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, 2015 and 2014

(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 of Public Hospital District No. 1 of King County, Washington, dba Valley Medical Center (VMC), a component unit of the University of Washington, and VMC's discretely presented component unit, The Imaging Partners at Valley (IPV), which comprise the statements of net position as of June 30, 2015 and 2014, and the related statement of revenues, expenses and changes in net position, and cash flows for the years then ended, and the related notes to the financial statements.

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 an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. 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 opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the business-type activities and the aggregate discretely presented component unit of VMC, IPV as of June 30, 2015 and 2014, and the results of its changes in net position and its cash flows for the years then ended in accordance with U.S. generally accepted accounting principles.

KPMG

Other Matters

U.S. generally accepted accounting principles require that the management's discussion and analysis on pages 3 through 18 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Government Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Our audits were conducted for the purpose of forming an opinion on the basic financial statements as a whole. The supplementary information included in the Aggregating Schedules on pages 61 through 63 is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has not been subjected to the auditing procedures applied in the audit of the basic financial statements, and accordingly, we do not express an opinion or provide any assurance on it.

KPMG LLP

Seattle, Washington
October 7, 2015

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, 2015, 2014 and 2013. 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

VMC's 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 required by the adoption of GASB Statement No. 65 as well as information to help compute the rate of return on investments, 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 reports 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 — net position 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 revenues and other revenue sources.

The statements of cash flows reports 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 2015

VMC recorded just over $13.6 million in net income from operations for fiscal year 2015; this is an improvement of $8.6 million from the net income from operations of $5.0 million in 2014. VMC improved its net position by $16.2 million to $228.1 million from $211.9 million. The improved net operating income primarily relates to strong growth in both inpatient and outpatient volumes, including outpatient surgeries, ambulatory outpatient hospital visits, and primary, urgent, and specialty care visits; Medicaid expansion; increased other operating revenue from outpatient and contracted pharmacies, and continued success in implementing process improvement initiatives in the areas of revenue cycle, supply chain, and resource utilization.

		2015	2014	2013
			(In thousands)	
Total operating revenues	$	515,711	470,732	443,609
Total operating expenses		502,083	465,741	461,435
Operating income (loss)		13,628	4,991	(17,826)
Property tax revenue		18,131	16,342	16,253
Interest income		3,779	3,165	4,009
Interest and amortization expense		(18,060)	(18,053)	(17,905)
Investment loss		(375)	(137)	(1,059)
Other, net		(889)	(273)	(421)
Nonoperating income (expense)		2,586	1,044	877
Increase (decrease) in net position		16,214	6,035	(16,949)
Net position, beginning of year		211,893	205,858	222,807
Net position, end of year	$	228,107	211,893	205,858

- In January 2014, the Washington state Medicaid program was expanded which significantly increased the number of Medicaid enrollees receiving benefits. Fiscal year 2015 was the first full year of that expansion. With the increase of eligible Medicaid enrollees, VMC has seen a decline in the number of charity care applicants as these applicants now are eligible for Medicaid, and has also experienced less self-pay patients, however an increase in Medicaid and healthcare exchanges.
- Outpatient surgery cases increased nearly 10% over prior year, and emergency visits increased approximately 10%.
- Inpatient days increased 7% over prior year.
- VMC experienced significant growth in outpatient volumes, particularly in the primary, urgent, and specialty care clinics, as multiple clinics added providers, several subspecialties were added, and the Maple Valley Clinic was open for all of fiscal year 2015 (opened in August 2014).
- VMC is continuing to invest in information technology.

- VMC management implemented cost saving initiatives through the process improvement program focusing on the purchasing standardization of high dollar medical supplies and equipment.
- New retirement and health benefit plans were implemented for the full year of fiscal 2015 for certain employee groups, resulting in reductions in overall benefit expense between fiscal 2015 and 2014.

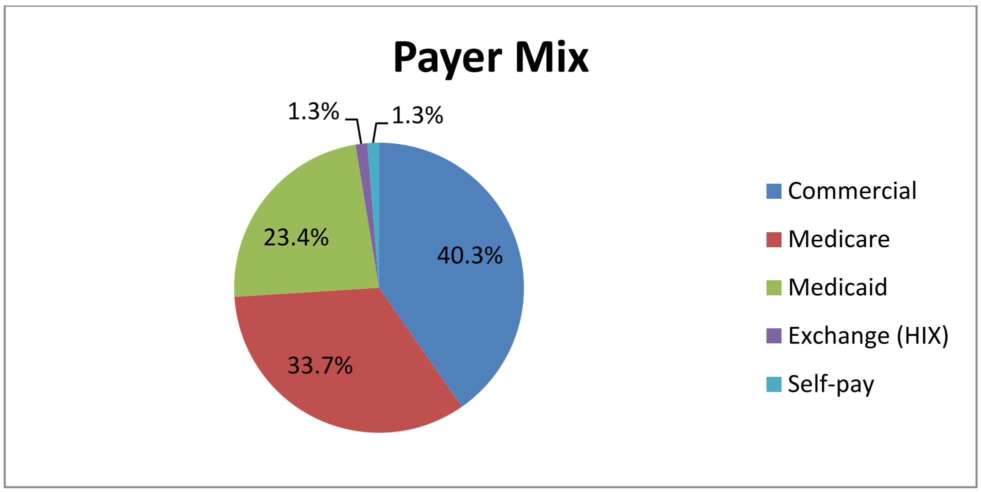
The chart below represents the key performance statistics for the last three years.

	2015	2014	2013
Available beds	283	270	270
Discharges	17,174	16,693	17,477
Patient days	65,792	61,395	65,769
Average length of stay	3.83	3.70	3.80
Occupancy	64%	62%	67%
Case mix index (CMI)	1.45	1.40	1.33
Surgery cases	12,006	11,270	11,171
Emergency room visits	81,250	73,763	74,202
Primary care clinic visits	177,612	154,546	152,594
Specialty/Urgent care clinic visits	294,168	248,623	209,680
Full time equivalents (FTEs)	2,599	2,421	2,456
Births	3,776	3,935	4,356

Total Operating Revenues

Total operating revenues consists primarily of net patient service revenue and other operating revenues. Net patient service revenues are recorded based on standard billing rates less contractual adjustments, charity, 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 its component unit, provide care at no charge or reduced charges to patients who qualify under VMC's charity 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 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 payer mix for 2015. For the year ended June 30, 2015, 2014, and 2013, Medicaid revenue represented 23%, 20%, and 18%, respectively. This increase in Medicaid revenue is a direct result of the expansion of the Medicaid program in Washington State as part of the Affordable Care Act. Due to Medicaid expansion, patients who were previously self-pay now qualify for Medicaid coverage, thus there is a decrease in the number of applicants for charity care and a decrease in the cost of charity care provided.

Reimbursement from governmental payers is generally below commercial rates and reimbursement rules are complex and subject to both interpretation and settlements. With the expansion of Medicaid, VMC will have higher government revenues which are subject to settlements.

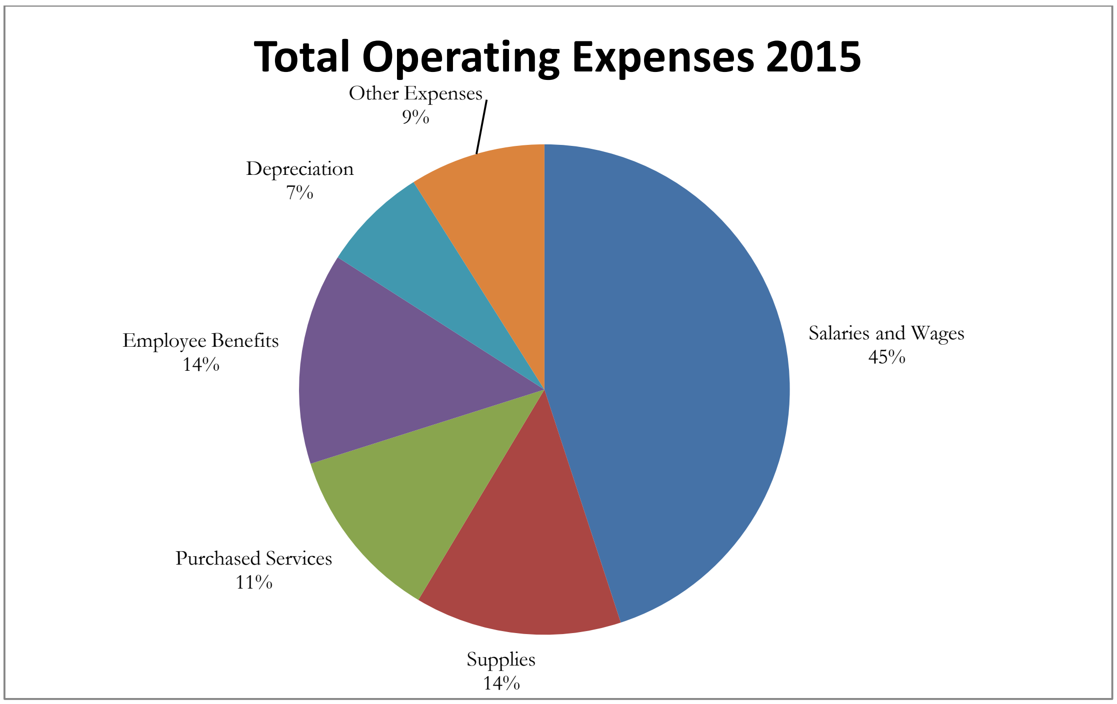
For the years ended June 30, 2015, 2014, and 2013, VMC's total operating revenues were $515.7 million, $470.7 million, and $443.6 million composed of $480.5 million, $440.7 million, and $416.3 million in net patient service revenues and $35.2 million, $30.0 million, and $27.3 million in other operating revenue, respectively.

In 2015, the increase in operating revenue is due both to growth in outpatient volumes across the clinic network (primary, specialty, and urgent care) and increased inpatient volumes, as well as continued increases in outpatient surgical procedures. The increase in other operating revenue is attributed to increases in the radiology imaging service line, in outpatient and contract pharmaceutical volumes, and in meaningful use incentives.

In 2014, the increase in operating revenues was due to increases in inpatient volumes. The increases within other operating revenue were primarily related to the opening of several new pharmacy locations, as well as a Medicaid electronic health record incentive payment.

Total Operating Expenses

Total operating expenses were $502.1 million for the year ended June 30, 2015 compared to $465.7 million for the year ended June 30, 2014. The composition of fiscal year 2015 operating expenses is illustrated in the pie chart below.



Salaries and wages increased $24.9 million from $209.4 million in fiscal year 2014 to $234.3 million in fiscal year 2015. The increase were primarily related to contractually agreed upon wage increases; the clinic network's expansion of services in primary, urgent and specialty care, and growth in certain hospital inpatient and outpatient departments.

Salaries and wages increased $5.8 million from $203.6 million in fiscal year 2013 to $209.4 million in fiscal year 2014. The increase was primarily related to the clinic network's expansion of services in urgent care; the opening of several outpatient pharmacies, and in general medical/surgical units due to volume increases.

Employee benefits decreased $0.7 million from $65.0 million in fiscal year 2014 to $64.3 million in fiscal year 2015 and decreased $3.0 million from $68.0 million in fiscal year 2013 to $65.0 million in fiscal year 2014. Employee benefit costs are a function of employment. In fiscal year 2015, the decrease was related to both the full year's impact of healthcare benefits restructure for certain employee groups, as well as the restructure of retirement benefits as a result of the pension plan in fiscal year 2014, and modification to the current 403B retirement plan.

The decrease in fiscal year 2014 was for the same events, but only for part of the year due to the timing of the restructures.

Purchased services expense, which consists of professional and consulting fees, increased $3.1 million from $71.9 million in fiscal year 2014 to $75.0 million in fiscal year 2015 and decreased $4.6 million from $76.5 million in fiscal year 2013 to $71.9 million in fiscal year 2014. The increase between fiscal year 2014 and 2015 is attributed to additional consultant fees. The decrease in purchased service expense between fiscal year 2013 and 2014 is primarily attributable to consulting fees incurred in fiscal year 2013 related to the completion of the electronic health record implementation that did not continue into fiscal year 2014.

Supplies and other expense include medical and surgical supplies, pharmaceutical supplies, insurance, taxes, and other expenses. In total, these expenses increased $11.0 million from $86.9 million in fiscal year 2014 to $97.9 million in fiscal year 2015. Much of the increase is due to increases in supplies, which correlate to increased volumes, particularly surgery volumes. Medical and pharmaceutical expense increased as a result of price inflation and the opening of several new outpatient pharmacies. In 2014, supplies and other expense increased $6.0 million from $80.9 million to $86.9 million as medical supplies expense increased as a result of price inflation and the opening of several new outpatient pharmacies caused pharmaceutical expense to also increase.

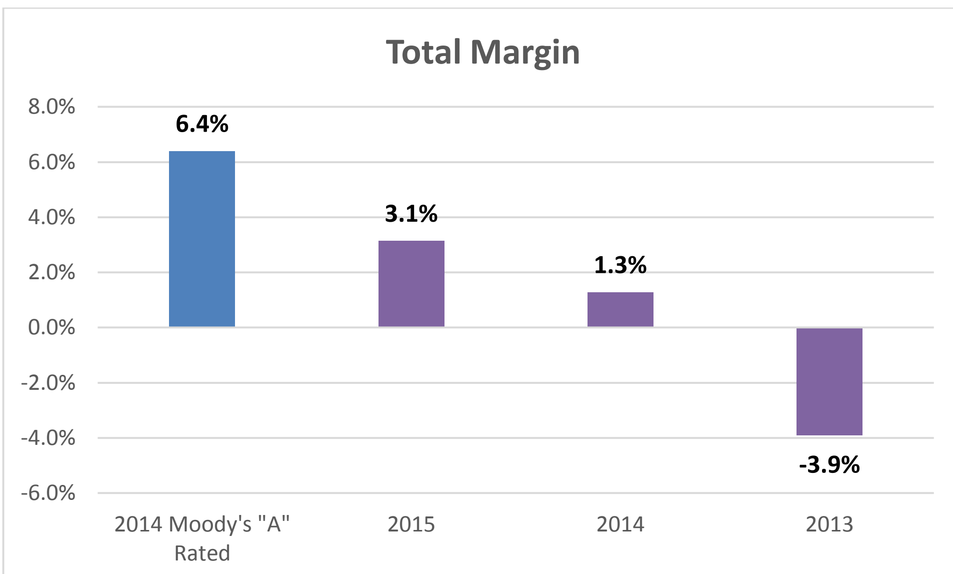
Depreciation expense decreased $1.9 million from $32.5 million in fiscal year 2014 to $30.6 million in fiscal year 2015 and decreased $0.1 million from $32.4 million in fiscal year 2013 to $32.5 million in fiscal year 2014 due to longer-lived assets becoming fully depreciated in fiscal year 2015.

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 increased $1.6 million between fiscal years 2015 and 2014, primarily due to the increase in revenue from taxation (as the pro-rationed amount of the tax levy was less than in fiscal year 2014). Net nonoperating revenue increased $0.1 million between fiscal years 2014 and 2013 due to a slight increase in revenue from taxation.

(Continued)

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 net income and is a common measure of total hospital profitability. Total margin for the fiscal years 2015, 2014 and 2013 compared to the industry median for Moody's A1 rated stand-alone hospitals is illustrated in the bar chart below.



Financial Health

Statement of Net Position

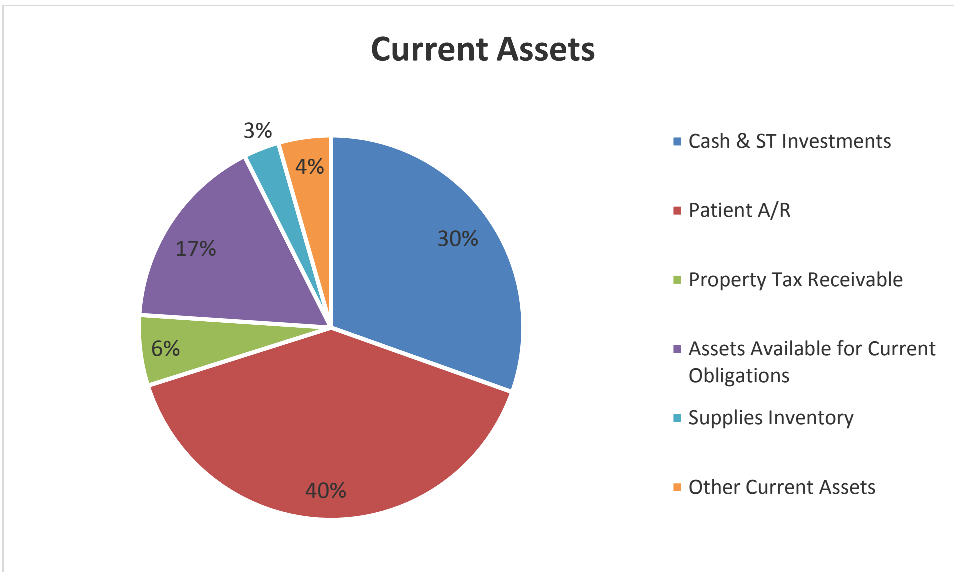
The table below is a presentation of certain condensed financial information derived from VMC's statement of net position for the fiscal years ended June 30, 2015, 2014 and 2013.

		2015	2014	2013
			(In thousands)	
Current assets	$	159,088	149,360	143,293
Noncurrent assets:				
Capital assets, net		348,546	366,830	386,179
Noncurrent assets		103,104	75,072	46,501
Long-term investments		20,860	18,393	31,264
Other		4,062	4,626	4,415
Total assets		635,660	614,281	611,652
Current liabilities		86,133	74,443	70,964
Noncurrent liabilities		311,795	319,360	326,807
Total liabilities		397,928	393,803	397,771
Total deferred inflows		9,625	8,585	8,023
Net position	$	228,107	211,893	205,858

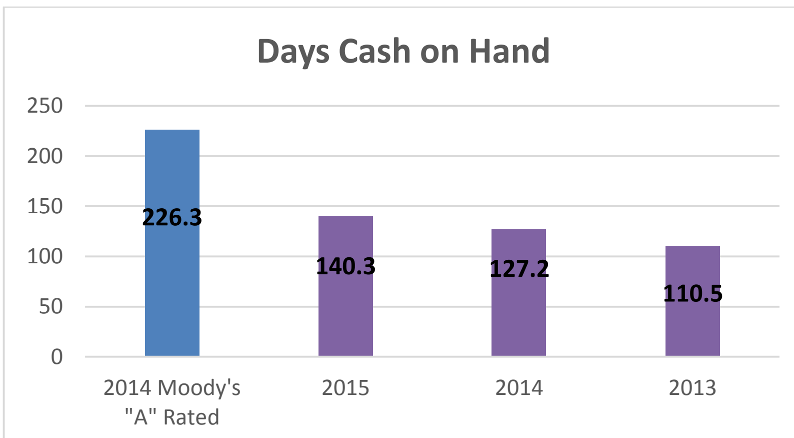
Total assets were $635.7 million at June 30, 2015 compared to $614.3 million at June 30, 2014, an increase of $21.4 million, and $611.7 million at June 30, 2013, an increase of $2.9 million between 2013 and 2014. The majority of the change between years is attributed to an increase in investment balances held for general capital improvements and operations.

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 $159.1 million at fiscal year-end 2015, compared to $149.4 million at year-end 2014. Fiscal year 2015 composition of current assets is illustrated in the pie chart below.



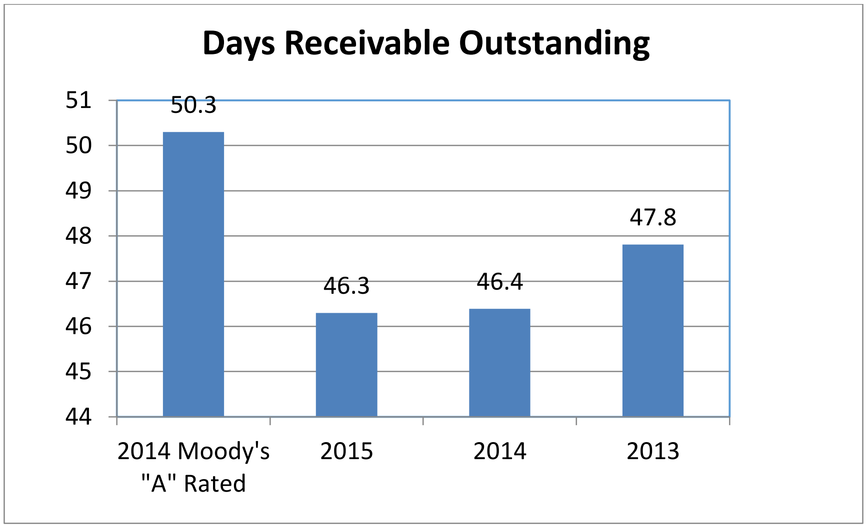
Cash and short-term investments held by VMC, the short-term investments consist of cash and cash equivalents. Cash and short-term investments increased $2.2 million in 2015 from $46.2 million at June 30, 2014 to $48.4 million at June 30, 2015. The increase in 2015 was attributed to less capital spending and improved operating performance. Cash and short-term investments increased $2.9 million from $43.3 million at June 30, 2013 to $46.2 million at June 30, 2014. 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 board designated assets for general capital improvements and operations, as of June 30 for fiscal years 2015, 2014 and 2013 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, increased 13 days from 127.2 days at June 30, 2014 to 140.3 days at June 30, 2015 and increased 16 days from 110.5 days at June 30, 2013 to 127.2 days at June 30, 2014. The increases in both years were primarily due to less capital spending and overall performance improvements.

Net patient accounts receivable was $63.1 million as of June 30, 2015, compared to $58.1 million at June 30, 2014. The increase of $5.0 million was driven by growth in revenue and industry trends regarding payer strategy for cost containment and contract management. The same factors contributed to the difference in net patient accounts receivable between June 30, 2014 and 2013 with amounts of $58.1 million and $52.9 million, respectively.

Days receivable outstanding illustrates an organization's ability to convert service revenue to cash. Days receivable outstanding as of June 30 for fiscal years 2015, 2014 and 2013 are illustrated in the graph below.



VMC's total net days receivable outstanding decreased 0.1 days from 46.4 days at June 30, 2014 to 46.3 days at June 30, 2015, and decreased 1.4 days from 47.8 days at June 30, 2013 to 46.4 days at June 30, 2014. The decreases between years was attributed primarily to the implementation of the new electronic health record system.

As of June 30, 2015 and 2014, 43% and 45% of the net patient accounts receivable balance is due from commercial payers, 51% and 48% is due from governmental payers Medicare and Medicaid, 4% and 6% from self-pay patients, and 2% and 1% is due from health exchange insured patients. As of June 30, 2013, 45% of net patient accounts receivable balance is due from commercial payers, 39% is due from governmental payers Medicare and Medicaid, and 16% from self-pay patients. On January 1, 2014, the Washington state Medicaid program was expanded which significantly increased the number of eligible Medicaid enrollees receiving benefits. Due to expansion of the Medicaid program, VMC has seen an increase in Medicaid gross patient accounts receivable and a decrease in self-pay gross accounts receivable at June 30, 2015, when compared to years prior to 2014.

Property tax receivable increased $1.0 million from $8.4 million at June 30, 2014 to $9.4 million at June 30, 2015 and is primarily reflective of a less pro-rationed property tax levy for calendar year 2015, as well as increased property values. In 2014, property tax receivable decreased $0.5 million as a result of a lower property tax levy calendar for 2013.

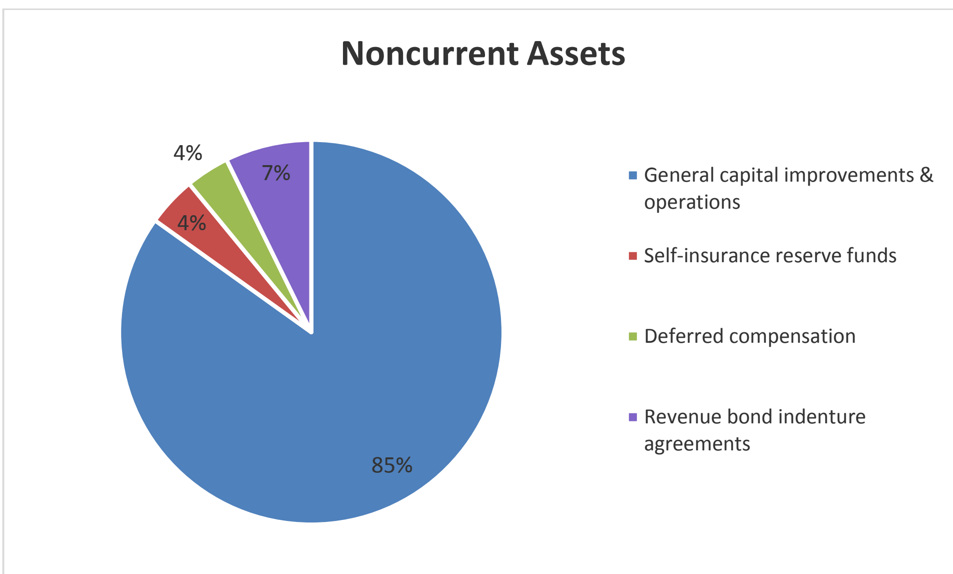
Noncurrent assets available for current obligations represents board designated and externally restricted funds expected to be used within one year for debt and interest obligations. Assets available for current obligations increased $26.6 million at June 30, 2014 to $26.3 million at June 30, 2015. The slight decrease in 2015 is a result of debt payments per the amortization schedule. Assets available for current obligations decreased $6.5 million in 2013 due to debt payments per the amortization schedule.

Noncurrent Assets

Capital assets decreased $18.2 million during fiscal year 2015 from $366.8 million at June 30, 2014 to $348.6 million at June 30, 2015, and decreased $19.4 million from $386.2 million at June 30, 2013 to $366.8 million at June 30, 2014.

Additional discussion regarding capital asset activity during the fiscal years can be found in the notes to the financial statements.

Noncurrent assets consist of board-designated and externally restricted assets held by VMC for general capital improvements and other operations, self-insurance reserves, and unearned compensation arrangements, and various revenue obligation bond agreements.



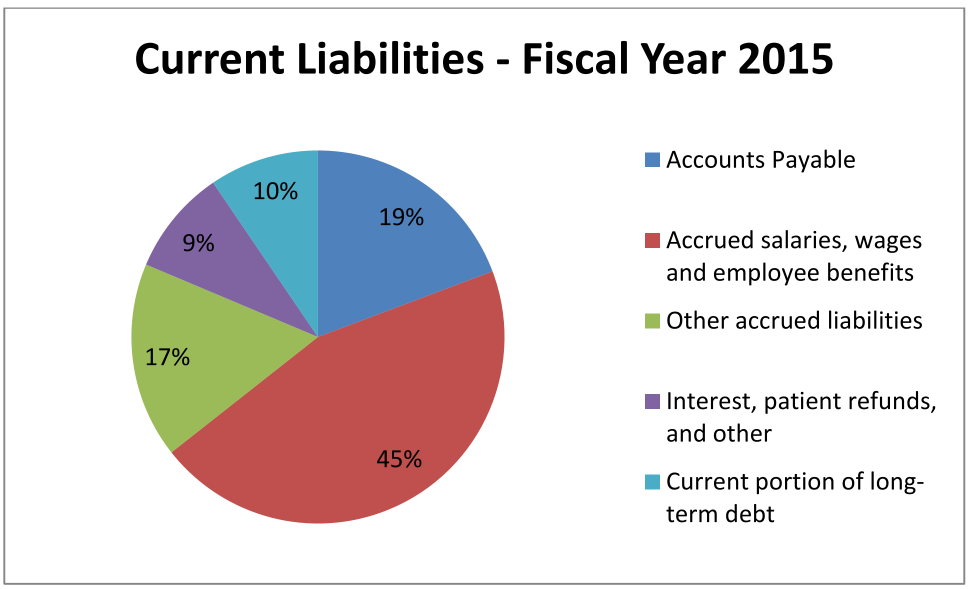
Total noncurrent assets increased from $75.1 million at June 30, 2014 to $103.1 million at June 30, 2015. The increase in 2015 is related to increased unrestricted assets and investments to be utilized for general capital improvements and operations. Total noncurrent assets increased $28.6 million between fiscal years 2013 and 2014 from $46.5 million to $75.1 million.

Long-term investments represent unrestricted and undesignated investments with greater than one year to maturity. Long-term investments increased $2.5 million from $18.4 million at June 30, 2014 to $20.9 million at June 30, 2015 and decreased $12.9 million from $31.3 million at June 30, 2013 to $18.4 million at June 30, 2014. The changes between years are primarily classification shifts between short and long-term investments.

Other noncurrent assets consist primarily of VMC's goodwill and intangible assets related to the acquisition of two physician practices and VMC's membership interest in First Choice Health Network. Other noncurrent assets decreased $0.5 million from $4.6 million at June 30, 2014 to $4.1 million at June 30, 2015 due primarily to amortization. The change between fiscal years 2013 and 2014 was due to the adoption of GASB 65, whereby the net position was restated at July 1, 2013, as a result of a retrospective write-off of debt issuance costs that were previously recorded as an asset for approximately $3.4 million.

Current Liabilities

Current liabilities consist of accounts payable and other accrued liabilities that are expected to be paid within a year. Total current liabilities were $86.1 million at June 30, 2015, compared to $74.4 million at June 30, 2014. Fiscal year 2015 composition of current liabilities is illustrated in the pie chart below.



Accounts payable increased $4.8 million between June 30, 2015 and June 30, 2014 from $11.8 million to $16.6 million and decreased $0.6 million from $12.4 million at June 30, 2013 to $11.8 million at June 30, 2014. Changes in accounts payable are primarily driven by timing of payments to vendors, as well as overall volume growth. Accounts payable include amounts accrued for capital related expenditures. Included in accounts payable as of June 30, 2015 and 2014 were amounts accrued for capital related expenditures of $1.1 million and $0.2 million, respectively.

Accrued salaries, wages and employee benefits increased $0.5 million from $38.3 million at June 30, 2014 to $38.8 million at June 30, 2015 and increased $3.0 million from $35.3 million at June 30, 2013 to $38.3 million at June 30, 2014. Changes in accrued salaries, wages and employee benefits are primarily 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 $7.0 million from 6.7 million at June 30, 2014 to $13.7 million at June 30, 2015 primarily due to estimated final Certified Public Expenditure CPE cost settlements for fiscal years 2011-2015, as well as a payable to the University of Washington. The increase in other accrued liabilities, including estimated third-party payer settlements was $0.2 million in fiscal year 2013.

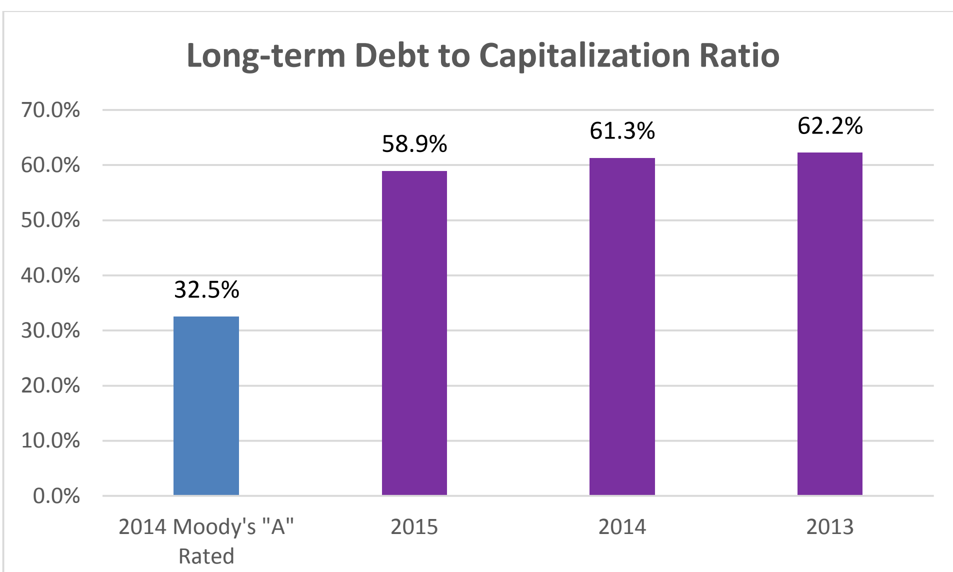
Other current liabilities consist of accrued interest relating to long-term debt, accrued taxes and retainage and accrued professional liability expense.

Noncurrent Liabilities

Noncurrent liabilities consist of long-term debt and other noncurrent liabilities. Total noncurrent liabilities were $311.8 million at June 30, 2015, compared to $319.4 million at June 30, 2014.

Long-term debt decreased from $315.6 million at June 30, 2014 to $307.7 million at June 30, 2015 and decreased $7.7 million from $323.3 million at June 30, 2013 to $315.6 million at June 30, 2014. Decreases in both years were a result of payments made in accordance with debt repayment schedules.

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 2015, 2014 and 2013 and comparison to the stand-alone hospital for Moody's A1 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 planned debt issues to fund several significant construction and information technology initiatives, including the 6th and 7th floor Emergency Services Tower expansion, the Covington Ambulatory Clinic, and the implementation of an electronic medical record system. Additional discussion regarding long-term debt activity during the fiscal years can be found in the notes to the financial statements.

Other noncurrent liabilities include unearned compensation arrangements with employees.

Deferred Inflow of Resources for Property Taxes

Deferred inflow of resources for property taxes increased $1.0 million from $8.6 million at June 30, 2014 to $9.6 million at June 30, 2015. Deferred inflow of resources for property taxes decreased $0.6 million at June 30, 2014 to $8.6 million compared to $8.0 million at June 30, 2013. The increase between June 30, 2014 and June 30, 2015 was due to a lower statutory pro-rationing impact on the District's actual tax levy for calendar year 2015 than in 2014.

Factors Affecting the Future

Strategic Collaborations

In 2015, UW Medicine, Skagit Regional Health and Cascade Valley Hospital and Clinics entered into a Clinical Affiliation Agreement intended to create a long-term and durable affiliation to integrate clinical programs to achieve the "Triple Aim" of better care for individuals, better health for populations and lower per capita costs.

In March 2014, UW Medicine and Capital Medical Center (Olympia, WA) signed an agreement selecting UW Medicine as the healthcare system of choice for complex tertiary and quaternary care for Capital Medical Center patients. This strategic collaboration, effective April 1, 2014 will provide Capital Medical Center patients prompt access to the highest level of care for advanced services while allowing the organizations to work together to continue improving the quality, safety and cost-effectiveness of care in the South Sound.

UW Medicine Accountable Care Network

In 2014, UW Medicine entered into a risk contract with a large local employer and also formed an accountable care network (ACN) with certain 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 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, 2015, VMC has recorded a liability of $925,000 for its portion of the estimated liability related to these risk-sharing arrangements which is reflected in payable to the University of Washington in the accompanying statements of net position.

(Continued)

Regulatory, Legislative, and Accounting Changes

The following regulatory and legislative activity will impact all entities in UW Medicine during fiscal year 2016 and beyond:

- ***International Classification of Diseases v10 (ICD-10)*** – Code of Federal Regulations (45 CFR Part 162) requires healthcare providers to implement ICD-10 no later than October 1, 2015. The implementation date has been delayed from October 1, 2014. ICD-10 represents a significant change in the standard healthcare coding system and will impact every system, process and transaction that contains or uses a diagnosis code or inpatient procedure code.

  UW Medicine has been undertaking activities related to the implementation of ICD-10 since the beginning of fiscal year 2012.

- ***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 in 2016.

- ***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 UW Medicine is examining performance to attain incentive dollars.

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, 2015 and 2014

	VMC		Component unit – IPV	
Assets	**2015**	**2014**	**2015**	**2014**
Current assets:				
Cash and cash equivalents	$ 25,904,764	36,110,782	1,272,511	1,139,702
Short-term investments	22,525,821	10,103,735	—	—
Accounts receivable, less allowance for uncollectible accounts	63,125,297	58,085,753	46,393	120,902
Property tax receivable	9,442,095	8,438,871	—	—
Due from:				
Primary government	—	—	932,942	541,942
Component unit	695,158	204,046	—	—
Noncurrent assets, required for current obligations	26,253,859	26,617,953	—	—
Supplies inventory	4,781,197	4,082,983	—	—
Prepaid expenses and other assets	6,359,450	5,716,209	39,276	43,067
Total current assets	159,087,641	149,360,332	2,291,122	1,845,613
Long-term investments	20,859,973	18,392,495	—	—
Other noncurrent assets:				
Unrestricted for general capital improvements and operations	111,974,300	86,310,653	—	—
Restricted for self-insurance reserve funds	5,873,073	4,230,744	—	—
Restricted under unearned compensation arrangements	4,111,144	3,748,959	—	—
Restricted under revenue bond indenture agreements	7,399,706	7,399,654	—	—
	129,358,223	101,690,010	—	—
Less amounts required for current obligations	(26,253,859)	(26,617,953)	—	—
Total other noncurrent assets	103,104,364	75,072,057	—	—
Capital assets:				
Land	13,413,733	13,299,497	—	—
Construction in progress	9,271,433	11,289,947	—	—
Depreciable capital assets, net of accumulated depreciation	325,861,024	342,240,606	1,419,760	2,284,253
Total capital assets	348,546,190	366,830,050	1,419,760	2,284,253
Goodwill, intangible assets and other	4,062,020	4,625,737	—	—
Total assets	$ 635,660,188	614,280,671	3,710,882	4,129,866

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, 2015 and 2014

	VMC		Component unit – IPV	
Liabilities and Net Position	**2015**	**2014**	**2015**	**2014**
Current liabilities:				
Accounts payable	$ 16,603,976	11,839,864	195,589	59,652
Accrued salaries, wages and benefits	38,848,283	38,294,347	22,892	21,622
Due to:				
Primary government	—	—	695,158	204,046
Component unit	932,942	541,942	—	—
Other accrued liabilities, including estimated third-party payor settlements	13,682,895	6,659,545	—	—
Interest, patient refunds and other	7,880,259	9,138,680	—	—
Current portion of long-term debt and capital lease obligations	8,185,000	7,968,374	290,848	470,966
Total current liabilities	86,133,355	74,442,752	1,204,487	756,286
Unearned compensation	4,111,144	3,748,959	—	—
Long-term debt and capital lease obligations, net of current portion	307,683,826	315,610,590	603,180	873,318
Total liabilities	397,928,325	393,802,301	1,807,667	1,629,604
Deferred inflow of resources for property taxes	9,624,694	8,585,293	—	—
Net position:				
Invested in capital assets net of related debt	32,643,761	43,155,954	525,732	939,969
Restricted:				
For debt service	7,399,706	7,399,654	—	—
Expendable for specific operating activities	611,854	413,843	—	—
Unrestricted	187,451,848	160,923,626	1,377,483	1,560,293
Total net position	228,107,169	211,893,077	1,903,215	2,500,262
Total liabilities, deferred inflows, and net position	$ 635,660,188	614,280,671	3,710,882	4,129,866

See accompanying notes to financial statements.

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

(A Component Unit of the University of Washington)

Statements of Revenue, Expenses, and Changes in Net Position

Years ended June 30, 2015 and 2014

	VMC		Component unit – IPV	
	2015	**2014**	**2015**	**2014**
Operating revenues:				
Net patient service revenue (net of provision for uncollectible accounts of $17,959,918 in 2015 and $22,365,806 in 2014)	$ 480,517,818	440,712,924	497,683	2,533,250
Other operating revenue	35,192,811	30,019,010	9,079,326	7,187,713
Total operating revenues	515,710,629	470,731,934	9,577,009	9,720,963
Operating expenses:				
Salaries and wages	234,262,208	209,411,491	190,329	190,184
Employee benefits	64,293,867	64,999,851	63,139	93,760
Purchased services	75,040,087	71,878,340	1,247,071	1,419,563
Supplies and other expenses	97,929,456	86,911,191	602,185	592,996
Depreciation	30,557,407	32,540,147	653,873	621,953
Total operating expenses	502,083,025	465,741,020	2,756,597	2,918,456
Operating income	13,627,604	4,990,914	6,820,412	6,802,507
Nonoperating income (expense):				
Property tax revenue	18,131,543	16,342,394	—	—
Interest income	3,778,753	3,165,356	—	—
Interest and amortization expense	(18,059,758)	(18,053,237)	(34,699)	(46,506)
Investment loss, net	(375,385)	(137,233)	—	—
Other, net	(888,665)	(273,179)	—	—
Members’ cash distributions	—	—	(7,382,760)	(6,642,357)
Net nonoperating income (expense)	2,586,488	1,044,101	(7,417,459)	(6,688,863)
Increase (decrease) in net position	16,214,092	6,035,015	(597,047)	113,644
Net position, beginning of year	211,893,077	205,858,062	2,500,262	2,386,618
Net position, end of year	$ 228,107,169	211,893,077	1,903,215	2,500,262

See accompanying notes to financial statements.

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

Statements of Cash Flows

Years ended June 30, 2015 and 2014

	VMC		Component unit – IPV	
	2015	**2014**	**2015**	**2014**
Cash flows from operating activities:				
Receipts from and on behalf of patients	$ 482,501,624	438,752,348	181,192	4,009,614
Payments to suppliers and contractors	(170,425,416)	(159,947,364)	(1,692,253)	(2,142,450)
Payments to employees	(297,639,954)	(271,168,838)	(252,198)	(285,124)
Other cash receipts	29,286,603	24,705,126	9,079,326	7,187,713
Net cash provided by operating activities	43,722,857	32,341,272	7,316,067	8,769,753
Cash flows from noncapital financing activities:				
Cash received from tax levy	18,167,720	16,494,215	—	—
Other	198,011	65,469	—	—
Net cash provided by noncapital financing activities	18,365,731	16,559,684	—	—
Cash flows from capital and related financing activities:				
Principal payments on long-term debt and capital lease obligations	(7,968,374)	(7,745,372)	(450,256)	(382,571)
Interest paid, net of amounts capitalized	(17,255,669)	(17,212,650)	(34,699)	(46,506)
Purchases of capital assets	(12,362,067)	(13,345,667)	—	(130,498)
Purchase of VM Oncology	—	(480,100)	—	—
Purchase of Southlake Cardiology Clinic	—	(960,000)	—	—
Purchase of Snow Building	(2,397,810)	—	—	—
Sale of Auburn property by VMC and capital assets by IPV	1,287,699	—	89,680	—
Other	140,927	57,922	—	—
Net cash used in capital and related financing activities	(38,555,294)	(39,685,867)	(395,275)	(559,575)
Cash flows from investing activities:				
Distributions from joint venture	5,415,096	6,530,079	—	—
Distribution to Valley Medical Center	—	—	(5,415,096)	(6,530,079)
Distribution to noncontrolling member of Imaging Partners at Valley, LLC	—	—	(1,372,887)	(1,648,425)
Sale of investments and noncurrent assets	33,558,763	46,384,117	—	—
Purchases of investments and noncurrent assets	(76,491,924)	(51,741,135)	—	—
Investment and interest income, net of amounts capitalized	3,778,753	3,165,356	—	—
Net cash (used in) provided by investing activities	(33,739,312)	4,338,417	(6,787,983)	(8,178,504)
Net (decrease) increase in cash and cash equivalents	(10,206,018)	13,553,506	132,809	31,674
Cash and cash equivalents, beginning of year	36,110,782	22,557,276	1,139,702	1,108,028
Cash and cash equivalents, end of year	$ 25,904,764	36,110,782	1,272,511	1,139,702

(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, 2015 and 2014

		VMC		Component unit – IPV	
		2015	**2014**	**2015**	**2014**
Reconciliation of operating income to net cash from operating activities:					
Operating income	$	13,627,604	4,990,914	6,820,412	6,802,507
Adjustments to reconcile operating income to net cash from operating activities:					
Depreciation		30,557,407	32,540,147	653,873	621,953
Provision for uncollectible accounts		17,959,918	22,365,806	(73,290)	7,133
Income recognized from joint venture		(5,906,208)	(5,313,884)	—	—
Amount expensed from purchase of Southlake Cardiology Clinic		—	185,000	—	—
Loss on sale of capital assets		—	—	120,940	—
Changes in assets and liabilities:					
Accounts receivable		(22,999,462)	(27,536,959)	147,799	174,184
Due from:					
Primary government		—	—	(391,000)	1,295,047
Supplies inventory		(698,214)	141,810	—	—
Prepaid expenses and other assets		(643,240)	1,230,273	3,791	12,580
Accounts payable		4,735,141	1,027,631	32,272	(133,186)
Accrued salaries, wages, and benefits		553,936	3,018,803	1,270	(1,180)
Due to:					
Component unit		391,000	(1,295,047)	—	—
Other accrued liabilities and estimated third-party payor settlements		7,023,350	3,210,577	—	—
Other liabilities		(1,240,560)	(2,447,500)	—	(9,285)
Unearned compensation		362,185	223,701	—	—
Net cash provided by operating activities	$	43,722,857	32,341,272	7,316,067	8,769,753
Supplemental disclosure of noncash investing, capital, and financing activities:					
Increase in capital assets included in accounts payable	$	28,971	242,135	—	—

See accompanying notes to 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.

On July 1, 2011, Public Hospital District No. 1 of King County, dba Valley Medical Center (VMC), and the University of Washington (the University) entered into a Strategic Alliance Agreement, whereby the governance of VMC was modified. VMC is managed as 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 2015 were:

Donna Russell, Chair
Gary Kohlwes, Vice Chair
Bernie Dochnahl
Carolyn Parnell (President of Board of Commissioners)
Julia Patterson
Johnese Spisso, R.N., M.P.A.
Mike Miller
Barbara Drennen (Commissioner)
Peter Evans
Paul Joos, M.D. (Commissioner)
Terry Block, M.D. (Commissioner – January 2015)
Lisa Jensen
Tamara Sleeter, M.D. (Commissioner)

VMC is under the direction of the Executive Director, 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 for the management of VMC.

The District, doing business as, 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 mission statement states that it "is committed to providing access to safe, quality healthcare for the public. The District healthcare system is integrated with UW Medicine and collaborates to ensure comprehensive, high quality, safe, compassionate, and cost-effective healthcare is provided."

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 (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. Financial accountability is defined as an appointment of the voting majority of the component unit's board, and either (a) the ability to impose will by the primary government, or (b) the possibility that the component unit will provide a financial benefit to or impose a financial burden on the primary government, or (c) the component unit is financially dependent on the primary government.

Component units are reported as part of the reporting entity under the blended or discrete method of presentation. Blending involves merging the component unit data with the primary government. There are two situations when blending is allowed: (1) when the board of the component unit is substantially the same as that of the primary government, and (2) when the component unit serves the primary government exclusively, or almost exclusively. VMC has no blended component units.

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

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 financial statements are prepared in accordance with accounting principles generally accepted in the United States of America using the accrual basis of accounting. VMC's financial statements and note disclosures are based on all applicable Government 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'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. generally accepted accounting principles, requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Significant estimates in VMC's financial statements include patient accounts receivable allowances, third-party payer settlements, liabilities related to self-insurance programs and the fair value of investments.

(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 state of Washington municipal corporation laws prescribed by the State Auditor under the authority of Chapter 43.09 RCW and the Department of Health in *Accounting and Reporting Manual for Hospitals*, as well as the Board of Commissioners' resolutions. Certain accounts maintained separately on the books of VMC have been combined for financial statements presentation.

Operating Account

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

Plant and Construction Accounts

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

Bond Account

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

Revenue Bond Account

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

2010 Refundable Credits Account

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

Restricted Accounts

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

(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. Cash and cash equivalents for the primary government were $25.9 million and $36.1 million at June 30, 2015 and 2014, respectively.

(Continued)

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, 2015, 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 WA Public Deposit Protection Commission. In 2014, VMC had bank balances of approximately $370,148 that were subject to custodial credit risk as they were neither insured nor collateralized.

(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 or money market funds with financial institutions in accordance with state guidelines. Investments are for the funding of future capital improvements, self-insurance reserves, and operational cash. In addition, certain funds are restricted by bond indentures to be used solely for debt service.

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 $2,500 or greater and a useful life of at least three years, are stated at cost at acquisition or if acquired by gift, at fair market 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

(Continued)

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
Leasehold improvements	The shorter of the lease tern or useful life

Equipment under capital lease is amortized on the straight-line method over the shorter of the lease term or the estimated useful life of the equipment. Such amortization is included in depreciation and amortization in the statements of revenues, expenses, and changes in net position.

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 2015 and 2014 was $301,909 and $451,332, 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 also has a membership interest, considered an other asset, in First Choice Health Network, a group purchasing cooperative.

(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. Forfeited balances are recognized at time of forfeiture.

Annual leave accrued at June 30, 2015 and 2014 was $14.6 million and $11.9 million, respectively. Sick leave accrued as of June 30, 2015 and 2014 was $4.3 million and $4.0 million, respectively.

(Continued)

(k) Payable to Contractual Agencies, 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 payable to contractual agencies, net 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 the primary government and component units to provide healthcare services to patients.

Nonoperating revenues and expenses are recorded for certain exchange and nonexchange transactions. These activities include tax levy income and debt service related to bonds and other peripheral or coincidental transactions.

(m) Net Patient Service Revenue

VMC has agreements with third-party payers that provide for payments to VMC at amounts different from its established rates. 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:

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. Third-party settlements are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined.

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.

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

UW Medicine Accountable Care Network

UW Medicine has entered into an agreement to provide healthcare services to nonunion employees of a corporation, in which VMC and the network members are at risk for reduction in payment levels from the contracted entity if certain financial benchmarks are not attained. This arrangement also provides an opportunity for shared savings between the members of the accountable care network. At June 30, 2015, VMC has recorded a liability estimate of $925,000 based on providing to care to these employees since January 1, 2015.

(n) Charity Care

VMC provides care without charge or at amounts less than established rates to patients who meet certain criteria under its charity care policy. VMC maintains records to identify and monitor the level of charity care it provides. These records include charges foregone for services and supplies furnished under its charity care policy to the uninsured and the underinsured. Because VMC does not pursue collection of amounts determined to qualify as charity care, they are not reported as net patient service revenue. The charges associated with charity care provided by VMC were approximately $8,671,895 and $22,740,801, respectively, for the years ended June 30, 2015 and 2014.

VMC estimates the cost of charity care using its cost to charge ratio of 27.1% and 30.1% for the fiscal years ended June 30, 2015 and 2014, respectively. Applying VMC's cost to charge ratio of 27.1% to total charity of $8,671,895 results in a cost of charity care of $2,350,084 for the fiscal year ended June 30, 2015. Applying VMC's cost to charge ratio of 30.1% to total charity of $22,740,801 results in a cost of charity care of $6,844,981 for the fiscal year ended June 30, 2014.

(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 IRS. During fiscal year 2013, because of what the District believed to be a clerical error, the District's 501(c)(3) was administratively revoked. The District received confirmation from the IRS in September 2014 that the District's 501(c)(3) status had been retroactively reinstated, and had been previously revoked in error.

VMC's discretely presented component unit is a limited liability company and, therefore, is not a tax-paying entity for federal income tax purposes. Accordingly, no current or deferred income tax expense has been recorded in the component unit's financial statements. Income of the component unit is taxed to the members on their individual tax returns, if applicable. The discretely presented component unit had no uncertain tax positions at June 30, 2015 and 2014.

(p) New Accounting Pronouncements

On July 1, 2013, VMC adopted GASB Statement No. 65 (GASB 65), "*Items Previously Reported as Assets and Liabilities*". This Statement establishes accounting and financial reporting standards that reclassify, as deferred outflows of resources or deferred inflows of resources, certain items that were previously reported as assets and liabilities and recognizes, as expenses or revenues, certain items that were previously reported as assets and liabilities. With the adoption of GASB 65, net position was restated at July 1, 2012, which resulted in a retrospective write-off of debt issuance costs that were previously recorded as an asset. The impact to the July 1, 2012 net position is reflected below (in thousands):

Net position at July 1, 2012, as previously reported	$	209,301,557
Adoption of GASB 65		(3,443,495)
Net position at July 1, 2012, as restated	$	205,858,062

VMC has an account that prior to the adoption of GASB No. 65 was presented as a liability that met the definition of a deferred inflow of resources. VMC's property taxes are levied on a calendar year, but VMC has a fiscal year-end of June 30. Therefore, six months of property tax revenue is considered a deferred inflow of resources for property taxes.

In June 2012, GASB issued Statement No. 68, "*Accounting and Financial Reporting for Pensions*," which is effective for the fiscal year beginning July 1, 2014. It requires governments providing defined benefit pensions to their employees to recognize the net pension liability for pension benefits on their statements of net position. Net position liability is measured as total pension liability, less the amount of the plan's fiduciary net position. Management evaluated the impact of this statement and determined that it is not applicable to the District as the District does not participate in the state pension plans.

In January 2013, GASB issued Statement No. 69, "*Government Combinations and Disposals of Government Operations*". This Statement requires disclosures to be made about government combinations and disposals of government operations in order to enable financial statement users to evaluate the nature and financial effects of those transactions. The requirements of this Statement are effective for financial reporting periods beginning in fiscal year 2015.

In February 2015 the GASB issued Statement No. 72 "Fair Value Measurement and Application", which will be effective for the fiscal year ending June 30, 2016. This Statement provides guidance for determining a fair value measurement for financial reporting purposes. This Statement also provides guidance for applying fair value to certain investments and disclosures related to all fair value measurements. This Statement establishes a three level hierarchy of inputs to valuation techniques used to measure fair value and requires disclosures to be made about fair value measurements, the level of fair value hierarchy, and valuation techniques. VMCis currently analyzing the impact of this statement.

In June 2015 the GASB issued Statement No. 76, "The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments", which is effective for the fiscal year ending June 30, 2016. The objective of this Statement is to identify the hierarchy of generally accepted accounting principles

(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 2015 and 2014, net patient service revenue includes approximately $4,044,636 and $1,313,544, 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 the years ended June 30, 2014 and 2013:

		VMC	
		2015	**2014**
Gross patient service revenue	$	1,550,749,311	1,402,386,880
Less adjustments to patient service revenue:			
Charity		(8,671,895)	(22,740,801)
Contractual discounts		(1,043,599,680)	(916,567,349)
Provision for uncollectible accounts		(17,959,918)	(22,365,806)
Total adjustments to patient service revenue		(1,070,231,493)	(961,673,956)
Net patient service revenue	$	480,517,818	440,712,924

	Component unit – IPV	
	2015	2014
Gross patient service revenue	$ 1,235,175	5,966,259
Less adjustments to patient service revenue:		
Charity	(4,866)	(19,566)
Contractual discounts	(805,916)	(3,406,310)
Provision for uncollectible accounts	73,290	(7,133)
Total adjustments to patient service revenue	(737,492)	(3,433,009)
Net patient service revenue	$ 497,683	2,533,250

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 charges from significant third-party payers at June 30, 2015 and 2014 was as follows:

	2015	
	VMC	
	Patient service charges	Accounts receivable
Medicare	34%	31%
Medicaid	24	20
Commercial and other	40	43
Self pay	1	4
Exchange (HIX)	1	2
Total	100%	100%

	2014	
	VMC	
	Patient service charges	Accounts receivable
Medicare	34%	28%
Medicaid	20	20
Commercial and other	42	45
Self pay	3	6
Exchange (HIX)	1	1
Total	100%	100%

(Continued)

(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. The payment method pays only the federal match portion of the allowable claims. VMC received $9,677,830 and $9,055,922 in claims payments under this program for the years ended June 30, 2015 and 2014, respectively.

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 $15,064,812 and $14,410,287 in DSH funding under this program for the years ended June 30, 2015 and 2014, respectively.

Since the inception of the program, the Washington State Legislature (the State) has provided through an annual budget provision, a "hold harmless" provision for hospitals participating in the CPE program. Through this provision, hospitals participating in the CPE program will receive no less in combined state and federal payments than they would have received under the previous payment methodology. In addition, the hold harmless provision ensures that participating hospitals receive DSH payments as specified in the legislation.

In the event of a shortfall between CPE program payments and the amount determined under the hold harmless provision, the difference is paid to the hospitals as a grant from state-only funds. VMC did not receive any state grants for the years ended June 30, 2015 or 2014. Claims payments and DSH payments are included in net patient service revenues 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 Year 2006 CPE program year has had a final settlement.

Interim state grant payments are retrospectively reconciled to "hold harmless" after actual claims are repriced using the applicable DRG payment methodology. Interim cost settlement is also performed after the Medicare and Medicaid cost report are filed. This process takes place approximately 12 months after the end of the fiscal year and results in either a payable to, or receivable from, the state Medicaid Program. Final settlement timelines are established by the State. VMC has estimated the expected final cost settlement amounts based on the difference between CPE DSH payments received and the estimated uncompensated care cost amount.

As of June 30, 2015 and 2014, for fiscal years 2006 through 2015 VMC had an estimated payable of $12.3 million and $6.2 million, respectively, which is included as a liability 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. CMS approved the PAP program in August 2014 for services on and after July 1, 2014.

Under the program, 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 recorded $244,148 and $265,785 for the years ended June 30, 2015 and 2014, respectively, in supplemental payments, via Intergovernmental Transfers (IGTs) to WSHCA related to professional claims paid in those fiscal years, which is 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 $712,912 and $593,425 in supplemental payments for the years ended June 30, 2015 and 2014, respectively. These payments are included in net patient service revenues in the statements of revenue, expenses, and changes in net position.

VMC recorded $624,378 for the year ended June 30, 2015 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 $742,239 in supplemental payments for the year ended June 30, 2015. These payments are included in net patient service revenue in the statements of revenue, 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 nonMedicare patient days. Under the original HSNA program, HSNA funds were used to prevent the significant budget cuts proposed during the 2009 session of the state legislature. The original legislation expired on June 30, 2013.

(Continued)

In its 2013 session, the Washington State legislature passed a new assessment program that was similar to the original program as they will use federal matching funds to increase Medicaid hospital payments. Under the new HSNA program, PPS hospitals receive supplemental Medicaid payments, Critical Access Hospitals receive disproportionate share payments and CPE hospitals receive state grants. The safety net assessment was subject to approval by the Center for Medicare and Medicaid Services before it took effect. CMS approved this program in 2015. The program has an expiration date of June 30, 2017.

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 $1.6 million for the years ended June 30, 2015 and 2014 respectively, and is recorded in other operating revenue in the statements of revenues, expenses, and changes in net position.

(d) Meaningful Use Incentives

The American Recovery and Reinvestment Act of 2009 (ARRA) established incentive payments to eligible professionals and hospitals participating in Medicare and Medicaid programs that adopt certified electronic health records (EHRs) but only if the technology is being used in a “meaningful” way that supports the ultimate goals of improving quality, safety, and efficiency of care. “Meaningful use” is defined with specific quality performance metrics for eligible healthcare professionals and hospitals and certain thresholds must be met and maintained to receive payment. Revenue recognition occurs when certain clinical measurements have been attested to.

VMC recorded meaningful use incentives of $3,050,943 and $1,130,797 for the years ended June 30, 2015 and 2014, respectively, which is included in other operating revenue in the statements of revenues, expenses, and changes in net position. These amounts are subject to future audits.

(4) Property Tax Revenues

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

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

The District is permitted by law to levy up to $0.75 per $1,000 assessed valuation for general district purposes. The Washington State Constitution and Washington State law, RCW 84.55.010, limit the rate. The District may also levy taxes at a lower rate. Greater amounts of tax, above the limit, need to be for a specific capital project and authorized by the vote of the people. In both late January 2015 and January 2014, the District received notification from the King County Assessor’s Office that the overall statutory aggregate limit (which is $5.90 per assessed $1,000 in property value) had been exceeded in certain District tax levy codes for the calendar years ended December 31, 2014 and 2013. Under Washington state statute, the Assessor's Office must recalculate the property tax levy rates when it is found the aggregate rate of certain senior and junior taxing districts within a given levy code area exceeds the $5.90 limit established by RCW 84.52.043. Any required rate recalculations are performed in a specific order specified within RCW 84.52.010(2). In summary, within these priorities, a hospital district receives the first $0.50 of its levy.

Consequently, as a result of this required rate recalculation, the District's tax levy rate was decreased from $0.51 per assessed $1,000 in property value pursuant to the District's authorized tax levy in November 2014, to $0.50 per assessed $1,000 in property value, resulting in a revised tax levy of $19,248,848. That is a reduction of $320,501, or 1.6%, from the original tax levy, in property tax revenues during calendar year 2015.

For calendar year 2014, due to the required rate recalculation, the District's tax levy rate was decreased from $0.54 per assessed $1,000 in property value pursuant to the District's authorized tax levy in November 2013, to $0.50 per assessed $1,000 in property value, resulting in a revised tax levy of $16,983,920. That is a reduction of $1,375,697, or 7.5%, from the original tax levy, in property tax revenues during calendar year 2014.

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 balance at June 30, 2015 and 2014 was $9,442,095 and $8,438,871, respectively, and is shown as a current asset on the statements of net position.

Revenues received from taxation was $18,131,543 and $16,342,394 at June 30, 2015 and 2014, for the fiscal 2015 and 2014 years, respectively, and is recorded as nonoperating revenue on 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 2004, 2008, 2010, and 2011 to finance construction, other capital improvements, medical equipment and technology, and information technology systems.

(Continued)

(5) Capital Assets

(a) VMC's Capital Assets

The activity in VMC's capital asset and related accumulated depreciation accounts for years ended June 30, 2015 and 2014 is set forth below:

	Balance June 30, 2014	Additions	Transfers	Retirements	Balance June 30, 2015
Nondepreciable capital assets:					
Land	$ 13,299,497	614,400	—	(500,164)	13,413,733
Construction in progress	11,289,947	11,939,027	(13,957,541)	—	9,271,433
Total capital assets, not being depreciated	24,589,444	12,553,427	(13,957,541)	(500,164)	22,685,166
Capital assets, being depreciated:					
Land improvements	18,698,859	—	—	(209,150)	18,489,709
Buildings, renovations and furnishings	416,426,137	1,783,410	8,070,656	(3,356,688)	422,923,515
Fixed equipment	24,720,016	—	13,567	(182,788)	24,550,795
Movable equipment	177,064,710	452,013	5,033,962	(1,792,468)	180,758,217
Minor equipment	14,487,710	—	839,356	(501,809)	14,825,257
Total capital assets, being depreciated	651,397,432	2,235,423	13,957,541	(6,042,903)	661,547,493
Total capital assets at historical cost	675,986,876	14,788,850	—	(6,543,067)	684,232,659
Less accumulated depreciation for:					
Land improvements	(10,877,116)	(344,076)	—	208,632	(11,012,560)
Buildings, renovations and furnishings	(148,779,679)	(12,977,732)	—	2,154,950	(159,602,461)
Fixed equipment	(21,371,469)	(496,737)	—	147,968	(21,720,238)
Movable equipment	(117,933,895)	(16,169,670)	—	1,665,230	(132,438,335)
Minor equipment	(10,194,667)	(959,888)	—	241,680	(10,912,875)
Total accumulated depreciation	(309,156,826)	(30,948,103)	—	4,418,460	(335,686,469)
Total capital assets, net	$ 366,830,050	(16,159,253)	—	(2,124,607)	348,546,190

		Balance June 30, 2013	Additions	Transfers	Retirements	Balance June 30, 2014
Nondepreciable capital assets:						
Land	$	13,299,497	—	—	—	13,299,497
Construction in progress		33,062,351	11,136,216	(32,908,620)	—	11,289,947
Total capital assets, not being depreciated		46,361,848	11,136,216	(32,908,620)	—	24,589,444
Capital assets, being depreciated:						
Land improvements		18,698,859	—	—	—	18,698,859
Buildings, renovations and furnishings		387,401,479	—	29,477,121	(452,463)	416,426,137
Fixed equipment		24,939,548	—	—	(219,532)	24,720,016
Movable equipment		172,943,570	2,518,788	2,951,653	(1,349,301)	177,064,710
Minor equipment		13,888,672	134,812	479,846	(15,620)	14,487,710
Total capital assets, being depreciated		617,872,128	2,653,600	32,908,620	(2,036,916)	651,397,432
Total capital assets at historical cost		664,233,976	13,789,816	—	(2,036,916)	675,986,876
Less accumulated depreciation for:						
Land improvements		(10,524,517)	(352,599)	—	—	(10,877,116)
Buildings, renovations and furnishings		(136,238,502)	(12,961,055)	—	419,878	(148,779,679)
Fixed equipment		(20,922,864)	(576,665)	—	128,060	(21,371,469)
Movable equipment		(101,376,412)	(17,831,040)	—	1,273,557	(117,933,895)
Minor equipment		(8,992,717)	(1,215,357)	—	13,407	(10,194,667)
Total accumulated depreciation		(278,055,012)	(32,936,716)	—	1,834,902	(309,156,826)
Total capital assets, net	$	386,178,964	(19,146,900)	—	(202,014)	366,830,050

Included in major movable equipment at June 30, 2015 and 2014 is $4,619,239 and $4,619,239, respectively, of equipment under capital lease. Accumulated amortization of the equipment under capital lease totaling $4,619,239 and $4,561,613 is included in accumulated depreciation at June 30, 2015 and 2014, respectively.

Depreciation expense was $30,948,103 and $32,936,716 as of June 30, 2015 and 2014, respectively, includes $390,696 and $396,569 of nonoperating depreciation expense. These assets are medical office buildings rented or leased to physician practices and others and, therefore, are not considered within the operations of VMC. Therefore, $30,557,407 and $32,540,147 in depreciation expense is reflected in operating expenses of the statements of revenues, expenses, and changes in net position as of June 30, 2015 and 2014, respectively.

(b) Discretely Presented Component Unit's Capital Assets

The activity in the component unit's capital asset accounts and the related accumulated depreciation accounts for the year ended June 30, 2015 is as follows:

	Balance June 30, 2014	Additions	Transfers	Retirements	Balance June 30, 2015
Nondepreciable capital assets:					
Land	$ —	—	—	—	—
Construction in progress	—	—	—	—	—
Total capital assets, not being depreciated	—	—	—	—	—
Capital assets, being depreciated:					
Land improvements	—	—	—	—	—
Buildings, renovations and furnishings	326,656	—	—	(56,306)	270,350
Fixed equipment	—	—	—	—	—
Movable equipment	7,828,611	—	—	(571,448)	7,257,163
Total capital assets, being depreciated	8,155,267	—	—	(627,754)	7,527,513
Total capital assets at historical cost	8,155,267	—	—	(627,754)	7,527,513

		Balance June 30, 2014	Additions	Transfers	Retirements	Balance June 30, 2015
Less accumulated depreciation for:						
Land improvements	$	—	—	—	—	—
Buildings, renovations and furnishings		(84,939)	(23,161)	—	47,132	(60,968)
Fixed equipment		—	—	—	—	—
Movable equipment		(5,786,075)	(633,040)	—	372,330	(6,046,785)
Total accumulated depreciation		(5,871,014)	(656,201)	—	419,462	(6,107,753)
Total capital assets, net	$	2,284,253	(656,201)	—	(208,292)	1,419,760

		Balance June 30, 2013	Additions	Transfers	Retirements	Balance June 30, 2014
Nondepreciable capital assets:						
Land	$	—	—	—	—	—
Construction in progress		—	—	—	—	—
Total capital assets, not being depreciated		—	—	—	—	—
Capital assets, being depreciated:						
Land improvements		—	—	—	—	—
Buildings, renovations and furnishings		227,055	99,601	—	—	326,656
Fixed equipment		—	—	—	—	—
Movable equipment		7,464,835	1,281,713	—	(917,937)	7,828,611
Total capital assets, being depreciated		7,691,890	1,381,314	—	(917,937)	8,155,267
Total capital assets at historical cost		7,691,890	1,381,314	—	(917,937)	8,155,267

(Continued)

	Balance June 30, 2013	Additions	Transfers	Retirements	Balance June 30, 2014
Less accumulated depreciation for:					
Land improvements	$ —	—	—	—	—
Buildings, renovations and furnishings	(62,599)	(22,340)	—	—	(84,939)
Fixed equipment	—	—	—	—	—
Movable equipment	(6,104,399)	(599,613)	—	917,937	(5,786,075)
Total accumulated depreciation	(6,166,998)	(621,953)	—	917,937	(5,871,014)
Total capital assets, net	$ 1,524,892	759,361	—	—	2,284,253

(6) 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 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, 2015 and 2014, deposits and investments of VMC consist of the following:

		2015	2014
Unrestricted cash and cash equivalents	$	8,711,791	24,756,693
Unrestricted investments:			
U.S. Treasury securities and bonds		152,230,146	114,046,290
U.S. government mutual funds		280,560	280,533
Investment pools		16,300,614	10,654,039
Municipal Bonds		550,968	—
Tax-exempt issues		2,578,980	760,593
		171,941,268	125,741,455
Restricted assets:			
Cash and cash equivalents		611,799	419,516
U.S. government mutual funds		13,272,779	11,630,398
Other assets		4,111,144	3,748,960
		17,995,722	15,798,874
	$	198,648,781	166,297,022

Interest income included in nonoperating revenue totaled approximately $3.8 million and $3.2 million for the years ended June 30, 2015 and 2014, respectively. Investment income includes realized and unrealized gains and losses. VMC realized net losses of approximately $(375) thousand and $(137) thousand for the years ended June 30, 2015 and 2014, respectively. VMC's net change in unrealized gains/(losses) on investments during the years ended June 30, 2015 and 2014 is approximately $(274) thousand and $(279) thousand, respectively.

Investments within the other assets category are related to the cash surrender value of life insurance and a 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 Statements No. 40, "*Deposit and Investment Risk Disclosures – an amendment of GASB Statements No. 3,*" unless there is information to the contrary, obligations of the U.S. government or obligations explicitly guaranteed by the U.S. government are not considered to have credit risk and do not require disclosure of credit quality.

As of June 30, 2015 and 2014, 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. VMC's share of the impaired investment pool principle was $169,762 at December 31, 2014 and VMC's fair value of these investments was $102,863 at December 31, 2014.

As of June 30, 2015 and 2014, all impaired commercial paper investments have completed enforcement events. The King County Impaired Investment Pool (Impaired Pool) held one commercial paper asset where the Impaired Pool accepted an exchange offer and is receiving the cash flows from the investment's underlying securities, and the residual investments in four commercial paper assets that were part of completed enforcement events where the Impaired Pool accepted the cash out option.

The composition of investments, reported at fair value by investment type and rating at June 30, 2015 and excluding cash balances of $9,323,590 is as follows:

Investment type		Fair value	Ratings	Percentage of totals
Money market mutual fund	$	1,815,401	AAA	1.0%
U.S. Treasury		70,482,182	Not rated	37.1
U.S. agency securities		48,943,262	AAA	25.9
U.S. agency mortgages		32,804,701	AAA	17.3
Tax-exempt issues		2,578,980	AAA	1.4
Municipal bonds		550,968	AAA	0.3
Mutual funds invested in U.S. government securities		11,737,939	AAA	6.2
King County investment pool		16,300,614	Not rated	8.6
Other assets		4,111,144	Not rated	2.2
Total	$	189,325,191		100.0%

The composition of investments, reported at fair value by investment type and rating at June 30, 2014 and excluding cash balances of $25,176,209, is as follows:

Investment type	Fair value	Ratings	Percentage of totals
Money market mutual fund	$ 1,317,751	AAA	0.9%
U.S. Treasury	56,346,682	Not rated	40.0
U.S. agency securities	27,435,578	AAA	19.4
U.S. agency mortgages	30,264,031	AAA	21.5
Tax-exempt issues	760,593	AAA	0.5
Mutual funds invested in U.S. government securities	10,593,179	AAA	7.5
King County investment pool	10,654,039	Not rated	7.5
Other assets	3,748,960	Not rated	2.7
Total	$ 141,120,813		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. As of June 30, 2015 and 2014, for those investments that require composition disclosure, VMC holds investments in U.S. government-sponsored entities totaling 11% and 15% of its total investments in Federal National Mortgage Association securities, 7% and 8% of its total investments in Federal Home Loan Mortgage Corporation securities, and 11% and 13%, respectively, of its total investments 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
Mutual funds consisting of only U.S. government bonds or U.S. guaranteed bonds	Average maturity < 4 years
Statutorily allowed certificates of deposit	24 months
Commercial paper	180 days
General obligation bonds of any state/local government	10 years

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 mutual funds and investment pools are shown using the weighted average duration of the underlying assets.

2015		Remaining maturity (in months)			
Investment type	**Fair value**	**12 months or less**	**13 to 24 months**	**25 to 48 months**	**More than 48 months**
Money market mutual fund	$ 1,815,401	1,815,401	—	—	—
U.S. Treasury	70,482,182	15,716,697	16,578,154	29,221,816	8,965,515
U.S. agency securities	48,943,262	5,576,300	13,423,289	21,213,135	8,730,538
U.S. agency mortgages	32,804,701	—	779,334	2,956,826	29,068,541
Tax-exempt issues	2,578,980	1,146,522	400,582	—	1,031,876
Mutual funds invested in U.S. government securities	11,737,939	—	—	11,737,939	—
King county investment pool	16,300,614	—	16,300,614	—	—
Municipal bonds	550,968	40,226	510,742	—	—
Other assets	4,111,144	—	—	—	4,111,144
	$ 189,325,191	24,295,146	47,992,715	65,129,716	51,907,614

2014		Remaining maturity (in months)			
Investment type	**Fair value**	**12 months or less**	**13 to 24 months**	**25 to 48 months**	**More than 48 months**
Money market mutual fund	$ 1,317,751	1,317,751	—	—	—
U.S. Treasury	56,346,682	8,768,202	17,377,685	24,828,600	5,372,195
U.S. agency securities	27,435,578	1,289,174	10,146,708	12,850,496	3,149,200
U.S. agency mortgages	30,264,031	46,360	298,161	2,285,757	27,633,753
Tax-exempt issues	760,593	—	760,593	—	—
Mutual funds invested in U.S. government securities	10,593,179	—	—	10,593,179	—
King county investment pool	10,654,039	—	10,654,039	—	—
Other assets	3,748,960	—	—	—	3,748,960
	$ 141,120,813	11,421,487	39,237,186	50,558,032	39,904,108

(7) Long-Term Debt and Capital Lease Obligations

(a) Primary Government's Long-Term Debt

Long-term debt, reported as a part of noncurrent liabilities, consists of the following as of June 30:

	2015	2014
Limited tax general obligation bonds:		
2011 term bond, 2.19%, due in June and December, in yearly amounts from $4,030,000 in fiscal year 2015 to $2,035,517 in fiscal year 2022, plus interest due semiannually, net of unamortized loss on refinance of $444,647	$ 21,311,765	25,214,861
2008 series A and B, 4.0% to 5.25%, due serially on December 1, in amounts from $1,165,000 in fiscal year 2015 to $17,365,000 in fiscal year 2038, plus interest due semiannually, net of unamortized premium of $259,607 and unamortized loss on refinancing of $2,397,360	212,312,247	213,587,277
2004 series, 3.75% to 4.25%, due serially on December 1, in amounts from $1,125,000 in fiscal year 2015 to $1,260,000 in fiscal year 2018, plus interest due semiannually, net of unamortized premiums of $5,199 and unamortized loss on refinance of $47,299	3,607,901	4,700,307
Revenue bonds:		
2010 series A, 3.00% to 5.125%, due serially in June, in amounts from $1,585,000 in 2015 to $2,395,000 in 2024, plus interest due semiannually, net of unamortized premium of $117, unamortized discount of $134,031, and unamortized loss on refinance of $264,172	17,481,913	18,858,144
Build America bonds:		
2010 series B, 7.90% to 8.00%, due serially in June, in amounts from $2,520,000 in 2025 to $5,485,000 in 2040, plus interest due semiannually	61,155,000	61,155,000
Bonds	315,868,826	323,515,589
Capital lease obligations, stated at present value of future minimum lease payments	—	63,375
Total long-term debt	315,868,826	323,578,964
Less current portion	(8,185,000)	(7,968,374)
Total long-term debt, net of current portion	$ 307,683,826	315,610,590

(Continued)

(i) Long-term Debt Overview

Series 2011 Bond Issue

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

The Series 2011 Term Bond was issued with fixed interest rates of 2.19%, and has eleven annual maturities of varying amounts between 2011 and 2021. The refunding resulted in a difference between the reacquisition price and the net carrying amount of the old debt of $444,647 and $571,551 for the years ended June 30, 2015 and 2014, respectively, which will be deferred and amortized over the life of the new bonds. The refunding resulted in an economic gain (difference between the present values of the old and new debt service payments) of $5,000,704.

The District has pledged tax revenues to secure the bonds.

Series 2010 Revenue Bond Issue

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

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

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

The Series 2010A consists of serial bonds of $16,255,000, which were issued with interest rates ranging from 3.00% to 5.00% at yields of 2.30% to 4.85%, maturing between 2012 and 2020, and an $8,890,000 5.125% term bond is due in 2024.

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

Under the BAB bonds, the District receives a direct cash subsidy payment from the United States Department of the Treasury equal to 35% of the interest payable on the Series 2010B Bonds as of each Interest Payment Date. For the years ended June 30, 2015 and 2014, the District received $1,581,734 and $1,583,441, respectively, in subsidy payments, which are recorded in other nonoperating revenues in the statements of revenues, expenses, and changes in net position.

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

Series 2008 Bond Issue

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

Series 2008A was for $113,315,000 and comprised $97,745,000 of 5.0%–5.25% term bonds maturing beginning with $14,730,000 maturing in 2023 to $59,725,000 5.0% bonds maturing in 2037. Within this subseries, $15,570,000 of this subseries was in 4.0%–5.0% serial bonds, which mature for eight consecutive years beginning in 2012. 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.

(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 including in VMC's budgets and making annual levies of taxes, within constitutional and statutory tax limitations provided by law upon on all property within the District subject to taxation, together with any other money legally available, to be sufficient to pay the principal and interest of the LTGO bonds.

Financing covenants associated with the District's revenue bonds require maintaining an amount within the Reserve Account 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.

Management is not aware of any violations with its debt covenants for the years ended June 30, 2015 and 2014.

(iii) Long-Term Debt Maturities

The following schedule shows debt service requirements for the next five years and thereafter, as of June 30, 2015, using the fixed interest rates, for both principal and interest:

	Principal	Interest	Total
2016	$ 8,185,000	17,292,025	25,477,025
2017	8,500,000	16,976,784	25,476,784
2018	8,810,000	16,659,555	25,469,555
2019	10,129,509	16,332,489	26,461,998
2020	7,735,188	16,008,112	23,743,300
2021–2025	46,901,715	74,516,462	121,418,177
2026–2030	67,400,000	58,425,314	125,825,314
2031–2035	86,865,000	36,430,625	123,295,625
2036–2040	74,365,000	10,056,419	84,421,419
Total payments	$ 318,891,412	262,697,785	581,589,197

(iv) Capital Leases

VMC acquired certain equipment under capital lease obligations. The imputed interest rate on the equipment under capital lease is 3.5%. These leases are collateralized by the related equipment. These leases had total future minimum lease payments of $64,491 and expired during fiscal year 2015. As of June 30, 2015, VMC does not have any outstanding capital leases.

(v) Change in Noncurrent Liabilities

Changes in noncurrent liabilities during the fiscal years ended June 30, 2015 and 2014 are summarized below:

	Balance June 30, 2014	Increases	Decreases	Balance June 30, 2015	Due within one year
Limited tax general obligation bonds:					
2011 series	$ 25,214,861	—	(3,903,096)	21,311,765	2,185,000
2008 series	213,587,277	—	(1,275,030)	212,312,247	3,175,000
2004 series	4,700,307	—	(1,092,406)	3,607,901	1,175,000
Revenue bonds:					
2010 Series A	18,858,144	—	(1,376,231)	17,481,913	1,650,000
Build America bonds:					
2010 Series B	61,155,000	—	—	61,155,000	—
Note payable	—			—	—
Capital lease obligations	63,375	—	(63,375)	—	—
Total long-term debt and capital lease obligations	323,578,964	—	(7,710,138)	315,868,826	8,185,000
Unearned compensation	3,748,959	362,185	—	4,111,144	—
Total noncurrent liabilities	$ 327,327,923	362,185	(7,710,138)	319,979,970	8,185,000

	Balance June 30, 2013	Increases	Decreases	Balance June 30, 2014	Due within one year
Limited tax general obligation bonds:					
2011 series	$ 29,616,666	—	(4,401,805)	25,214,861	4,030,000
2008 series	214,229,599	—	(642,322)	213,587,277	1,165,000
2004 series	5,723,799	—	(1,023,492)	4,700,307	1,124,999
Revenue bonds:					
2010 Series A	20,158,045	—	(1,299,901)	18,858,144	1,585,000
Build America bonds:					
2010 Series B	61,155,000	—	—	61,155,000	—
Note payable	480,100		(480,100)	—	—
Capital lease obligations	143,746	—	(80,371)	63,375	63,375
Total long-term debt and capital lease obligations	331,506,955	—	(7,927,991)	323,578,964	7,968,374
Unearned compensation	3,525,258	493,892	(270,191)	3,748,959	—
Total noncurrent liabilities	$ 335,032,213	493,892	(8,198,182)	327,327,923	7,968,374

(b) Discretely Presented Component Unit's Long-Term Debt and Capital Leases

The component unit has no outstanding long-term debt. The capital lease obligation as of June 30, 2015 and 2014 consists of an equipment lease with a present value of $894,048 and $1,344,284, with total monthly payments of $42,304, including imputed interest of 6.2%, maturing in 2015.

The schedule of changes in capital leases is as follows:

	Balance June 30, 2014	Increases	Decreases	Balance June 30, 2015	Due within one year
Capital lease obligations	$ 1,344,284	—	(450,256)	894,028	290,848

	Balance June 30, 2013	Increases	Decreases	Balance June 30, 2014	Due within one year
Capital lease obligations	$ 476,039	1,250,816	(382,571)	1,344,284	470,966

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

Fiscal year ending June 30:		June 30 2015
2016	$	311,518
2017		272,292
2018		272,292
2019		78,288
Total minimum lease payments		934,390
Less amount representing interest		(40,362)
Net		894,028
Less current portion		(290,848)
Present value of capital lease, net of current portion	$	603,180

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

(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. 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.

On December 17, 2010, VMC was served with a lawsuit, *Oliver Wuth, et al. v. Valley Medical Center, et al.*, filed in the State Superior Court of King County, Washington. The lawsuit alleges that VMC was negligent in the handling of a pre-natal genetic test order that allegedly resulted in the parents being given incorrect information. The matter was tried to a jury beginning on October 21, 2013. On December 10, 2013, the jury returned a verdict in the plaintiffs' favor in the amount of $50.0 million, with 50% liability apportioned to VMC and 50% of liability apportioned to co-defendant Laboratory Corporation of America. VMC filed post-judgment motions for a new trial, which were denied, and vigorously pursued an appeal of the judgment on multiple grounds. On May 22, 2015, VMC and the plaintiffs reached a settlement on this case that was less than the original judgment, and VMC has been subsequently dismissed as a party related to any further litigation. Insurance coverage (both primary and excess) were sufficient to cover the liability in this case.

Other than mentioned above, settlement amounts have not exceeded insurance coverage in the last three years.

(b) 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 $225,000 specific deductible and $122,000 aggregating specific deductible for 2015 and 2014. VMC has recorded an actuarially estimated liability for health claims that have been incurred but not reported of $2,353,192 and $3,179,714 as of June 30, 2015 and 2014, respectively. These liabilities are included in accrued salaries, wages, and employee benefits in the accompanying VMC statements of net position. The health benefit claims reserve at June 30, 2015 and 2014 is based on undiscounted calculations.

(c) Workers' Compensation

VMC is self-insured for workers' compensation claims. The self-insured retention under the workers' compensation program was $500,000 per claim in 2015 and 2014. Excess insurance coverage is purchased for risk above the per claim self-insured retention level. The accrued liabilities for the self-insured components of this plan include the unpaid portion of claims that have been reported and estimates for claims that have been incurred but not reported. VMC has recorded an actuarially determined estimated liability for workers' compensation claims of $4,587,490 and $3,691,567 at June 30, 2015 and 2014, respectively, which is included in accrued salaries, wages, and benefits in the accompanying VMC statements of net position. The workers' compensation reserve at June 30, 2015 and 2014 is based on undiscounted calculations.

(Continued)

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

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

Changes in the self-insurance reserve as it relates to the tail liability for professional liability insurance as of June 30, 2015 and 2014 are noted below:

Reserve at June 30, 2013	$	1,260,000
Incurred claims and changes in estimates		30,000
Claims payments		—
Reserve at June 30, 2014		1,290,000
Incurred claims and changes in estimates		30,000
Claims payments		—
Reserve at June 30, 2015	$	1,320,000

The self-insurance reserve is included in the interest, patient refunds and other line item on the statements of net position.

(9) Retirement Plans

VMC offers its employees two deferred compensation plans created in accordance with IRC Sections 403(b) and 457. The plans, available to all employees, permit them to defer a portion of their salary until future years. Employee contributions to the plans totaled $11,569,482 and $7,759,024 for the years ended June 30, 2015 and 2014, respectively. The deferred compensation is payable to employees upon termination, retirement, death, or unforeseen emergency.

VMC contributes a 5% employer contribution into the 403B plan for all employee groups with a 2% match on a 2% employer contribution, except for one collectively bargained group. That represented group receives a 6% employer contribution under the terms of an executed memorandum of understanding. The terms of VMC's 403B plan were incorporated into their respective collectively bargained agreements or executed memorandum of understanding.

Employer contributions into the 403B plan totaled $15,602,996 for the year ended June 30, 2015.

(Continued)

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 Statements 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 $3,737,000 and $992,589 was paid by VMC to divisions of the University for the years ended June 30, 2015 and 2014, respectively, for transactions primarily related to reference laboratory work, providing contracted nursing assistance with the Valley Nurse Line, management assistance within various departments. VMC received $477,000 in revenue from related parties.

(b) Intra-Governmental Transactions

VMC and its discretely presented component unit engage in a number of transactions with each other. These transactions are primarily for lease of medical office space and operational services.

Lease of Medical Office Space

The component unit has several lease agreements with VMC. Office space for three different locations is leased from VMC for approximately $788,532 and $930,789 for the years ended June 30, 2015 and 2014, respectively. The leases expire in June 2015, December 2019, and April 2020, respectively. The component unit has $1,695,000 in total outstanding minimum lease payments due to VMC.

Operational Services

During the years ended June 30, 2015 and 2014, IPV provided radiology services on behalf of VMC, which reimburses IPV for those services. Net patient service revenue for these services was approximately $5.9 million and $9.6 million, respectively. In April 2013, the contract between VMC and IPV was modified. VMC now bills for all IPV patients seen at the Olympic Building location. VMC pays IPV for services rendered, which is represented by the $5.9 million in other operating revenue for 2015.

(11) Commitments and Contingencies

(a) Operating Leases

VMC leases certain medical office space and equipment under operating lease arrangements with its discretely presented component unit and third parties. Similarly, the discretely presented component unit leases certain medical office space and equipment under operating leases with VMC and third parties. Total rental expense in the year ended June 30, 2015 was $7,024,395 and $788,532 for VMC and the discretely presented component unit, respectively. Total rental expense in the year ended June 30, 2014 was $7,714,879 and $630,732 for VMC and the discretely presented component unit, respectively.

The following schedule shows future minimum lease payments by fiscal year for VMC and the discretely presented component unit as of June 30, 2015:

		VMC	Component unit
2016	$	6,756,040	339,000
2017		6,278,354	339,000
2018		6,002,420	339,000
2019		5,219,465	339,000
2020		4,346,299	339,000
Thereafter		11,287,925	—
Total minimum lease payments	$	39,890,503	1,695,000

(b) Construction Commitments

VMC has current commitments at June 30, 2015 of $9.5 million related to various construction projects, equipment purchases and information technology implementations. VMC intends to use capital funds for these commitments.

(c) 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.

(d) 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.

(e) Collective Bargaining Agreements

VMC has a total of approximately 2,795 employees. Of this total, approximately 71% and 72% are covered collective bargaining agreements as of June 30, 2015 and 2014, respectively. Nurses are represented by SEIU 1199 and other healthcare and support workers are represented by OPEIU, UFCW, and IUOE Operating Engineers. The collective bargaining agreements with SEIU 1199 expired on June 30, 2015. OPEIU, UFCW, and IUOW Operating Engineers expire on June 30, 2017; March 31, 2017 and October 31, 2016, respectively.

(12) Subsequent Event

The collective bargaining agreement with SEIU 1199 expired on June 30, 2015. VMC's management and SEIU continue to negotiate the terms of a new agreement, and during the interim time period, SEIU members continue to work under the terms of the expired agreement.

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 Net Position

June 30, 2015

Assets	VMC	Component unit-IPV	Eliminations	Aggregated
Current assets:				
Cash and cash equivalents	$ 25,904,764	1,272,511	—	27,177,275
Short-term investments	22,525,821	—	—	22,525,821
Accounts receivable, less allowance for uncollectible accounts	63,125,297	46,393	—	63,171,690
Property tax receivable	9,442,095	—	—	9,442,095
Due from:				
Primary government	—	932,942	(932,942)	—
Component unit	695,158	—	(695,158)	—
Noncurrent assets, required for current obligations	26,253,859	—	—	26,253,859
Supplies inventory	4,781,197	—	—	4,781,197
Prepaid expenses and other assets	6,359,450	39,276	—	6,398,726
Total current assets	159,087,641	2,291,122	(1,628,100)	159,750,663
Long-term investments	20,859,973	—	—	20,859,973
Other noncurrent assets:				
Unrestricted for general capital improvements and operations	111,974,300	—	—	111,974,300
Restricted for self-insurance reserve funds	5,873,073	—	—	5,873,073
Restricted under unearned compensation arrangements	4,111,144	—	—	4,111,144
Restricted under revenue bond indenture agreements	7,399,706	—	—	7,399,706
	129,358,223	—	—	129,358,223
Less amounts required for current obligations	(26,253,859)	—	—	(26,253,859)
Total other noncurrent assets	103,104,364	—	—	103,104,364
Capital assets:				
Land	13,413,733	—	—	13,413,733
Construction in progress	9,271,433	—	—	9,271,433
Depreciable capital assets, net of accumulated depreciation	325,861,024	1,419,760		327,280,784
Total capital assets	348,546,190	1,419,760	—	349,965,950
Goodwill, intangible assets and other	4,062,020	—	—	4,062,020
Total assets	$ 635,660,188	3,710,882	(1,628,100)	637,742,970

(Continued)

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

Supplementary Information

Aggregating Statements of Net Position

June 30, 2015

Liabilities and Net Position		VMC	Component unit-IPV	Eliminations	Aggregated
Current liabilities:					
Accounts payable	$	16,603,976	195,589	—	16,799,565
Accrued salaries, wages and benefits		38,848,283	22,892	—	38,871,175
Due to:					
Primary government		—	695,158	(695,158)	—
Component unit		932,942	—	(932,942)	—
Other accrued liabilities, including estimated third-party payor settlements		13,682,895	—	—	13,682,895
Interest, patient refunds and other		7,880,259	—	—	7,880,259
Current portion of long-term debt and capital lease obligations		8,185,000	290,848	—	8,475,848
Total current liabilities		86,133,355	1,204,487	(1,628,100)	85,709,742
Unearned compensation		4,111,144	—	—	4,111,144
Long-term debt and capital lease obligations, net of current portion		307,683,826	603,180	—	308,287,006
Total liabilities		397,928,325	1,807,667	(1,628,100)	398,107,892
Deferred inflow of resources for property taxes		9,624,694	—	—	9,624,694
Net position:					
Invested in capital assets net of related debt		32,643,761	525,732	—	33,169,493
Restricted:					
For debt service		7,399,706	—	—	7,399,706
Expendable for specific operating activities		611,854	—	—	611,854
Unrestricted		187,451,848	1,377,483	—	188,829,331
Total net position		228,107,169	1,903,215	—	230,010,384
Total liabilities, deferred inflows, and net position	$	635,660,188	3,710,882	(1,628,100)	637,742,970

See accompanying notes to financial statements.

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

Supplementary Information

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

Year ended June 30, 2015

	VMC	Component unit-IPV	Eliminations	Aggregated
Operating revenues:				
Net patient service revenue (net of provision for uncollectible accounts of $17,959,918 for VMC)	$ 480,517,818	497,683	—	481,015,501
Other operating revenue	35,192,811	9,079,326	(6,755,800)	37,516,337
Total operating revenues	515,710,629	9,577,009	(6,755,800)	518,531,838
Operating expenses:				
Salaries and wages	234,262,208	190,329	—	234,452,537
Employee benefits	64,293,867	63,139	—	64,357,006
Purchased services	75,040,087	1,247,071	(9,189,641)	67,097,517
Supplies and other expenses	97,929,456	602,185	—	98,531,641
Depreciation	30,557,407	653,873	—	31,211,280
Total operating expenses	502,083,025	2,756,597	(9,189,641)	495,649,981
Operating income	13,627,604	6,820,412	2,433,841	22,881,857
Nonoperating income (expense):				
Property tax revenue	18,131,543	—	—	18,131,543
Interest income	3,778,753	—	—	3,778,753
Interest and amortization expense	(18,059,758)	(34,699)	—	(18,094,457)
Investment loss	(375,385)	—	—	(375,385)
Other, net	(888,665)	—	—	(888,665)
Members' cash distributions	—	(7,382,760)	(2,433,841)	(9,816,601)
Net nonoperating income (expense)	2,586,488	(7,417,459)	(2,433,841)	(7,264,812)
Increase (decrease) in net position	16,214,092	(597,047)	—	15,617,045
Net position, beginning of year	211,893,077	2,500,262	—	214,393,339
Net position, end of year	$ 228,107,169	1,903,215	—	230,010,384

See accompanying notes to financial statements.