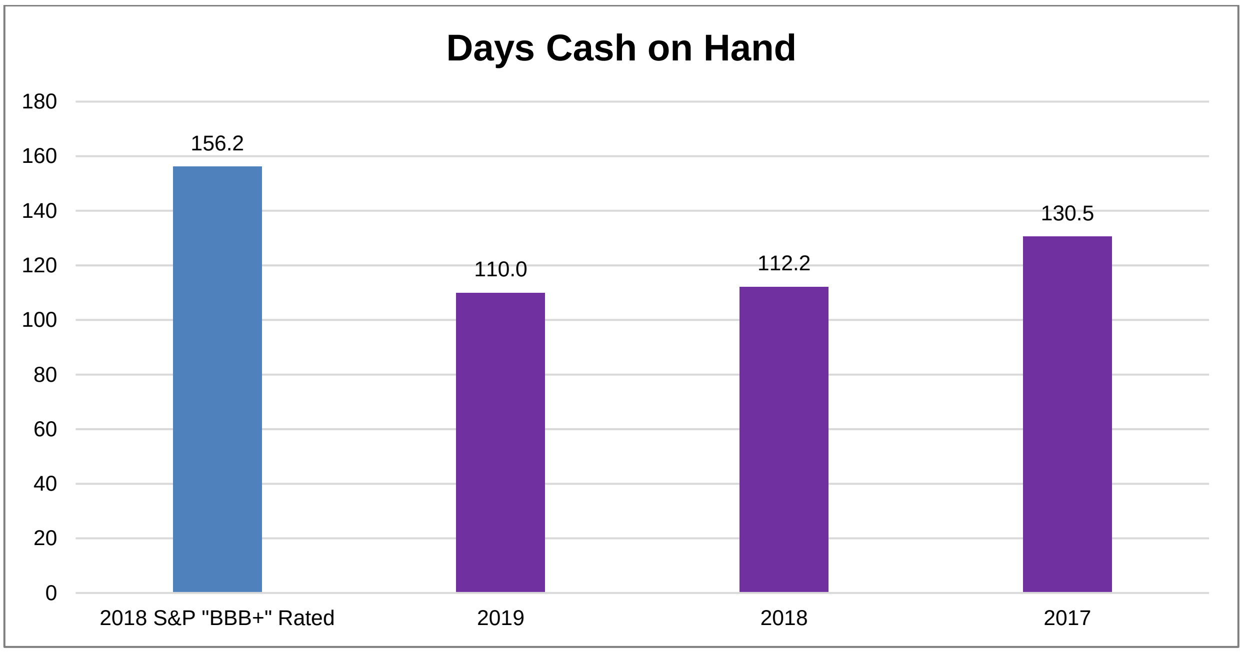
Total assets were $751.7 million at June 30, 2019 compared to $688.8 million at June 30, 2018, an increase of $62.9 million, and $681.2 million at June 30, 2017, an increase of $7.6 million between 2017 and 2018. Most of the change between 2018 and 2019 is attributed to $45 million of unspent bond proceeds in 2019.

Current Assets

Current assets consist of cash and cash equivalents, and other current assets that are expected to be converted to cash within a year. Current assets also include net patient accounts receivable valued at the estimated net realizable amount due from patients and insurers. Total current assets were $213.2 million at fiscal year-end 2019, compared to $226.5 million at year-end 2018. Fiscal year 2019 composition of current assets is illustrated in the pie chart below.



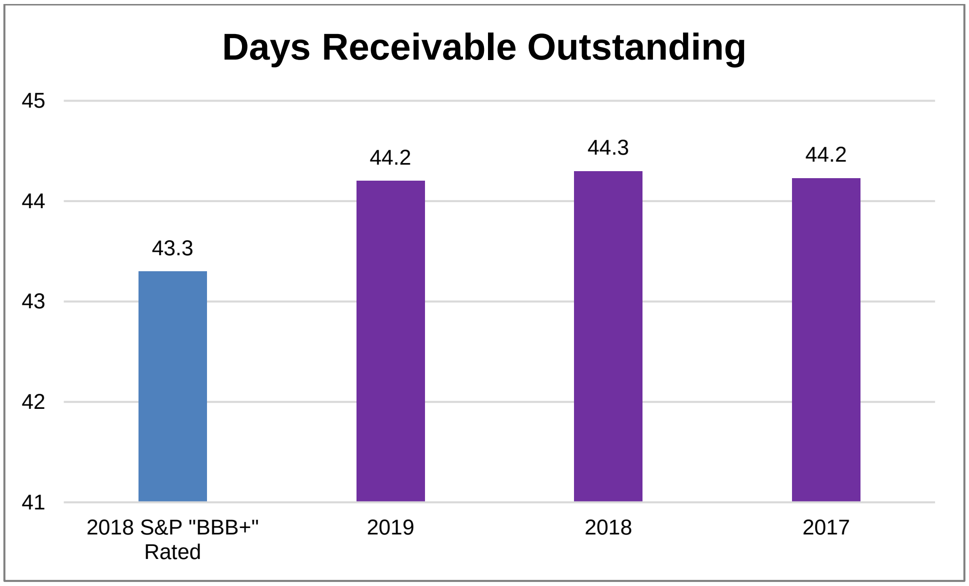
Cash and short-term investments held by VMC consist of cash, cash equivalents and investments expected to mature in 12 months or less. Cash and short-term investments increased $13.0 million in 2019 from $88.4 million at June 30, 2018 to $101.4 million at June 30, 2019. The increase in 2019 was attributed to keeping cash collected from operations in short-term investments. Cash and short-term investments decreased $7.2 million in 2018 from $95.6 million at June 30, 2017 to $88.4 million at June 30, 2018. The decrease in 2018 was attributed to capital costs of building a garage funded by operations. Days cash on hand is utilized to evaluate an organization's continuing ability to meet its short-term operating needs. Days cash on hand, including short and long-term investments and noncurrent assets unrestricted for general capital improvements and operations, as of June 30 for fiscal years 2019, 2018 and 2017 are illustrated in the graph below.



VMC's total days cash on hand, including short and long-term investments and board designated assets for general capital improvements and operations, decreased 2.2 days from 112.2 days at June 30, 2018 to 110.0 days at June 30, 2019 and decreased 18.3 days from 130.5 days at June 30, 2017 to 112.2 days at June 30, 2018. The decrease between 2018 and 2019 was primarily due to capital spending, weaker financial performance and expenses increased at a greater rate than cash collected. The decrease between 2017 and 2018 was primarily due to capital spending.

Net patient accounts receivable was $75.4 million as of June 30, 2019, compared to $72.7 million at June 30, 2018. The increase of $2.7 million was driven by growth in revenue. Net patient accounts receivable at June 30, 2018 and 2017 were $72.7 million and $66.0 million, respectively. The increase of $6.7 million was driven by growth in revenue and industry trends regarding payer strategy for cost containment and contract management.

Days receivable outstanding illustrates an organization's ability to convert patient service revenue to cash. Days receivable outstanding as of June 30 for fiscal years 2019, 2018 and 2017 are illustrated in the graph below.



VMC's total net days receivable outstanding decreased 0.1 days from 44.3 days at June 30, 2018 to 44.2 days at June 30, 2019 and increased 0.1 days from 44.2 days at June 30, 2017 to 44.3 days at June 30, 2018. Net patient accounts receivable days were essentially even between 2018 and 2019 and between 2017 and 2018, representing continued strong revenue cycle management.

As of June 30, 2019, 42% of the patient accounts receivable balance is due from commercial payers, 53% is due from governmental payers Medicare and Medicaid, 4% from self-pay patients, and 1% is due from health exchange insured patients. As of June 30, 2018 and 2017, 40% of patient accounts receivable balance is due from commercial payers, 54% is due from governmental payers Medicare and Medicaid, 5% from self-pay patients and 1% from health exchange insured patients.

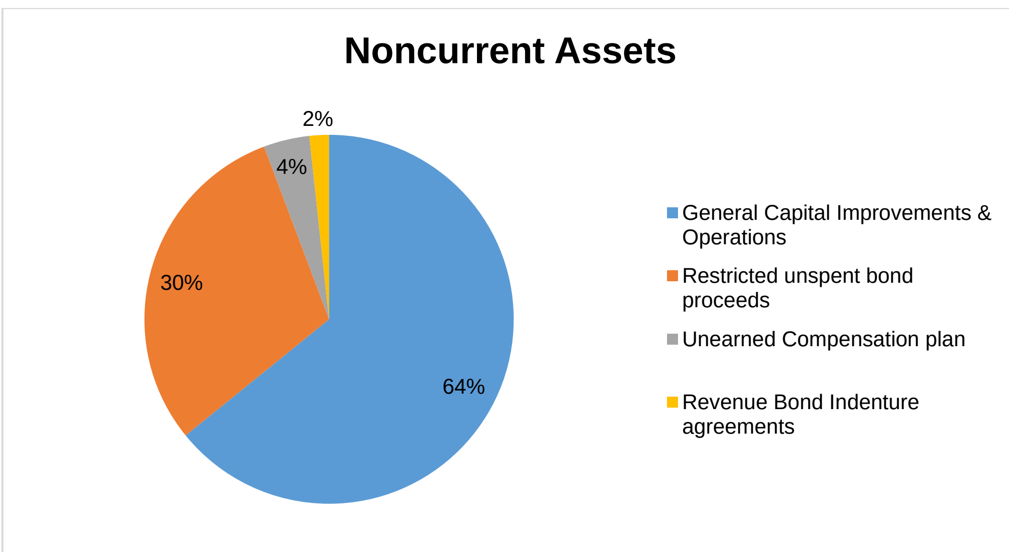
Property tax receivable increased $0.2 million from $11.3 million at June 30, 2018 to $11.5 million at June 30, 2019 and is primarily reflective of increased property values. In 2018, property tax receivable increased $0.3 million for the same reason.

Non Current assets available for current obligations represents board designated and externally restricted funds expected to be used within one year for debt, interest obligations, and payments of accrued construction-in-progress liabilities. Assets available for current obligations decreased from $29.7 million at June 30, 2018 to $0 at June 30, 2019. The $29.7 million decrease in 2019 was due to changes in investments strategy and current assets are sufficient to fund current obligations. Assets available for current obligations increased from $29.2 million at June 30, 2018 to $29.7 million at June 30, 2018. The $0.5 million increase in 2018 was due to current portion of bond payments.

Noncurrent Assets

Noncurrent assets consist of board-designated assets held by VMC for general capital improvements and other operations, restricted unspent bond proceeds, unearned compensation plan arrangements, and various revenue obligation bond agreements. VMC issued series 2018 bonds on December 18, 2018 that resulted in $50 million new bond proceeds to fund capital projects. Restricted unspent bond proceeds were $44.9 million as of June 30, 2019.

The chart below outlines the composition of noncurrent assets as of June 30, 2019.

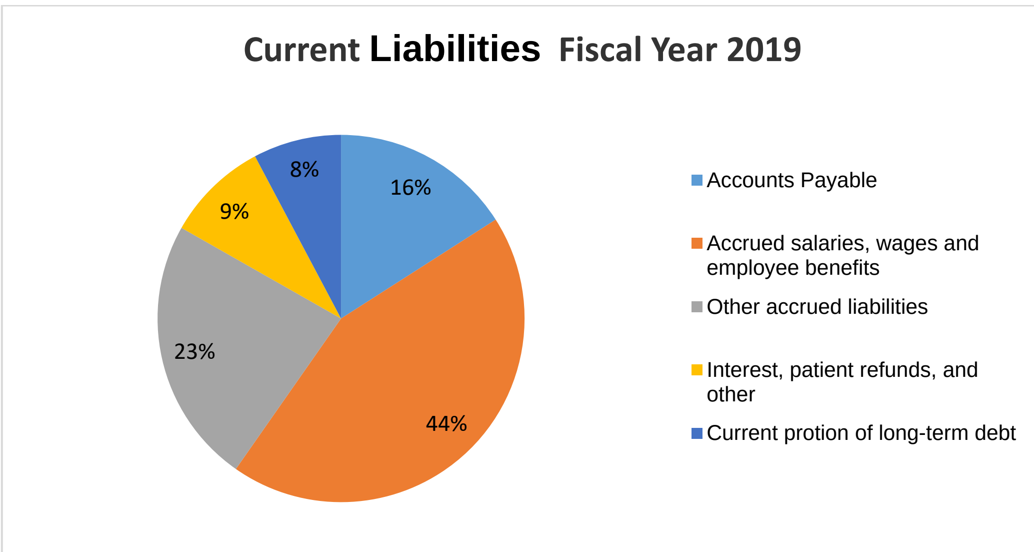


Total other noncurrent assets increased $70.6 million from $78.6 million at June 30, 2018 to $149.2 million at June 30, 2019. The increase in 2019 is primarily related to unspent bond proceeds of $44.9 million. Total other noncurrent assets decreased $15.1 million between fiscal years 2017 and 2018 from $93.7 million to $78.6 million. The decrease in 2018 was related to capital spending.

Capital assets increased $5.6 million during fiscal year 2019 from $379.5 million at June 30, 2018 to $385.1 million at June 30, 2019, and increased $17.0 million during fiscal year 2018 from $362.6 million at June 30, 2017 to $379.5 million at June 30, 2018. The increase in 2019 was primarily due to improvements done in the second floor of the hospital. The increase in 2018 was primarily due to the construction of a parking garage.

Current Liabilities

Current liabilities consist of accounts payable and other accrued liabilities that are expected to be paid within one year. Total current liabilities were $135.8 million at June 30, 2019, compared to $119.5 million at June 30, 2018. Fiscal year 2019 composition of current liabilities is illustrated in the pie chart below.



Accounts payable increased $0.8 million between June 30, 2018 and June 30, 2019 from $19.8 million to $20.6 million and decreased $0.2 million between June 30, 2017 and June 30, 2018 from $20.0 million to $19.8 million. Changes in accounts payable are primarily driven by timing of payments to vendors, as well as overall volume growth. Included in accounts payable as of June 30, 2019 and 2018 were amounts accrued for capital related expenditures of $3.7 million and $4.5 million, respectively.

Accrued salaries, wages and employee benefits increased $6.9 million from $52.6 million at June 30, 2018 to $59.5 million at June 30, 2019 and decreased $6.5 million from $59.1 million at June 30, 2017 to $52.6 million at June 30, 2018. Changes in accrued salaries, wages and employee benefits are also related to timing of payments to employees, as well as the overall growth in FTEs due to volume growth and expansion.

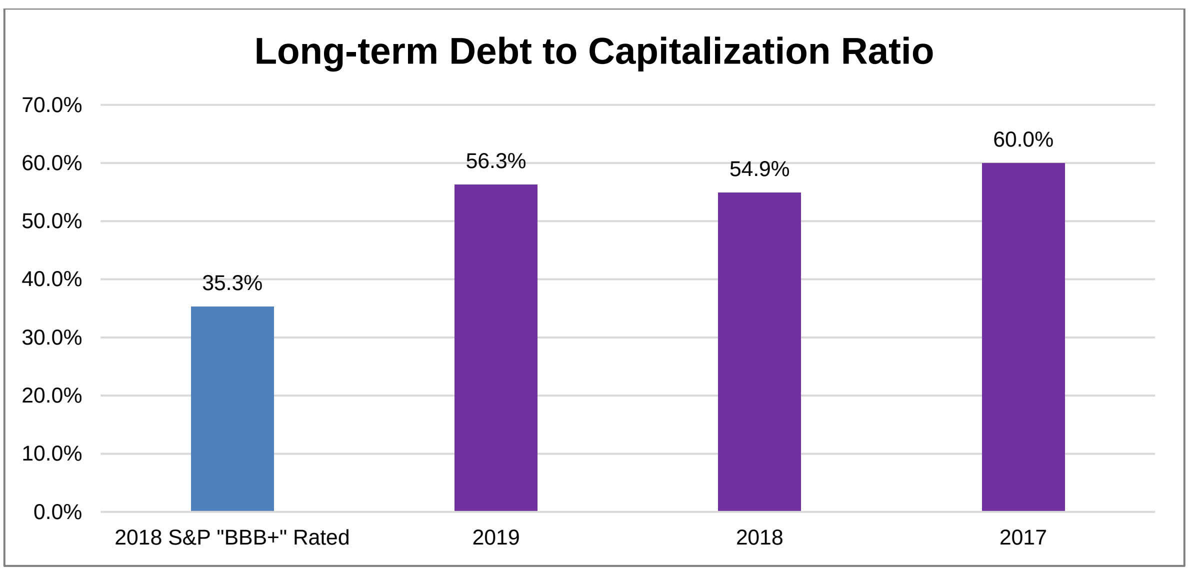
Other accrued liabilities, including estimated third-party payer settlements increased $6.4 million from $25.5 million at June 30, 2018 to $31.9 million at June 30, 2019 and increased $0.7 million from $24.8 million at June 30, 2017 to $25.5 million at June 30, 2018. The increases in both years were primarily due to estimated and actual final Certified Public Expenditure cost settlements for fiscal years 2010-2019.

Noncurrent Liabilities

Noncurrent liabilities consist of long-term debt and other noncurrent liabilities. Total noncurrent liabilities were $338.4 million at June 30, 2019, compared to $299.3 million at June 30, 2018.

Long-term debt increased from $293.5 million at June 30, 2018 to $332.4 million at June 30, 2019 and decreased from $305.0 million at June 30, 2017 to $293.5 million at June 30, 2017. The increase in 2019 was due to a bond issuance made to refinance older bonds and to secure incremental amounts to fund capital projects. The decrease in 2018 was a result of payments made in accordance with debt repayment schedules. Management is not aware of any violations with its debt covenants for the years ended June 30, 2019 and 2018.

Long-term debt to capitalization is a ratio used to evaluate the capital structure of healthcare organizations. The graph below shows the long-term debt to capitalization ratio as of June 30 for 2019, 2018 and 2017 and comparison to the S&P BBB+ rated hospitals has been included in the bar chart below.



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

Net Position

Invested in capital assets net of related debt increased by $15.2 million from $87.0 million at June 30, 2018 to $102.2 million at June 30, 2019 and increased by $25.7 million from $61.3 million at June 30, 2017 to

$87.0 million at June 30, 2017. The increases in both 2019 and 2018 were due to capital additions and repayment of related debt.

Unrestricted increased by $1.6 million from $162.4 million at June 30, 2018 to $164.0 million at June 30, 2019 and increased by $14.3 million from $148.1 million at June 30, 2017 to $162.4 million at June 30, 2018. The increase in 2019 was due to the increase in net position in the statement of revenues, expenses, changes in net position, increase in net investment in capital and decrease in restricted for debt services. The increase in 2018 was due to the increases in both net position in the statement of revenues, expenses, changes in net position and net investment in capital.

Deferred Outflows and Inflows of Resources

Deferred outflows of resources increased by $3.6 million from $12.5 million at June 30, 2018 to $16.1 million at June 30, 2019. Deferred outflows of resources decreased by $0.7 million from $13.2 million at June 30, 2017 to $12.5 million at June 30, 2018. The increase in 2019 was due to the addition of deferred amount from debt refinancing from the issuance of 2018 bonds. The decrease in 2018 was due to amortization of the deferred amount from the debt refinancing.

Deferred inflows of resources decreased $1.2 million from $25.0 million at June 30, 2018 to $23.8 million at June 30, 2019. The decrease between June 30, 2018 and June 30, 2019 was due to amortization of a deferred gain on sale of VPCN. Deferred inflows of resources decreased $17.7 million from $42.7 million at June 30, 2017 to $25.0 million at June 30, 2018. The decrease between June 30, 2017 and June 30, 2018 was due to the $16.5 million deposit received in May 2017 related to the expected sale of the joint venture lab that was recognized as a gain in 2018 when the transaction closed.

Factors Affecting the Future

Economic Uncertainty Facing the Healthcare Industry

The healthcare industry, in general, and the acute care hospital business, in particular, are experiencing significant regulatory uncertainty based, in large part, on legislative efforts to significantly modify or repeal and potentially replace the Patient Protection and Affordable Care Act, as amended by the Health Care and Education Reconciliation Act of 2010 (Affordable Care Act or ACA). It is difficult to predict the full impact of these actions on VMC's future revenues and operations. Changes to the ACA are likely to significantly impact VMC.

However, we believe that our ultimate success in increasing profitability depends in part on our success in executing our strategies. In general, these strategies are intended to improve financial performance through the reduction of costs and streamlining how we provide clinical care, as well as mitigating the recent negative reimbursement trends being experienced within the market. With a continued focus on patient volumes shifting from inpatient to outpatient settings due to technological advancements and demand for care that is more convenient, affordable and accessible as well as the industry-wide migration to value-based payment models as government and private payers shift risk to providers, VMC's success at managing costs and delivering care efficiently is paramount.

Embright LLC

UW Medicine and MultiCare Health System (MultiCare) announced the formation of a new alliance in 2017 to expand access to high-quality healthcare and allow the two organizations to engage in joint activities to further the mission of each organization. UW Medicine, MultiCare and LifePoint Health formed the Pacific Northwest Clinically Integrated Network, LLC dba Embright, following University board of regent approval in October 2018. As a clinically integrated network in the Pacific Northwest owned by healthcare provider organizations, Embright enables the partners to develop care delivery models that will improve patient care and experience at a more affordable cost. Together, the founding organizations represent 14 hospitals, more than 6,500 providers and over 600 outpatient sites of care. Embright's broad geographical reach assures that patients will have access to the full continuum of care, including preventive, primary, secondary, tertiary, quaternary and post-acute care. Throughout the network, teams are also implementing evidence-based clinical protocols and care pathways, standardized processes and care management services for complex patients.

Regulatory, Legislative, and Accounting Changes

The following regulatory and legislative activity will impact all entities in UW Medicine during fiscal year 2019 and beyond:

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

(Continued)

Contacting VMC's Financial Management

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

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

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

Statements of Net Position

June 30, 2019 and 2018

	VMC		Component unit – IPV	
Assets	**2019**	**2018**	**2019**	**2018**
Current assets:				
Cash and cash equivalents	$ 34,157,051	46,997,037	1,215,727	1,189,381
Short-term investments	67,197,753	41,430,627	—	—
Accounts receivable, less allowance for uncollectible accounts of $15,947,030 in 2019 and $18,514,319 in 2018	75,422,286	72,651,206	—	—
Property tax receivable	11,501,467	11,298,408	—	—
Due from:				
Primary government	—	—	1,060,469	1,275,927
Component unit	763,798	909,458	—	—
Noncurrent assets, required for current obligations	—	29,744,687	—	—
Supplies inventory	7,214,995	6,626,816	—	—
Prepaid expenses and other assets	16,983,339	16,867,992	48,464	73,921
Total current assets	213,240,689	226,526,231	2,324,660	2,539,229
Long-term investments	544,722	1,378,162	—	—
Other noncurrent assets:				
Unrestricted for general capital improvements and operations	95,754,383	95,029,508	—	—
Restricted unspent bond proceeds	44,939,869	—	—	—
Restricted under unearned compensation plan arrangements	5,996,269	5,793,939	—	—
Restricted under revenue bond indenture agreements	2,549,216	7,524,065	—	—
	149,239,737	108,347,512	—	—
Less amounts required for current obligations	—	(29,744,687)	—	—
Total other noncurrent assets	149,239,737	78,602,825	—	—
Capital assets:				
Land	13,413,733	13,413,733	—	—
Construction in progress	32,804,243	44,591,910	—	—
Depreciable capital assets, net of accumulated depreciation	338,913,104	321,534,060	769,821	905,628
Total capital assets	385,131,080	379,539,703	769,821	905,628
Goodwill, intangible assets and other	3,519,818	2,795,535	—	—
Total assets	751,676,046	688,842,456	3,094,481	3,444,857
Deferred outflow of resources	16,118,824	12,491,284	—	—
Total assets and deferred outflows	$ 767,794,870	701,333,740	3,094,481	3,444,857

(Continued)

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

Statements of Net Position

June 30, 2019 and 2018

	VMC		Component unit – IPV	
Liabilities and Net Position	**2019**	**2018**	**2019**	**2018**
Current liabilities:				
Accounts payable	$ 20,602,256	19,816,107	239,578	241,973
Accrued salaries, wages and benefits	59,451,262	52,634,976	—	—
Due to:				
Primary government	—	—	763,798	909,458
Component unit	1,060,469	1,275,927	—	—
Other accrued liabilities, including estimated third-party payer settlements	31,918,358	25,533,650	—	—
Interest, patient refunds and other	12,247,994	10,069,964	—	—
Current portion of long-term debt and capital lease obligations	10,550,188	10,129,509	—	78,075
Total current liabilities	135,830,527	119,460,133	1,003,376	1,229,506
Unearned compensation plan	5,996,269	5,793,939	—	—
Long-term debt and capital lease obligations, net of current portion	332,377,770	293,468,348	—	—
Total liabilities	474,204,566	418,722,420	1,003,376	1,229,506
Deferred inflows of resources	23,848,966	25,031,251	—	—
Net position:				
Invested in capital assets net of related debt	102,167,528	86,989,664	769,821	827,553
Restricted:				
For debt service	2,549,216	7,524,065	—	—
Expendable for specific operating activities	975,947	715,562	—	—
Unrestricted	164,048,647	162,350,778	1,321,284	1,387,798
Total net position	269,741,338	257,580,069	2,091,105	2,215,351
Total liabilities, deferred inflows, and net position	$ 767,794,870	701,333,740	3,094,481	3,444,857

See accompanying notes to basic financial statements.

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

Statements of Revenues, Expenses, and Changes in Net Position

Years ended June 30, 2019 and 2018

	VMC		Component unit – IPV	
	2019	**2018**	**2019**	**2018**
Operating revenues:				
Net patient service revenue (net of VMC's provision for uncollectible accounts of $16,018,976 in 2019 and $20,549,829 in 2018)	$ 622,817,721	598,620,249	6,255	12,195
Other operating revenue	62,066,057	45,215,073	9,511,018	9,693,782
Total operating revenues	684,883,778	643,835,322	9,517,273	9,705,977
Operating expenses:				
Salaries and wages	347,820,114	315,905,760	—	—
Employee benefits	84,176,684	75,912,798	—	—
Purchased services	91,007,543	82,908,600	774,931	797,614
Supplies and other expenses	129,912,760	124,268,032	305,021	237,908
Depreciation	36,976,516	33,011,305	225,232	155,789
Total operating expenses	689,893,617	632,006,495	1,305,184	1,191,311
Operating (loss) income	(5,009,839)	11,828,827	8,212,089	8,514,666
Nonoperating income (expense):				
Property tax revenue	23,258,119	22,722,217	—	—
Interest income	4,001,389	4,277,316	—	—
Interest and amortization expense	(14,852,667)	(14,252,926)	(406)	(5,342)
Investment income (loss), net	3,785,392	(1,809,288)	—	—
Funding from affiliates	4,051,934	3,604,560	—	—
Funding to affiliates	(3,683,575)	(3,276,872)	—	—
Gain recognized from sale of joint venture lab	—	16,522,486	—	—
Other, net	610,516	564,177	—	—
Distributions to members	—	—	(8,335,929)	(8,455,704)
Net nonoperating income (expense)	17,171,108	28,351,670	(8,336,335)	(8,461,046)
Increase (decrease) in net position	12,161,269	40,180,497	(124,246)	53,620
Net position, beginning of year	257,580,069	217,399,572	2,215,351	2,161,731
Net position, end of year	$ 269,741,338	257,580,069	2,091,105	2,215,351

See accompanying notes to basic financial statements.

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

Statements of Cash Flows

Years ended June 30, 2019 and 2018

	VMC		Component unit – IPV	
	2019	**2018**	**2019**	**2018**
Cash flows from operating activities:				
Receipts from and on behalf of patients	$ 626,431,349	592,710,519	6,255	12,195
Payments to suppliers and contractors	(218,285,687)	(213,047,536)	(1,020,474)	(1,050,103)
Payments to employees	(424,978,182)	(397,715,930)	—	—
Other cash receipts	62,211,717	44,990,974	9,726,476	9,494,221
Net cash provided by operating activities	45,379,197	26,938,027	8,712,257	8,456,313
Cash flows from noncapital financing activities:				
Cash received from tax levy	23,393,946	22,686,525	—	—
Distribution to Valley Medical Center	—	—	(6,814,404)	(6,540,465)
Distribution to noncontrolling member of Imaging Partners at Valley, LLC	—	—	(1,703,601)	(1,635,116)
Other	628,744	427,803	—	—
Net cash provided by (used in) noncapital financing activities	24,022,690	23,114,328	(8,518,005)	(8,175,581)
Cash flows from capital and related financing activities:				
Principal payments on long-term debt and capital lease obligations	(10,129,509)	(8,810,000)	(78,075)	(244,259)
Interest paid	(14,235,121)	(14,582,090)	(406)	(5,342)
Purchases of capital assets	(43,862,522)	(50,847,652)	(89,425)	(22,213)
Cash paid on note payable	(240,000)	—	—	—
Sale of capital assets	—	—	—	1,480
Proceeds from issuance of refunding bonds	101,745,000	—	—	—
Proceeds from premium on refunding bonds	9,834,924	—	—	—
Payment to refunding bond escrow agent	(65,757,800)	—	—	—
Cash paid for bond issuance	(888,011)	—	—	—
Other	(669,705)	(593,250)	—	—
Net cash used in capital and related financing activities	(24,202,744)	(74,832,992)	(167,906)	(270,334)
Cash flows from investing activities:				
Sale of investments and noncurrent assets	55,950,418	48,324,952	—	—
Purchases of investments and noncurrent assets	(117,990,936)	(54,472,062)	—	—
Investment and interest income	4,001,389	4,277,316	—	—
Net cash used in investing activities	(58,039,129)	(1,869,794)	—	—
Net (decrease) increase in cash and cash equivalents	(12,839,986)	(26,650,431)	26,346	10,398
Cash and cash equivalents, beginning of year	46,997,037	73,647,468	1,189,381	1,178,983
Cash and cash equivalents, end of year	$ 34,157,051	46,997,037	1,215,727	1,189,381

(Continued)

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

Statements of Cash Flows

Years ended June 30, 2019 and 2018

	VMC		Component unit – IPV	
	2019	2018	2019	2018
Reconciliation of operating (loss) income to net cash provided by operating activities:				
Operating (loss) income	$ (5,009,839)	11,828,827	8,212,089	8,514,666
Adjustments to reconcile operating income to net cash provided by operating activities:				
Depreciation	36,976,516	33,011,305	225,232	155,789
Provision for uncollectible accounts	16,018,976	20,549,829	—	—
Changes in assets and liabilities:				
Accounts receivable	(18,790,056)	(27,203,714)	—	—
Due from:				
Primary government	—	—	215,458	(199,561)
Component unit	145,660	(224,099)	—	—
Supplies inventory	(588,179)	(1,169,440)	—	—
Prepaid expenses and other assets	(115,347)	(4,961,319)	25,457	(12,753)
Accounts payable	1,579,442	247,607	34,021	(1,828)
Accrued salaries, wages, and benefits	6,816,286	(6,458,038)	—	—
Due to:				
Component unit	(215,458)	199,561	—	—
Other accrued liabilities and estimated third-party payer settlements	6,384,708	744,155	—	—
Other liabilities	1,974,158	(187,313)	—	—
Unearned compensation	202,330	560,666	—	—
Net cash provided by operating activities	$ 45,379,197	26,938,027	8,712,257	8,456,313
Supplemental disclosure of noncash investing, capital, and financing activities:				
Decrease in accrued capital included in accounts payable	$ (793,293)	(448,038)	—	—

See accompanying notes to basic financial statements.

(1) Organization

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

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

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

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

The Board of Trustees is designed to include all of the then-current Public Hospital District Commissioners, as well as five trustees who reside within the District Service Area, at least three of whom also reside within the boundaries of the District. In addition, two current or former trustees of the UW Medicine board or a Board of another component unit within UW Medicine and the CEO of UW Medicine and dean of the School of Medicine, University of Washington or his designee also serve on the Board of Trustees. The Board of Trustees members, which included the five elected Board of Commissioners, during fiscal year 2019 were:

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

The District, dba VMC, is comprised of a 321 licensed bed hospital and a network of primary care, specialty care and behavioral health clinics. The district health system changed its mission statement during fiscal year 2019 that states that we are “caring for our community like family.”

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

Financial Reporting Entity

As defined by generally accepted accounting principles (GAAP), the financial reporting entity consists of VMC as the primary government, and its component unit, which is a legally separate organization for which the primary government is financially accountable. The primary government is financially accountable if an organization is fiscally dependent on and there is a potential for the organization to provide specific financial benefits to, or impose specific financial burdens on, the primary government.

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

The Imaging Partners at Valley (IPV) is a limited liability company formed under the laws of Washington State. IPV has two members: the District and Mustang Technology Group, LLC. IPV provides inpatient and outpatient magnetic resonance, positron emission tomography, and computed tomography imaging services to patients. IPV is considered a component unit of the District because IPV's operating budget is subject to the overall approval of the District and IPV provides financial benefits to the District.

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

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

(2) Summary of Significant Accounting Policies

(a) Accounting Standards

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

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

(b) Basis of Accounting

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

(c) Use of Estimates

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

(d) General Accounts

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

(i) Operating Account

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

(ii) Plant and Construction Accounts

These account for land, buildings, and equipment; and the proceeds of the 2018 limited tax general obligation bonds. The District transfers sufficient taxation revenues to the bond redemption fund to make principal payments and interest payments on the Series 2008, 2011, 2016 and 2018 bonds.

(iii) Bond Account

Principal and interest payments on the Series 2008, 2011, 2016 and 2018 bonds are made from this account.

(iv) Revenue Bond Account

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

(v) 2010 Refundable Credits Account

Created pursuant to Bond Resolution 943, this account receives all refundable credits (the subsidy), if any, from the U.S. Department of the Treasury in respect to the Series 2010B Build America Bonds (BABs). The District has irrevocably pledged the 2010 Refundable Credits to the payment of principal and interest on the Series 2010B Bonds only, and such funds will not be used for any other purpose until all of the Series 2010 Bonds have been paid in full. Series 2010B Bonds were refunded with the Series 2018 bonds.

(vi) Restricted Accounts

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

(e) Cash and Cash Equivalents

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

Custodial credit risk for deposits is the risk that in the event of a financial institution failure, the deposits may not be returned to the depositor. The Federal Deposit Insurance Corporation (FDIC) provides insurance to depositors to guard against custodial credit risk. Under FDIC insurance coverage is provided for account balances up to $250,000 per depositor, per insured bank. As of June 30, 2019 and 2018, VMC had no bank balances subject to custodial credit risk as any deposits in excess of $250,000 were covered by collateral held in a multi financial institution collateral pool administered by the Washington Public Deposit Protection Commission.

(f) Investments

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

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

(g) Inventories

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

(h) Capital Assets

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

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

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

Qualifying interest is capitalized on construction projects as a cost of the related project beginning with commencement of construction and ceases when the construction period ends and the related asset is placed in service. Interest capitalized during 2019 and 2018 was $1,062,346 and $1,232,834, respectively.

(i) Goodwill, Intangible Assets, and Other

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

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

(j) Compensated Absences

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

Annual leave accrued at June 30, 2019 and 2018 was $17.4 million and $16.1 million, respectively. Sick leave accrued as of June 30, 2019 and 2018 was $5.4 million and $4.8 million, respectively. The accrued annual and sick leave liabilities are included in accrued salaries, wages and benefits in the accompanying primary government statements of net position.

(k) Third Party Payer Settlements, Net

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

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

(l) Classification of Revenues and Expenses

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

Operating expenses are all expenses, other than financing costs, incurred by VMC and IPV to provide healthcare services to patients.

Nonoperating revenues and expenses are recorded for certain exchange and nonexchange transactions. These activities include tax levy income, investment activity, funding to/from affiliates and debt service related to bonds and other peripheral or incidental transactions.

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(m) Net Patient Service Revenue

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

Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined. A summary of the payment arrangements with major third-party payers is as follows:

(i) Medicare

Acute inpatient services rendered to Medicare program beneficiaries are paid at prospectively determined rates per discharge based on Medicare severity diagnosis-related groupings (MS-DRGs), as well as reimbursements related to capital costs. These rates vary according to a patient classification system that is based on clinical, diagnostic, and other factors. Payments for Medicare outpatient services are provided based upon a prospective payment system known as ambulatory payment classifications (APCs). APC payments are prospectively established and may be greater than or less than the primary government’s actual charges for its services. The Medicare program utilizes the prospective payment system known as case mix group (CMGs) for rehabilitation services reimbursement. As with MS-DRGs, CMG payments are prospectively established and may be greater than or less than VMC’s actual charges for its services.

(ii) Medicaid

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

(iii) Commercial

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

(iv) UW Medicine Accountable Care Network

UW Medicine has formed an accountable care network (ACN) with other health care organizations and healthcare professionals to share financial and clinical responsibility for the healthcare of particular populations of patients. VMC is a network member of the UW Medicine ACN and as such shares in any risk contract surplus or deficits based on agreed upon contractual terms. Since its inception, the ACN has entered into various contracts which include provisions for shared risk as well as shared savings based on achieving certain quality and financial benchmarks. VMC and the other network members share in the financial risk or savings. At June 30, 2019 and 2018, VMC

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recorded liabilities of $1,115,645 and $4,299,172, respectively for its portion of the estimated liability related to these risk-sharing arrangements. These amounts are reflected in other accrued liabilities, including estimated third-party payer settlements in the accompanying statements of net position.

(n) Financial Assistance

VMC provides care without charge or at amounts less than established charges to patients who meet certain criteria under its financial assistance policy. VMC maintains records to identify and monitor the level of financial assistance it provides. These records include charges foregone for services and supplies furnished under its financial assistance policy to the uninsured and the underinsured. Because VMC does not pursue collection of amounts determined to qualify as financial assistance, they are not reported as net patient service revenue. The charges associated with financial assistance provided by VMC were approximately $20,906,704 and $25,050,647 respectively, for the years ended June 30, 2019 and 2018.

VMC estimates the cost of financial assistance using its cost to charge ratio of 24.1% and 26.0% for the fiscal years ended June 30, 2019 and 2018, respectively. Applying VMC’s cost to charge ratio of 24.1% to total financial assistance of $20,906,704 results in a cost of financial assistance of approximately $5,038,516 for the fiscal year ended June 30, 2019. Applying VMC’s cost to charge ratio of 26.0% to total financial assistance of $25,050,647 results in a cost of financial assistance of approximately $6,513,168 for the fiscal year ended June 30, 2018.

(o) Federal Income Taxes

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

IPV 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 IPV’s financial statements. Income of IPV is taxed to the members on their individual tax returns, if applicable. IPV had no uncertain tax positions at June 30, 2019 and 2018.

(p) Deferred Outflows and Inflows of Resources

Deferred outflows of resources consist of the excess of the reacquisition price over the carrying amount of bonds refinanced in fiscal years 2017 and 2019. This balance is amortized to interest expense through 2040. The balance was $16,118,824 and $12,491,284 at June 30, 2019 and June 30, 2018, respectively.

Deferred inflows of resources consist of property tax revenue and a deferred gain from the sale of Valley Professional Center North (VPCN). Deferred property tax revenue is recorded in January and amortized to property tax revenue over the calendar year. The balance of deferred gain on sale of VPCN is being amortized to other nonoperating income through 2028. The following are the components of deferred inflows of resources as of June 30, 2019 and 2018:

		VMC	
		2019	**2018**
Property tax revenue	$	11,878,857	11,539,970
Deferred gain on sale of VPCN		11,970,109	13,491,281
Total deferred inflows of resources	$	23,848,966	25,031,251

(q) Net Position

Net position of VMC is classified in various components. Net investment in capital assets consists of capital assets net of accumulated depreciation reduced by outstanding borrowings used to finance the purchase or construction of those assets. Restricted for debt service consists of assets restricted, by each revenue bonds' official terms for expenditures of principal and interest. Restricted and expendable for specific operating activities are noncapital net assets that must be used for a particular purpose, as specified by donors external to VMC. Unrestricted net position is the remaining net position that does not meet the definition of net investment in capital assets or restricted.

(r) Recently Adopted and Upcoming Accounting Pronouncements

In November 2016, the GASB issued Statement No. 83, "*Certain Asset Retirement Obligations*," which is effective for the fiscal year ending June 30, 2019. An asset retirement obligation (ARO) is a legally enforceable liability associated with the retirement of a tangible capital asset. Governments that have legal obligations to perform future tangible asset retirement activities must recognize a liability and offsetting deferred outflow of resources when incurred and reasonably estimable. VMC has analyzed the impact of this statement and concluded that it has no ARO's as defined by the standard.

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

In June 2018, the GASB issued Statement No. 89, "*Accounting for Interest Cost Incurred before the End of a Construction Period,*" which will be effective for the fiscal year ending June 30, 2021. This Statement requires that interest cost incurred before the end of a construction period be recognized as expense in the period in which the cost is incurred for financial statements prepared using the

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economic resources measurement focus. As a result, these costs will not be included in the capitalized cost of capital assets reported by VMC. This Statement will be applied on a prospective basis and interest costs capitalized prior to implementation will continue to be recognized as those assets are depreciated. VMC estimates that implementation of this Statement will result in approximately $1,000,000 of additional interest expense being recognized annually.

In August 2018, the GASB issued Statement No. 90, *"Majority Equity Interests,"* which will be effective for the fiscal year ending June 30, 2020. This Statement modifies previous guidance for reporting a government's majority equity interest in a legally separate organization. When a majority equity interest meets the definition of an investment as defined by GASB, the equity interest is to be reported as an investment for financial reporting purposes and measured using the equity method. Majority equity interests that do not meet the definition of an investment are to be reported as a component unit. This Statement also provides guidance for valuing the acquisition of assets and liabilities of 100% equity interests that remain legally separate, and brings this reporting in line with existing standards that apply to acquisitions that do not remain legally separate. VMC has analyzed the impact of this statement and concluded that the impact is not material.

(3) Net Patient Service Revenue

Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payers, and others for services rendered, including estimated retroactive adjustments and estimated risk share settlements under reimbursement agreements with third-party payers. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined. In 2019 and 2018, net patient service revenue includes approximately $5,079,000 decrease to revenue and $402,000 increase to revenue, respectively, relating to prior years' net Medicare and Medicaid cost report settlements and revised estimates, including disproportionate share reimbursement.

The following are the components of net patient service revenue for VMC for the years ended June 30, 2019 and 2018:

	VMC	
	2019	**2018**
Gross patient service revenue	$ 2,155,890,591	2,021,898,198
Less adjustments to patient service revenue:		
Financial assistance	(20,906,704)	(25,050,647)
Contractual discounts	(1,496,147,190)	(1,377,677,473)
Provision for uncollectible accounts	(16,018,976)	(20,549,829)
Total adjustments to patient service revenue	(1,533,072,870)	(1,423,277,949)
Net patient service revenue	$ 622,817,721	598,620,249

VMC grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payer agreements. The mix of gross patient service charges by primary payer and accounts receivable from significant payers as of and for the years ended June 30, 2019 and 2018 were as follows:

	2019	
	VMC	
	Patient service charges	Accounts receivable
Medicare	39 %	34 %
Medicaid	20	19
Commercial and other	38	42
Self pay	2	4
Exchange (HIX)	1	1
Total	100 %	100 %

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

(a) Medicaid Certified Public Expenditure Reimbursement

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

“Full cost” payments are determined using the respective hospital’s Medicaid ratio of cost to charges to determine the cost for covered medically necessary services. The costs will be certified as actual expenditures by the hospital and the State claim will be allowed federal match on the amount of the related certified public expenditures. Per the Centers for Medicare and Medicaid Services (CMS) approved Medicaid State Plan, participating hospitals receive only the federal match portion of the allowable costs. VMC recognized $5,914,351 and $7,277,822 of net patient service revenue under this program for the years ended June 30, 2019 and 2018, respectively.

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In addition, VMC receives the federal match portion of Disproportionate Share Payments (DSH), which are the lesser of qualifying uncompensated care cost or the hospital's specific limit. VMC received $19,606,065 and $17,035,608 in DSH funding under this program for the years ended June 30, 2019 and 2018, respectively. VMC recognized $6,017,897 and $13,152,390 in net patient service revenue from DSH funding for the years ended June 30, 2019 and 2018, respectively, in the statements of revenues, expenses, and changes in net position.

CPE payments are subject to retrospective determination of actual costs once VMC's Medicare Cost Report is audited by CMS. CPE program payments are not considered final until retrospective cost reconciliation is complete, after VMC receives its Medicare Notice of Program Reimbursements (NPR) for the corresponding cost reporting year. To date, beginning with the 2006 CPE year, State Fiscal Years 2006 to 2013 CPE program years have had a final settlement. Fiscal year 2013 final settlement was paid in July 2019. As of June 30, 2019, VMC had estimated payables of $29.7 million for fiscal years 2013 to 2019. As of June 30, 2018, VMC had estimated payables of $20.0 million for fiscal years 2011 to 2018 which are included as liabilities in other accrued liabilities, including estimated third-party payer settlements in the accompanying statements of net position.

(b) Professional Services Supplemental Payment (PSSP) Program

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

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

VMC paid $140,338 and $171,462 for the years ended June 30, 2019 and 2018, respectively, in supplemental payments, via Intergovernmental Transfers (IGTs) to WSHCA related to professional claims paid for the PSSP program. Those amounts are included in net patient service revenue in the statements of revenues, expenses, and changes in net position.

WSHCA used the federal match funds to make professional services payments to VMC. VMC received $358,095 and $403,348 in supplemental payments for the years ended June 30, 2019 and 2018, respectively. VMC recognized net revenue of $220,757 and $198,887 from the PSSP program for the years ended June 30, 2019 and 2018, respectively. These amounts are included in net patient service revenue- in the statements of revenues, expenses, and changes in net position.

VMC paid $2,791,298 and $3,558,734 for the years ended June 30, 2019 and 2018, respectively, in supplemental payment, via Intergovernmental Transfers (IGTs) to WSHCA related to professional claims paid for the PAP program. Those amounts are included in the net patient service revenue in the statements of revenues, expenses, and changes in net position.

WSHCA used the federal match funds to make professional services payments to VMC for the PAP program. VMC received $10,594,036 and $8,365,324 in supplemental payments for the years ended June 30, 2019 and 2018, respectively. VMC recognized net revenue of $7,300,000 from the PAP program for both years ended June 30, 2019 and 2018. These amounts are included in net patient service revenue in the statements of revenues, expense, and changes in net position.

(c) Hospital Safety Net Program

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

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

VMC received grant funding of $2.1 million each year for the years ended June 30, 2019 and 2018, which is recorded in other operating revenue in the statements of revenues, expenses, and changes in net position.

(4) Property Tax Revenue

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

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

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

For the calendar year 2019, the District’s tax levy rate was $0.42 per assessed $1,000 in property value pursuant to the District’s authorized tax levy in December 2018 resulting in a tax levy of $24,022,607.

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

Property taxes are recorded as receivables when levied. Because State law allows for the sale of property for failure to pay taxes, no estimate of uncollectible taxes is made. Given property taxes are recorded on a calendar-year basis, the property tax receivable balances at June 30, 2019 and 2018 are $11,501,467 and

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$11,298,408, respectively, and are shown as current assets in the statements of net position. See note 2p for deferred inflow for deferred property tax revenue.

Revenues from taxation are $23,258,119 and $22,722,217, for the fiscal 2019 and 2018 years, respectively, and are recorded as nonoperating revenue in the statements of revenues, expenses and changes in net position.

The District has pledged its future tax revenues, as well as operating revenues, to repay its limited tax general obligation and revenue bonds issued in 2010, 2011, 2016 and 2018 to finance construction, other capital improvements, medical equipment and technology, and information technology systems.

(5) Deposits and Investments

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

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

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

At June 30, 2019 and 2018, deposits and investments of VMC consist of the following:

		2019	2018
Unrestricted cash	$	23,081,008	25,326,109
Unrestricted investments and cash equivalents:			
U.S. Treasury and agency securities and bonds		136,979,016	119,045,471
Commercial paper		1,972,044	5,464,782
Corporate notes		21,642,898	12,689,038
Supranational bonds		2,393,433	—
Investment pools		10,214,418	20,952,392
Municipal bonds		400,000	639,007
		173,601,809	158,790,690

		2019	2018
Restricted assets:			
Cash and cash equivalents	$	6,951,191	1,442,763
U.S. Treasury and agency securities and bonds		15,999,390	6,145,618
Municipal bonds		470,000	654,219
Investment pools		25,039,596	—
Other assets		5,996,269	5,793,939
		54,456,446	14,036,539
	$	251,139,263	198,153,338

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

(a) Credit Risk

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

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

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

As of June 30, 2019 and 2018, VMC's investment in the Pool was not rated by a NRSRO. In compliance with state statutes, Pool policies authorize investments in U.S. Treasury securities, U.S. agency and mortgage-backed securities, municipal securities (rated at least A by two NRSROs), commercial paper (rated at least the equivalent of A-1 by two NRSROs), certificates of deposit issued by qualified public depositories, repurchase agreements, and the LGIP managed by the Washington State Treasurer's Office.

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

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

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

Level 3 – Unobservable inputs for an asset or liability

The composition of investments, reported at fair value by investment type and rating at June 30, 2019 and excluding unrestricted and restricted cash balances of $30,032,199, is as follows:

Investment type	Level 1	Level 2	Ratings	Percentage of total
U.S. Treasury securities	$ —	116,455,966	AA+/A-1+	62.7 %
U.S. agency securities	—	25,990,210	AA+	14.0
U.S. agency mortgages	—	10,532,230	AA+	5.7
Municipal bonds	—	870,000	Various	0.5
Commercial paper	1,972,044	—	A-1	1.1
Corporate notes	—	21,642,898	Various	11.6
Supranational bonds	—	2,393,433	AAA	1.3
Other assets	5,996,269	—	Not rated	3.1
Total investments by fair value level	$ 7,968,313	177,884,737		100.0 %

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

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

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

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

There are no investments whose fair value exceeds 5% of total investments that are with any one issuer other than the U.S. Treasury, U.S. agency, or U.S. government-sponsored entities. Corporate notes are investments with several companies where each company note does not exceed 5% of total investments. As of June 30, 2019 and 2018, for those investments that require composition disclosure, VMC holds investments in U.S. government-sponsored entities totaling 10% and 16% of its total investments in the table above less other assets in Federal National Mortgage Association securities, 5% and 9% of its total investments in the table above less other assets in Federal Home Loan Mortgage Corporation securities, and 5% and 8%, respectively, of its total investments in the table above less other assets in Government National Mortgage Association securities.

(b) Custodial Credit Risk

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

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

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

(c) Interest Rate Risk

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

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

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

Issuer/instrument	Maximum length of maturity
U.S. Treasury bonds, certificates, and bills	10 years
Other obligations of the U.S. government or its agencies	10 years
Statutorily allowed certificates of deposit	24 months
Commercial paper	270 days
Municipal bonds	10 years
Corporate notes	5.5 years
Supranational bonds	5 years
General obligation bonds of any state/ local government	10 years

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

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

2019		Remaining maturity (in months)			
Investment type	**Fair value**	**12 months or less**	**13 to 24 months**	**25 to 48 months**	**More than 48 months**
U.S. Treasury securities	$ 116,455,966	64,369,266	16,695,459	21,508,976	13,882,265
U.S. agency securities	25,990,210	7,919,721	6,403,390	8,261,477	3,405,622
U.S. agency mortgages	10,532,230	566,379	345,832	97,344	9,522,675
King County investment Pool	35,254,014	—	35,254,014	—	—
Municipal bonds	870,000	200,000	—	—	670,000
Commercial paper	1,972,044	1,972,044	—	—	—
Corporate notes	21,642,898	—	4,036,030	14,409,358	3,197,510
Supranational bonds	2,393,433	—	—	2,393,433	—
Other assets	5,996,269	—	—	—	5,996,269
	$ 221,107,064	75,027,410	62,734,725	46,670,588	36,674,341

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

(6) Capital Assets

(a) VMC's Capital Assets

The activity in VMC's capital asset and related accumulated depreciation accounts for years ended June 30, 2019 and 2018 is set forth below:

		Balance June 30, 2018	Additions/ adjustments	Transfers	Retirements	Balance June 30, 2019
Nondepreciable capital assets:						
Land	$	13,413,733	—	—	—	13,413,733
Construction in progress		44,591,910	44,005,467	(55,793,134)	—	32,804,243
Total capital assets, not being depreciated		58,005,643	44,005,467	(55,793,134)	—	46,217,976
Capital assets, being depreciated:						
Land improvements		18,858,718	—	—	(16,262)	18,842,456
Buildings, renovations and furnishings		457,360,415	(947,310)	38,979,512	(201,258)	495,191,359
Fixed equipment		22,699,216	—	—	(29,320)	22,669,896
Movable equipment		166,509,448	5,727	16,240,033	(1,466,582)	181,288,626
Minor equipment		21,139,691	5,345	573,589	(319,848)	21,398,777
Total capital assets, being depreciated		686,567,488	(936,238)	55,793,134	(2,033,270)	739,391,114
Total capital assets at historical cost		744,573,131	43,069,229	—	(2,033,270)	785,609,090
Less accumulated depreciation for:						
Land improvements		(12,143,135)	(317,930)	—	15,240	(12,445,825)
Buildings, renovations and furnishings		(193,554,810)	(15,240,260)	—	163,756	(208,631,314)
Fixed equipment		(20,572,592)	(275,269)	—	29,035	(20,818,826)
Movable equipment		(125,340,428)	(19,575,009)	—	1,305,743	(143,609,694)
Minor equipment		(13,422,463)	(1,845,792)	—	295,904	(14,972,351)
Total accumulated depreciation		(365,033,428)	(37,254,260)	—	1,809,678	(400,478,010)
Total capital assets, net	$	379,539,703	5,814,969	—	(223,592)	385,131,080

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

Included in movable equipment at June 30, 2019 and 2018 is $4,258,362 of equipment under capital lease. Accumulated amortization of the equipment under capital lease totaling $4,258,362 is included in accumulated depreciation at June 30, 2019 and 2018.

Depreciation expense was $37,254,260 and $33,283,839 for the years ended June 30, 2019 and 2018, respectively and includes $277,744 and $272,534 of nonoperating depreciation expense. This nonoperating expense is associated with medical office buildings rented or leased to physician practices and others and, therefore, are not considered within the operations of VMC. Therefore, $36,976,516 and $33,011,305 in depreciation expense is reflected in operating expenses in the statements of revenues, expenses, and changes in net position for the years ended June 30, 2019 and 2018, respectively.

(Continued)

(b) IPV's Capital Assets

The activity in IPV's capital asset and related accumulated depreciation accounts for the years ended June 30, 2019 and 2018 is set forth below:

	Balance June 30, 2018	Additions/ adjustments	Transfers	Retirements	Balance June 30, 2019
Buildings, renovations and furnishings	$ 267,686	—	—	—	267,686
Movable equipment	5,960,683	89,425	—	(124,156)	5,925,952
Total capital assets, being depreciated at historical cost	6,228,369	89,425	—	(124,156)	6,193,638
Less accumulated depreciation for:					
Buildings, renovations and furnishings	(112,878)	(17,608)	—	—	(130,486)
Movable equipment	(5,209,863)	(207,624)	—	124,156	(5,293,331)
Total accumulated depreciation	(5,322,741)	(225,232)	—	124,156	(5,423,817)
Total capital assets, net	$ 905,628	(135,807)	—	—	769,821

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

(Continued)

(7) Long-Term Debt and Capital Lease Obligations

(a) VMC's Long-Term Debt

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

		2019	2018
Limited tax general obligation bonds:			
2018 series, 4% to 5%, due serially on December 1, in amounts from $2,695,000 in 2020 to $3,995,000 in 2044, plus interest due semiannually, including unamortized premium of $9,447,680	$	111,192,680	—
2016 series, 4% to 5%, due serially on December 1, in amounts from $2,750,000 in 2020 to $16,455,000 in 2038, plus interest due semiannually, including unamortized premium of $17,570,559		211,470,559	213,132,540
2011 term bond, 2.19%, due in June and December, in yearly amounts from $4,939,509 in 2019 to $2,035,517 in 2022, plus interest due semiannually, net of unamortized loss on refinance of $79,899		8,532,004	13,406,109
2008 term bond, 5%, due serially on December 1 with last payment of $3,320,000 in December 2018.		—	3,310,753
Revenue bonds:			
2010 series A, 3.00% to 5.125%, due serially in June, in amounts from $1,870,000 in 2019 to $2,395,000 in 2024, plus interest due semiannually, net of unamortized discount of $43,475, and unamortized loss on refinance of $33,810		10,772,715	12,593,455
Build America bonds:			
2010 series B, 7.90% to 8.00%, legally defeased and refunded mainly with proceeds from 2018 bonds issued in December 2018.		—	61,155,000
Notes payable:			
Pinnacle Therapy Group, LLC due serially in January, in amount of $240,000 each year from 2020 to 2023, plus 3.76% interest		960,000	—
Total long-term debt		342,927,958	303,597,857
Less current portion		(10,550,188)	(10,129,509)
Total long-term debt, net of current portion	$	332,377,770	293,468,348

(i) Long-Term Debt Overview

Series 2018 Bond Issue

The 2018 Limited Tax General Obligation Refunding Bond was issued for the principal amount of $101,745,000. These proceeds were used to refund all series 2010B bonds and to finance renovations and improvements to the District's main campus, construction of new facilities at a satellite campus, and other capital improvements. The District has pledged tax revenues to secure the bonds. The difference between the cash flows required to service the old debt and the cash flows required to service the new debt and complete the refunding was $8,153,588. The economic gain was $5,370,365. The deferred amount on the refunding is being amortized over the life of the bond and is recorded in deferred outflow of resources in the statements of net position.

Series 2016 Bond Issue

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

Series 2011 Bond Issue

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

Series 2010 Revenue Bond Issue

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

The Series 2010B term BAB bonds were issued to construct, renovate, remodel, and equip projects at VMC and satellite facilities, including completion of the top floors of VMC's Emergency Services Tower and the construction of a freestanding emergency department within the District's boundaries. The Series 2010B term BAB bonds of $61,155,000 were issued with interest rates ranging from 7.9% to 8.0% and mature in 2030 and 2040. The series 2010B bonds have been legally defeased and refunded with debt proceeds from series 2018 bonds issued on December 18, 2018. The funds in escrow will pay the debt service on these bonds while they remain legally outstanding and will be used to repay the bonds on their first call date of June 15, 2020.

Under the BAB bonds, the District received a direct cash subsidy payment from the United States Department of the Treasury equal to 35% of the interest payable on the Series 2010B Bonds as of each interest payment date. For the years ended June 30, 2019 and 2018, the District received $800,252 and $1,593,678, respectively, in subsidy payments, which are recorded in other nonoperating revenues in the statements of revenues, expenses, and changes in net position.

Series 2008 Bond Issue

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

Series 2008A is insured by a rated bond insurer. Series 2008B was for $104,905,000 5.25% term bonds, beginning with $8,920,000 maturing in 2023 to $69,260,000 maturing in 2037. Series 2008B is uninsured. The District has pledged tax revenues to secure the bonds. Majority of the 2008 bonds were refunded by the 2016 bonds. The unrefunded balance of $3.2 million was paid in fiscal year 2019.

(ii) Debt Compliance

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

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

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

(iii) Long-Term Debt Maturities

The following schedule shows debt service requirements for the next five years and thereafter, as of June 30, 2019, for both principal and interest. Total unamortized premiums and discounts are $26,861,055 as of June 30, 2019.

	Principal	Interest	Total
2020	$ 10,550,188	15,279,158	25,829,346
2021	10,951,198	14,905,701	25,856,899
2022	9,125,517	14,505,356	23,630,873
2023	11,775,000	14,036,712	25,811,712
2024	12,335,000	13,437,744	25,772,744
2025–2029	61,495,000	58,062,375	119,557,375
2030–2034	85,305,000	39,834,875	125,139,875
2035–2039	94,705,000	15,356,125	110,061,125
2040–2044	19,825,000	2,399,875	22,224,875
Total payments	$ 316,066,903	187,817,921	503,884,824

(iv) Change in Total Long-Term Liabilities

Changes in total liabilities during the fiscal years ended June 30, 2019 and 2018 are summarized below:

	Balance June 30, 2018	Increases	Decreases	Balance June 30, 2019	Due within one year
Limited tax general obligation bonds:					
2018 Series	$ —	111,579,924	(387,244)	111,192,680	2,695,000
2016 Series	213,132,540	—	(1,661,981)	211,470,559	2,750,000
2011 Series	13,406,109	—	(4,874,105)	8,532,004	2,905,188
2008 Series	3,310,753	—	(3,310,753)	—	—
Revenue bond:					
2010 Series A	12,593,455	—	(1,820,740)	10,772,715	1,960,000
Build America bonds:					
2010 Series B	61,155,000	—	(61,155,000)	—	—
Note payable	—	1,200,000	(240,000)	960,000	240,000
Total long-term debt	303,597,857	112,779,924	(73,449,823)	342,927,958	10,550,188
Unearned compensation	5,793,939	202,330	—	5,996,269	—
Total liabilities	$ 309,391,796	112,982,254	(73,449,823)	348,924,227	10,550,188

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

(b) IPV's Capital Lease Obligations

The capital lease obligations as of June 30, 2019 and 2018 consist of equipment leases with a present value of $0 and $78,075, respectively.

The schedule of changes in capital leases is as follows:

	Balance June 30, 2018	Increases	Decreases	Balance June 30, 2019	Due within one year
Capital lease obligations	$ 78,075	—	(78,075)	—	—

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

(8) Risk Management

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

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

(a) Professional and General Liability

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

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

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

Changes in the self-insurance liability as it relates to the tail liability for professional liability insurance as of June 30, 2019 and 2018 are noted below:

Liability at June 30, 2017	$	1,440,000
Incurred claims and changes in estimates		—
Claims payments		—
Liability at June 30, 2018		1,440,000
Incurred claims and changes in estimates		352,000
Claims payments		—
Liability at June 30, 2019	$	1,792,000

(Continued)

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

(c) Employee Medical

VMC is self-insured for medical and dental benefits. The accrued liabilities for the self-insured component of the plan include the unpaid portion of claims that have been reported and estimates for claims that have been incurred but not reported. VMC also carries stop-loss coverage for claims in excess of the $300,000 and $275,000 specific deductible for calendar year 2019 and 2018 respectively, and $183,000 aggregating specific deductible for both calendar year 2019 and 2018. VMC has recorded an actuarially estimated liability for health claims that have been incurred but not reported of $2,798,824 as of June 30, 2019 and 2018. These liabilities are included in accrued salaries, wages, and employee benefits liabilities in the accompanying VMC statements of net position. The health benefit claims liability at June 30, 2019 and 2018 is based on undiscounted calculations.

(d) Workers' Compensation

VMC is self-insured for workers' compensation claims up to $500,000 per claim in 2019 and 2018. Excess insurance coverage is purchased for risk above the per claim self-insured retention level. The accrued liabilities of the plan include the self-insured components of unpaid portion of claims that have been reported and estimates for claims that have been incurred but not reported. VMC has recorded an actuarially determined estimated liability for workers' compensation claims of $5,118,198 and $5,233,638 at June 30, 2019 and 2018, respectively, which are included in accrued salaries, wages, and benefits liabilities in the accompanying VMC statements of net position. The workers' compensation current liability at June 30, 2019 and 2018 is based on undiscounted calculations.

(9) Retirement Plans

VMC offers its employees two deferred compensation plans created in accordance with Internal Revenue Code Sections 403(b) and 457. The plans, available to all employees, permit them to defer a portion of their salary until future years. Employee contributions to the plans totaled $21,994,742 and $19,522,410 for the years ended June 30, 2019 and 2018, respectively. The deferred compensation is payable to employees upon termination, retirement, death, or unforeseen emergency.

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

Employer contributions into the 403(b) plan totaled $16,054,062 and $14,670,609 for the years ended June 30, 2019 and 2018, respectively.

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

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

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

(10) Related-Party Transactions

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

(a) University of Washington

A total of $8,972,000 and $7,509,000 was paid and recognized by VMC to divisions of the University for the years ended June 30, 2019 and 2018, respectively, for transactions primarily related to referenced laboratory work, providing contracted nursing assistance with the Valley Nurse Line and management assistance within various departments. The expenses are recorded as purchased services expense in the statements of revenues, expenses, and changes in net position. VMC received and recognized $324,000 and $762,000 in revenue from related parties for the years ended June 30, 2019 and 2018, respectively. The revenue is recorded as other operating revenue in the statements of revenues, expenses, and changes in net position.

(b) Intra-Governmental Transactions

VMC and IPV engage in a number of transactions with each other. These transactions are primarily for lease of medical office space and operational services.

(i) Lease of Medical Office Space

IPV has several lease agreements with VMC. Office space for two different locations is leased from VMC for $373,750 and $362,706 for the years ended June 30, 2019 and 2018, respectively. The leases expire in December 2019, and April 2021, respectively. IPV has $220,791 in total outstanding minimum lease payments due to VMC.

(ii) Operational Services

During the years ended June 30, 2019 and 2018, IPV provided radiology services on behalf of VMC, which reimburses IPV for those services. VMC incurs expenses for services rendered by IPV, which is represented by $9,511,018 and $9,695,235 in VMC’s purchased services expense for 2019 and 2018 respectively. VMC receives members’ distributions from IPV, which is represented by $6,668,743 and $6,764,564 in VMC’s other operating revenue for 2019 and 2018 respectively.

(c) State of Washington

The State of Washington Medicaid Transformation Demonstration (MTD) program which commenced in fiscal year 2018 is a five year contract between the state and CMS, authorizing up to $1.5 billion federal matching funds to promote innovative, sustainable and systemic changes that improve the overall health of the state. WSHCA requested intergovernmental transfers from other state and local public entities to finance a portion of the nonfederal share. VMC recorded $3,683,575 and $3,276,872 for the years ended June 30, 2019 and 2018, respectively, in intergovernmental transfers to the state, which is included in funding to affiliates in the statement of revenues, expenses, and changes in net position.

The state of Washington submitted and received approval for incentive payments under the MTD program, of which VMC received $4,051,934 and $3,604,560 for the years ended June 30, 2019 and 2018, respectively, which is included in funding from affiliates in the statement of revenues, expenses, and changes in net position.

(11) Commitments and Contingencies

(a) Operating Leases

VMC leases certain medical office space and equipment under operating lease arrangements with IPV and third parties. Similarly, IPV leases certain medical office space and equipment under operating leases with VMC and third parties. Total rental expense in the year ended June 30, 2019 was $12,208,568 and $373,750 for VMC and IPV, respectively. Total rental expense in the year ended June 30, 2018 was $10,396,841 and $362,706 for VMC and IPV, respectively. Rental expense is included in purchased services expense in the statements of revenues, expenses, and changes in net position.

The following schedule shows future minimum lease payments by fiscal year for VMC and IPV as of June 30, 2019:

	VMC	IPV
2020	$ 12,738,866	188,356
2021	12,314,102	32,435
2022	12,166,238	—
2023	10,915,967	—
2024	8,049,342	—
Thereafter	22,006,641	—
Total minimum lease payments	$ 78,191,156	220,791

(b) Construction Commitments

VMC has current commitments at June 30, 2019 of $21,077,635 related to various construction projects, equipment purchases and information technology implementations. VMC intends to use capital funds for these commitments.

(Continued)

(c) Capital Commitments by IPV

IPV has current commitments at June 30, 2019 of $1,931,728 related to equipment purchases.

(d) Regulatory Environment

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

(e) Litigation

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

(f) Collective Bargaining Agreements

VMC has a total of approximately 3,834 employees. Of this total, approximately 68% and 69% are covered under collective bargaining agreements as of June 30, 2019 and 2018, respectively. Nurses are represented by Service Employees International Union (SEIU) 1199 and other healthcare and support workers are represented by Office and Professional Employees International Union (OPEIU), United Food and Commercial Workers (UFCW), and International Union of Operating Engineers (IUOE) Operating Engineers. The collective bargaining agreements with SEIU 1199 expire on June 30, 2023. OPEIU, UFCW, and IUOE Operating Engineers expire on October 31, 2020; March 31, 2020 and October 31, 2020, respectively.

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

(A Component Unit of the University of Washington)

Supplementary Information

Aggregating Statement of Net Position

June 30, 2019

Assets		VMC	Component unit – IPV	Eliminations	Aggregated
Current assets:					
Cash and cash equivalents	$	34,157,051	1,215,727	—	35,372,778
Short-term investments		67,197,753	—	—	67,197,753
Accounts receivable, less allowance for uncollectible accounts		75,422,286	—	—	75,422,286
Property tax receivable		11,501,467	—	—	11,501,467
Due from:					
Primary government		—	1,060,469	(1,060,469)	—
Component unit		763,798	—	(763,798)	—
Supplies inventory		7,214,995	—	—	7,214,995
Prepaid expenses and other assets		16,983,339	48,464	—	17,031,803
Total current assets		213,240,689	2,324,660	(1,824,267)	213,741,082
Long-term investments		544,722	—	—	544,722
Other noncurrent assets:					
Unrestricted for general capital improvements and operations		95,754,383	—	—	95,754,383
Restricted unspent bond proceeds		44,939,869	—	—	44,939,869
Restricted under unearned compensation plan arrangements		5,996,269	—	—	5,996,269
Restricted under revenue bond indenture agreements		2,549,216	—	—	2,549,216
Total other noncurrent assets		149,239,737	—	—	149,239,737
Capital assets:					
Land		13,413,733	—	—	13,413,733
Construction in progress		32,804,243	—	—	32,804,243
Depreciable capital assets, net of accumulated depreciation		338,913,104	769,821	—	339,682,925
Total capital assets		385,131,080	769,821	—	385,900,901
Goodwill, intangible assets and other		3,519,818	—	—	3,519,818
Total assets		751,676,046	3,094,481	(1,824,267)	752,946,260
Deferred outflow of resources		16,118,824	—	—	16,118,824
Total assets and deferred outflows	$	767,794,870	3,094,481	(1,824,267)	769,065,084

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

Supplementary Information

Aggregating Statement of Net Position

June 30, 2019

Liabilities and Net Position	VMC	Component unit – IPV	Eliminations	Aggregated
Current liabilities:				
Accounts payable	$ 20,602,256	239,578	—	20,841,834
Accrued salaries, wages and benefits	59,451,262	—	—	59,451,262
Due to:				
Primary government	—	763,798	(763,798)	—
Component unit	1,060,469	—	(1,060,469)	—
Other accrued liabilities, including estimated third-party payer settlements	31,918,358	—	—	31,918,358
Interest, patient refunds and other	12,247,994	—	—	12,247,994
Current portion of long-term debt and capital lease obligations	10,550,188	—	—	10,550,188
Total current liabilities	135,830,527	1,003,376	(1,824,267)	135,009,636
Unearned compensation plan	5,996,269	—	—	5,996,269
Long-term debt and capital lease obligations, net of current portion	332,377,770	—	—	332,377,770
Total liabilities	474,204,566	1,003,376	(1,824,267)	473,383,675
Deferred inflows of resources	23,848,966	—	—	23,848,966
Net position:				
Invested in capital assets net of related debt	102,167,528	769,821	—	102,937,349
Restricted:				
For debt service	2,549,216	—	—	2,549,216
Expendable for specific operating activities	975,947	—	—	975,947
Unrestricted	164,048,647	1,321,284	—	165,369,931
Total net position	269,741,338	2,091,105	—	271,832,443
Total liabilities, deferred inflows, and net position	$ 767,794,870	3,094,481	(1,824,267)	769,065,084

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)

Supplementary Information

Aggregating Statements of Revenues, Expenses, and Changes in Net Position

Year ended June 30, 2019

	VMC	Component unit – IPV	Eliminations	Aggregated
Operating revenues:				
Net patient service revenue	$ 622,817,721	6,255	—	622,823,976
Other operating revenue	62,066,057	9,511,018	(16,544,262)	55,032,813
Total operating revenues	684,883,778	9,517,273	(16,544,262)	677,856,789
Operating expenses:				
Salaries and wages	347,820,114	—	—	347,820,114
Employee benefits	84,176,684	—	—	84,176,684
Purchased services	91,007,543	774,931	(9,875,519)	81,906,955
Supplies and other expenses	129,912,760	305,021	—	130,217,781
Depreciation	36,976,516	225,232	—	37,201,748
Total operating expenses	689,893,617	1,305,184	(9,875,519)	681,323,282
Operating (loss) income	(5,009,839)	8,212,089	(6,668,743)	(3,466,493)
Nonoperating income (expense):				
Property tax revenue	23,258,119	—	—	23,258,119
Interest income	4,001,389	—	—	4,001,389
Interest and amortization expense	(14,852,667)	(406)	—	(14,853,073)
Investment income	3,785,392	—	—	3,785,392
Funding from affiliates	4,051,934	—	—	4,051,934
Funding to affiliates	(3,683,575)	—	—	(3,683,575)
Other, net	610,516	—	—	610,516
Members' distributions	—	(8,335,929)	6,668,743	(1,667,186)
Net nonoperation income	17,171,108	(8,336,335)	6,668,743	15,503,516
Increase (decrease) in net position	12,161,269	(124,246)	—	12,037,023
Net position, beginning of year	257,580,069	2,215,351	—	259,795,420
Net position, end of year	$ 269,741,338	2,091,105	—	271,832,443

See accompanying independent auditors' report.