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, 2016 and 2015

(With Independent Auditors' Report Thereon)

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

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KPMG LLP
Suite 2900
1918 Eighth Avenue
Seattle, WA 98101

Independent Auditors' Report

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

We have audited the accompanying financial statements of the business-type activities and the discretely presented component unit of Public Hospital District No. 1 of King County, Washington dba Valley Medical Center (the Medical Center), as of and for the years ended June 30, 2016 and 2015, and the related notes to the financial statements, which collectively comprise the Medical Center's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

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

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

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

Opinions

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the the business-type activities and the discretely presented component unit of Public Hospital District No. 1 of King County, Washington dba Valley Medical Center, as of June 30, 2016 and 2015, and the respective changes in financial position and cash flows thereof for the years then ended in accordance with U.S. generally accepted accounting principles.

Other Matters

Required Supplementary Information

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

Supplementary Information

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

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

KPMG LLP

Seattle, Washington
September 30, 2016

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

Management's Discussion and Analysis

June 30, 2016 and 2015

(Unaudited)

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, 2016, 2015 and 2014. 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 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 report all of the revenues and expenses during the time period indicated. Net position, the difference between the sum of assets and the sum of liabilities and deferred inflows and outflows — is one way to measure the financial health of VMC and whether the organization has been able to recover all its costs through net patient service revenues and other revenue sources.

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

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

Results of Operations for Fiscal Year 2016

VMC recorded $5.8 million in net operating income for fiscal year 2016; this is a decrease of $7.9 million from the net operating income from operations of $13.6 million in 2015. VMC improved its net position by $11.5 million to $239.6 million from $228.1 million. The decrease in net operating income primarily relates to lower reimbursement from payers; Medicaid expansion; higher pharmaceutical costs; and higher premium wages due to growth in both inpatient and outpatient volumes, including outpatient surgeries, ambulatory outpatient hospital visits, and primary, urgent, and specialty care visits.

	2016	2015	2014
		(In thousands)	
Total operating revenues	$ 556,819	515,711	470,732
Total operating expenses	551,065	502,083	465,741
Operating income	5,754	13,628	4,991
Property tax revenue	19,902	18,131	16,342
Interest income	4,290	3,779	3,165
Interest and amortization expense	(17,698)	(18,060)	(18,053)
Investment income (loss)	377	(375)	(137)
Other, net	(1,134)	(889)	(273)
Nonoperating income	5,737	2,586	1,044
Increase in net position	11,491	16,214	6,035
Net position, beginning of year	228,107	211,893	205,858
Net position, end of year	$ 239,598	228,107	211,893

- In January 2014, the Washington state Medicaid program was expanded which significantly increased the number of Medicaid enrollees receiving benefits. Fiscal year 2016 was the second 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.
- Outpatient surgery cases increased nearly 9% over prior year, and emergency visits increased approximately 2%.
- 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 and subspecialties.
- 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.

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- New retirement and health benefit plans were implemented for the full year of fiscal 2016 for all employee groups. While overall benefit expense increased, the changes in benefit plans resulted in reductions in overall medical benefits as a percentage of salaries and wages between fiscal 2016 and 2015.

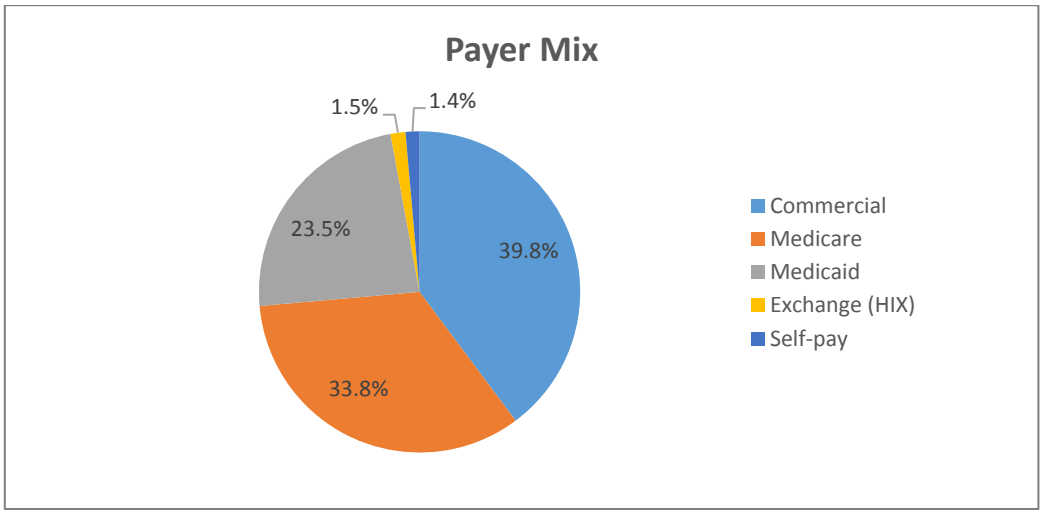
The chart below represents the key performance statistics for the last three years.

	2016	2015	2014
Available beds	283	283	270
Discharges	17,518	17,174	16,693
Patient days	70,148	65,792	61,395
Average length of stay	4.00	3.83	3.70
Occupancy	68%	64%	62%
Case mix index (CMI)	1.48	1.45	1.40
Surgery cases	12,665	12,006	11,270
Emergency room visits	83,067	81,250	73,763
Primary care clinic visits	185,154	177,612	154,546
Specialty/Urgent care clinic visits	314,660	294,168	248,623
Full time equivalents (FTEs)	2,813	2,599	2,421
Births	3,809	3,776	3,935

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



VMC's payer mix is a key factor in the overall financial operating results. The chart above illustrates payer mix for 2016. For the years ended June 30, 2016, 2015, and 2014, Medicaid revenue represented 24%, 24%, and 20%, 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.

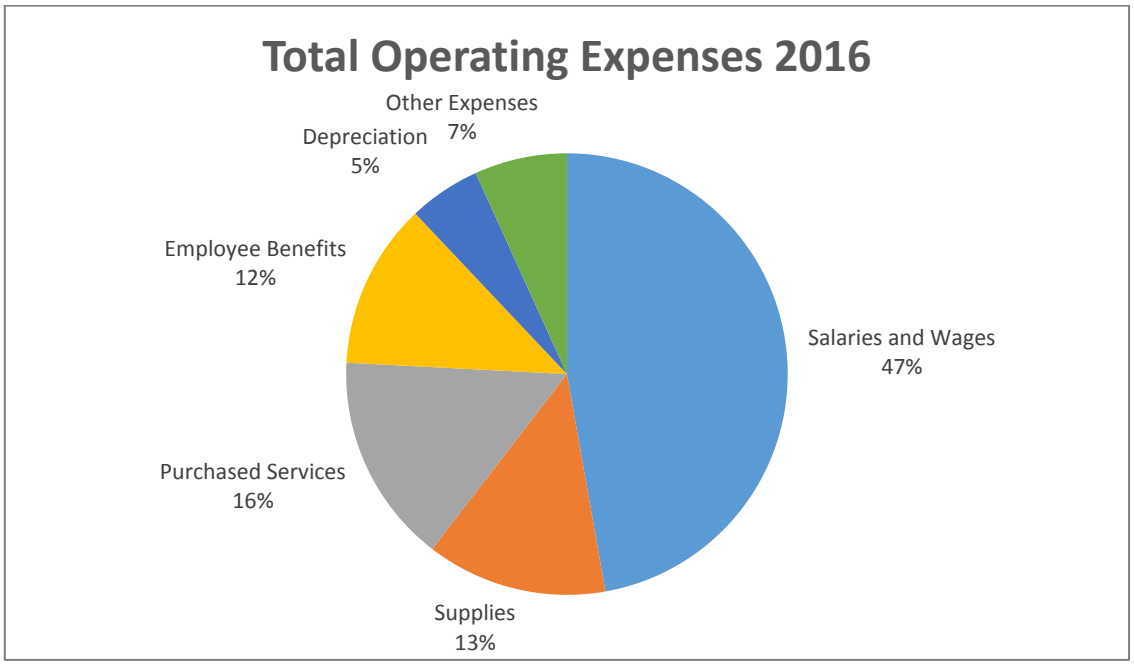
Reimbursement from governmental payers is generally below commercial rates and reimbursement rules are complex and subject to both interpretation and settlements. With the expansion of Medicaid, VMC will have higher government revenues which are subject to settlements.

For the years ended June 30, 2016, 2015, and 2014, VMC's total operating revenues were $556.8 million, $515.7 million, and $470.7 million composed of $519.8 million, $480.5 million, and $440.7 million in net patient service revenues and $37.0 million, $35.2 million, and $30.0 million in other operating revenue, respectively.

In 2016 and 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.

Total Operating Expenses

Total operating expenses were $551.1 million for the year ended June 30, 2016 compared to $502.1 million for the year ended June 30, 2015. The composition of fiscal year 2016 operating expenses is illustrated in the pie chart below.



Salaries and wages increased $25.9 million from $234.3 million in fiscal year 2015 to $260.1 million in fiscal year 2016. The increase was primarily related to contractually agreed upon wage increases; continued addition of providers in the clinic network's services in primary, urgent and specialty care, and growth in certain hospital inpatient and outpatient departments.

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 was 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.

Employee benefits increased $2.6 million from $64.3 million in fiscal year 2015 to $66.9 million in fiscal year 2016 and decreased $0.7 million from $65.0 million in fiscal year 2014 to $64.3 million in fiscal year 2015. Employee benefit costs are a function of employment. In fiscal year 2016, benefits increased by 4%, while salaries and wages increased by 11%. The lower benefits increase was related to the full year's impact of healthcare benefits restructure for all employee groups, as well as the restructure of retirement benefits and modification to the current 403(b) retirement plan.

Purchased services expense, which consists of professional and consulting fees, increased $9.7 million from $75.0 million in fiscal year 2015 to $84.7 million in fiscal year 2016 and increased $3.1 million from $71.9 million in fiscal year 2014 to $75.0 million in fiscal year 2015. The increase between fiscal year 2015 and 2016 is attributed to additional physician fees and contracted services agreements from growth in volumes. The increase between fiscal year 2014 and 2015 is attributed to additional consulting fees.

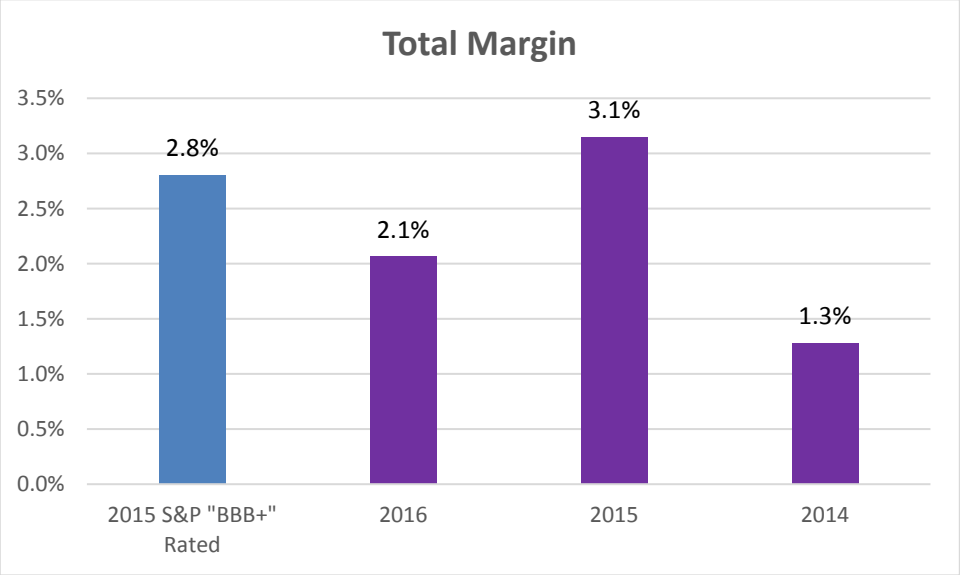
Supplies and other expense include medical and surgical supplies, pharmaceutical supplies, insurance, taxes, and other expenses. In total, these expenses increased $12.4 million from $97.9 million in fiscal year 2015 to $110.3 million in fiscal year 2016. Much of the increase is due to increases in supplies, which correlate to increased volumes, particularly surgery volumes. Medical and pharmaceutical expense increased as a result of price inflation. In 2015, supplies and other expense increased $11.0 million from $86.9 million to $97.9 million as medical supplies expense increased as a result of increased volumes, price inflation and the opening of several new outpatient pharmacies caused pharmaceutical expense to also increase.

Depreciation expense decreased $1.6 million from $30.6 million in fiscal year 2015 to $29.0 million in fiscal year 2016 and decreased $1.9 million from $32.5 million in fiscal year 2014 to $30.6 million in fiscal year 2015 due to longer-lived assets becoming fully depreciated.

Nonoperating revenue consists of revenue from property taxes, interest and investment income offset by interest and amortization expense and other activities not directly related to patient care. Net nonoperating revenue increased $3.1 million between fiscal years 2016 and 2015, primarily due to the increase in revenue from taxation (as the pro-rationed amount of the tax levy was less than in fiscal year 2015) and an increase in interest income. Net nonoperating revenue increased $1.6 million between fiscal years 2015 and 2014 due to an increase in tax revenue.

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 2016, 2015 and 2014 compared to the industry median for S&P's BBB+ rated stand-alone hospitals is illustrated in the bar chart below.



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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 as of June 30, 2016, 2015 and 2014.

	2016	2015	2014
		(In thousands)	
Current assets	$ 187,957	159,088	149,360
Noncurrent assets:			
Capital assets, net	348,083	348,546	366,830
Noncurrent assets	117,904	103,104	75,072
Long-term investments	12,596	20,860	18,393
Other	3,531	4,062	4,626
Total assets	670,071	635,660	614,281
Current liabilities	100,842	86,133	74,443
Noncurrent liabilities	302,887	311,795	319,360
Total liabilities	403,729	397,928	393,803
Total deferred inflows	26,744	9,625	8,585
Net position	$ 239,598	228,107	211,893

Total assets were $670.1 million at June 30, 2016 compared to $635.7 million at June 30, 2015, an increase of $34.4 million, and $614.3 million at June 30, 2014, an increase of $21.4 million between 2014 and 2015. The majority of the change between years is attributed to an increase in investment balances held for general capital improvements and operations. The $18.5 million proceeds from the sale of a medical office building in 2016 also attributed to the increase from 2015 to 2016.

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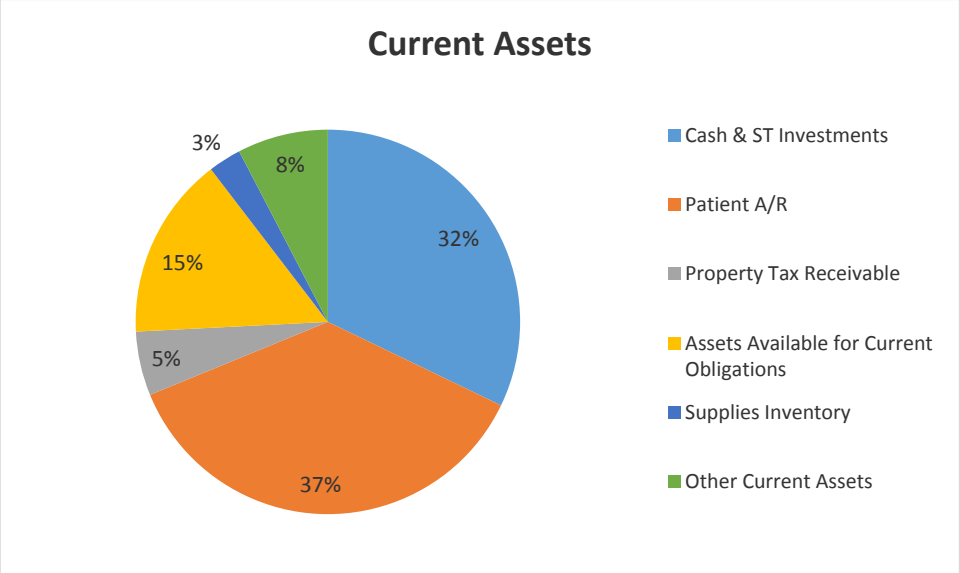
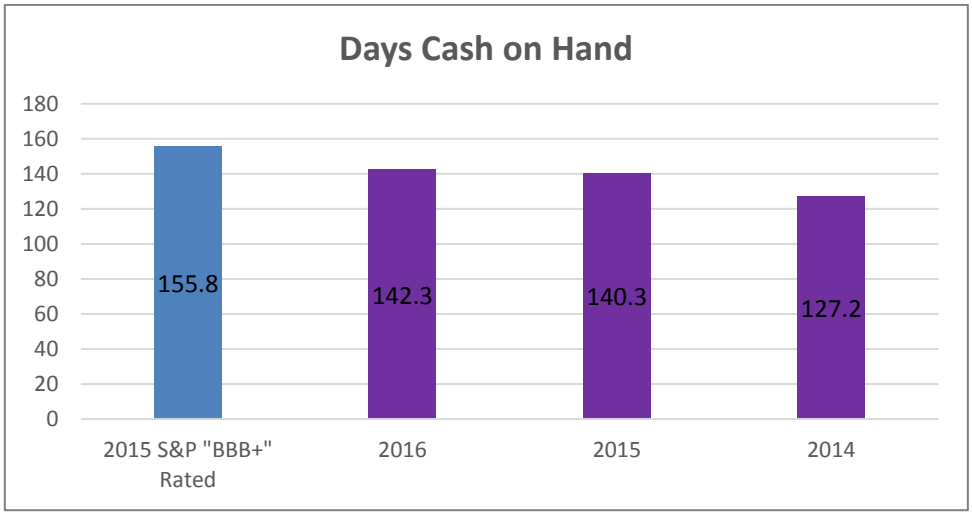
Current Assets

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 $188.0 million at fiscal year-end 2016, compared to $159.1 million at year-end 2015. Fiscal year 2016 composition of current assets is illustrated in the pie chart below.



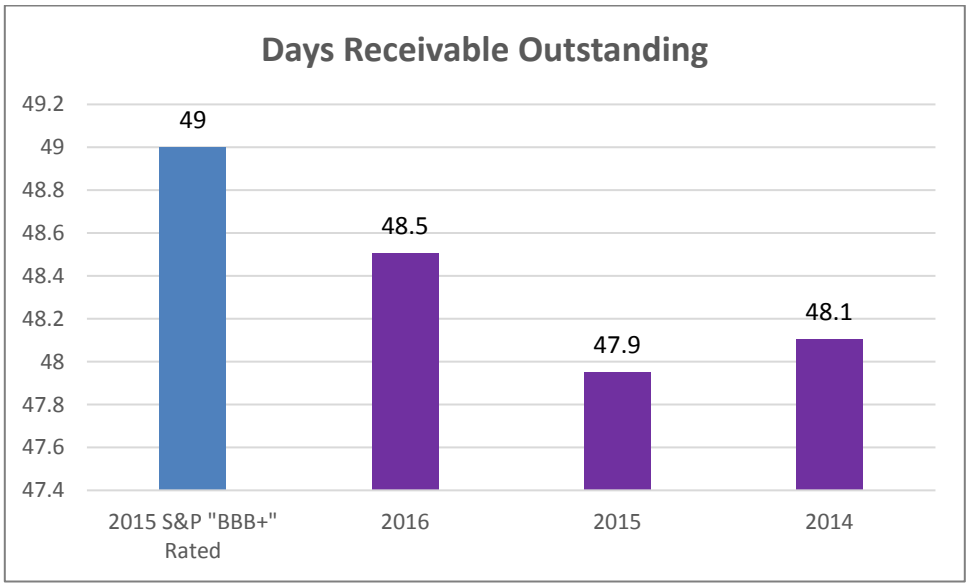
Cash and short-term investments held by VMC consist of cash, cash equivalents and investments expected to mature in 12 months or less. Cash and short-term investments increased $12.0 million in 2016 from $48.4 million at June 30, 2015 to $60.4 million at June 30, 2016. The increase in 2016 was attributed to tax collections not being moved into long term investments. Cash and short-term investments increased $2.2 million from $46.2 million at June 30, 2014 to $48.4 million at June 30, 2015. 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 2016, 2015 and 2014 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 2 days from 140.3 days at June 30, 2015 to 142.3 days at June 30, 2016 and increased 13 days from 127.2 days at June 30, 2014 to 140.3 days at June 30, 2015. The increases in both years were primarily due to less capital spending and overall positive financial performance.

Net patient accounts receivable was $68.9 million as of June 30, 2016, compared to $63.1 million at June 30, 2015. The increase of $5.8 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, 2015 and 2014 with amounts of $63.1 million and $58.1 million, respectively.

Days receivable outstanding illustrates an organization's ability to convert patient service revenue to cash. Days receivable outstanding as of June 30 for fiscal years 2016, 2015 and 2014 are illustrated in the graph below.



VMC's total net days receivable outstanding increased 0.6 days from 47.9 days at June 30, 2015 to 48.5 days at June 30, 2016, and decreased 0.2 days from 48.1 days at June 30, 2014 to 47.9 days at June 30, 2015. The increase from 2015 to 2016 was primarily due to ICD10 conversion. The decrease from 2014 to 2015 was attributed primarily to the implementation of a new electronic health record system.

As of June 30, 2016 and 2015, 41% and 43% of the patient accounts receivable balance is due from commercial payers, 53% and 51% is due from governmental payers Medicare and Medicaid, 4% and 4% from self-pay patients, and 2% and 2% is due from health exchange insured patients. As of June 30, 2014, 45% of patient accounts receivable balance is due from commercial payers, 48% is due from governmental payers Medicare and Medicaid, and 6% 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, 2016, when compared to years prior to 2015.

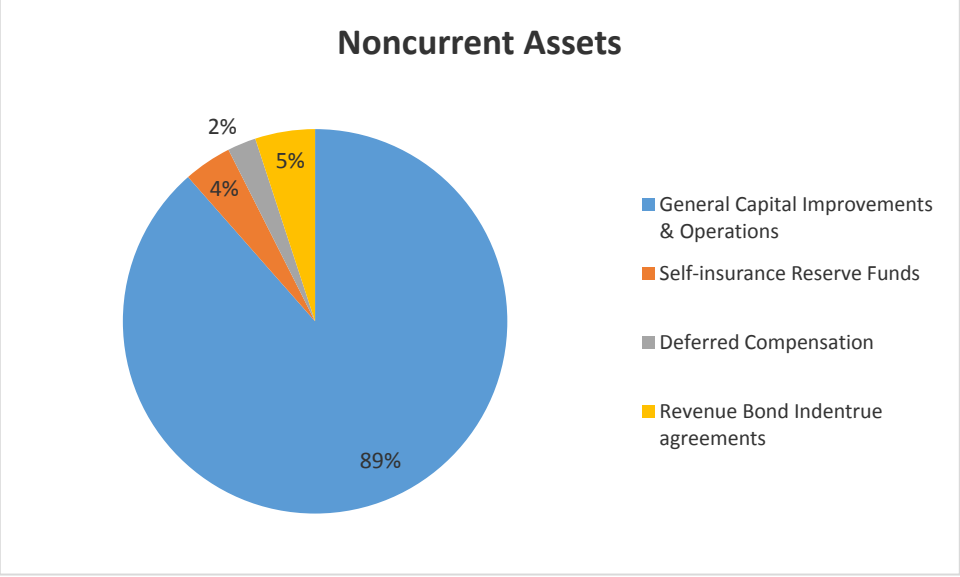
Property tax receivable increased $0.7 million from $9.4 million at June 30, 2015 to $10.1 million at June 30, 2016 and is primarily reflective of a less pro-rationed property tax levy for calendar year 2016, as well as increased property values. In 2015, property tax receivable increased $1.0 million for the same reasons.

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 from $26.3 million at June 30, 2015 to $28.9 million at June 30, 2016. The $2.6 million increase in 2016 is a result of higher accrued Construction-in-Progress. Assets available for current obligations increased $0.3 million in 2015 due to debt payments per the amortization schedule.

Noncurrent Assets

Long-term investments represent unrestricted and undesignated investments with greater than one year to maturity. Long-term investments decreased $8.3 million from $20.9 million at June 30, 2015 to $12.6 million at June 30, 2016 and increased $2.5 million from $18.4 million at June 30, 2014 to $20.9 million at June 30, 2015. The changes between years are primarily classification shifts between short and long-term investments.

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.



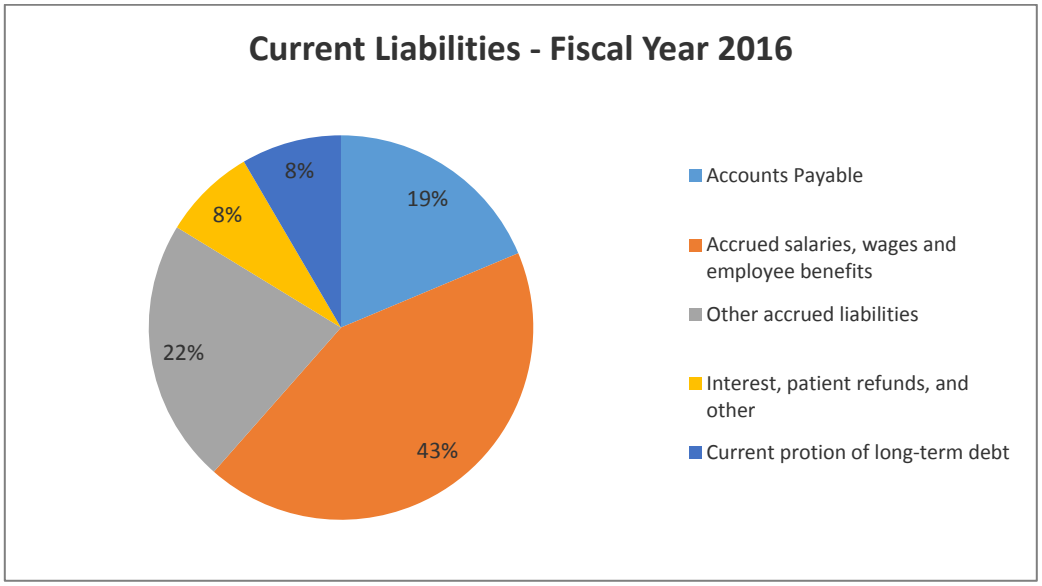
Total noncurrent assets increased from $103.1 million at June 30, 2015 to $117.9 million at June 30, 2016. The increase in 2016 is related to increased unrestricted assets and investments to be utilized for general capital improvements and operations. Total noncurrent assets increased $28.0 million between fiscal years 2014 and 2015 from $75.1 million to $103.1 million.

Capital assets decreased $0.5 million during fiscal year 2016 from $348.6 million at June 30, 2015 to $348.1 million at June 30, 2016, and decreased $18.2 million from $366.8 million at June 30, 2014 to $348.6 million at June 30, 2015.

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

Current Liabilities

Current liabilities consist of accounts payable and other accrued liabilities that are expected to be paid within one year. Total current liabilities were $100.8 million at June 30, 2016, compared to $86.1 million at June 30, 2015. Fiscal year 2016 composition of current liabilities is illustrated in the pie chart below.



Accounts payable increased $1.5 million between June 30, 2015 and June 30, 2016 from $16.6 million to $18.1 million and increased $4.8 million from $11.8 million at June 30, 2014 to $16.6 million at June 30, 2015. 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, 2016 and 2015 were amounts accrued for capital related expenditures of $3.8 million and $1.1 million, respectively.

Accrued salaries, wages and employee benefits increased $4.4 million from $38.8 million at June 30, 2015 to $43.2 million at June 30, 2016 and increased $0.5 million from $38.3 million at June 30, 2014 to $38.8 million at June 30, 2015. 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.

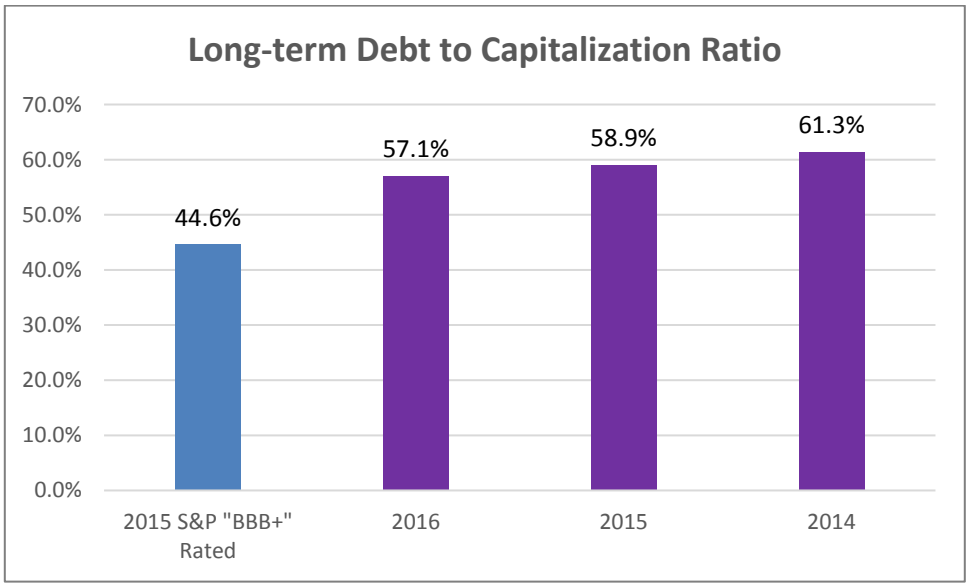
Other accrued liabilities, including estimated third-party payer settlements increased $8.7 million from 13.7 million at June 30, 2015 to $22.4 million at June 30, 2016 primarily due to estimated final Certified Public Expenditure cost settlements for fiscal years 2010-2016, as well as a payable to the University of Washington.

Noncurrent Liabilities

Noncurrent liabilities consist of long-term debt and other noncurrent liabilities. Total noncurrent liabilities were $302.9 million at June 30, 2016, compared to $311.8 million at June 30, 2015.

Long-term debt decreased from $307.7 million at June 30, 2015 to $299.4 million at June 30, 2016 and decreased $7.9 million from $315.6 million at June 30, 2014 to $307.7 million at June 30, 2015. 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 2016, 2015 and 2014 and comparison to the stand-alone hospital for S&P BBB+ rated hospitals has been included in the bar chart below.



VMC's long-term debt to capitalization ratio is higher than the stand-alone hospital median due to 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.

Deferred Inflows of Resources

Deferred inflows of resources increased $17.1 million from $9.6 million at June 30, 2015 to $26.7 million at June 30, 2016. The increase between June 30, 2015 and June 30, 2016 was due to a $16.4 million deferred gain from sale of a medical office building in April 2016. Deferred inflows of resources increased $1.0 million at June 30, 2015 to $9.6 million compared to $8.6 million at June 30, 2014. 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

UW Medicine Accountable Care Network

In 2014, UW Medicine formed an Accountable Care Network (ACN) with other selected healthcare organizations and healthcare professionals in Western Washington to form a care delivery network to assume responsibility for the healthcare of contracted populations of patients to achieve the Triple Aim: improved healthcare experience for the individual, improved health of the population, and more affordable care.

- The ACN has contracted with the Washington Health Care Authority (HCA) to participate in its new Puget Sound Accountable Care Program (ACP) as a healthcare benefit option for Public Employees Benefits Board (PEBB) members. The ACP is offered to all PEBB members who reside in Snohomish, King, Kitsap, Pierce, and Thurston Counties, with possible expansion into a number of additional counties planned in 2017. This contract with HCA to cover PEBB members began January 1, 2016.
- A subset of the network members have also agreed to participate with the ACN in a contract with Premera as part of its new Accountable Health System (AHS) product. As an AHS, the UW Medicine ACN will share in accountability for the quality and cost of healthcare for Premera members who select this plan. This product was sold both on and off the Washington Health Exchange in select counties with coverage that began January 1, 2016 and must have 5,000 planwide members per product, per region to share in financial savings and risk.
- The UW Medicine ACN also entered into an agreement to provide health care services to nonunion employees of a large local employer with coverage that began January 1, 2015.

These arrangements provide an opportunity for shared savings between the ACN and the contracted entity based on achieving quality and financial benchmarks. If certain financial benchmarks are not attained, UW Medicine, along with its network members, are at risk for reductions in payment levels from the contracted entity based on the agreement.

Regulatory, Legislative, and Accounting Changes

The following regulatory and legislative activity will impact all entities in UW Medicine during fiscal year 2017 and beyond:

- **Medicare Sequestration** – On April 1, 2013, a provision of the Budget Control Act of 2011 requiring mandatory across-the-board reductions in Federal spending commenced (commonly referred to as sequestration). The provision included a 2% reduction to Medicare payments made to healthcare providers, including payments made under the meaningful use incentive program. The payment reduction is effective until 2023.

- **Medicaid Expansion** – On January 1, 2014, the Washington state Medicaid program was expanded to significantly increase the number of Medicaid enrollees receiving benefits. Due to the increased access to Medicaid coverage, VMC has experienced a reduction in uninsured and underinsured patients and an increase in patients who qualify for Medicaid. The reduction of uninsured and underinsured patients is expected to have an impact on Medicare and Medicaid Disproportionate Share (DSH) reimbursement methodologies in the future. VMC has experienced a change to their payer mix, which is anticipated to continue.
- **Pay for Performance** – The Affordable Care Act mandated programs that affect reimbursement through evaluation of the quality of care and cost of care provided to patients at the federal level, however, there are an increasing number of programs arising from state and private interests. These programs provide incentives (and/or penalties) for reporting performance data and those that provide incentives (and/or penalties) based on benchmarking performance data against other providers regionally and nationally. The pay for performance programs will continue into the future and 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, 2016 and 2015

Assets	VMC 2016	VMC 2015	Component unit – IPV 2016	Component unit – IPV 2015
Current assets:				
Cash and cash equivalents	$ 44,054,561	25,904,764	1,217,020	1,272,511
Short-term investments	16,373,635	22,525,821	—	—
Accounts receivable, less allowance for uncollectible accounts of $13,576,934 in 2016 and $12,726,450 in 2015	68,896,343	63,125,297	—	46,393
Property tax receivable	10,129,253	9,442,095	—	—
Due from:				
Primary government	—	—	779,319	932,942
Component unit	494,984	695,158	—	—
Noncurrent assets, required for current obligations	28,943,415	26,253,859	—	—
Supplies inventory	5,201,606	4,781,197	—	—
Prepaid expenses and other assets	13,862,703	6,359,450	31,723	39,276
Total current assets	187,956,500	159,087,641	2,028,062	2,291,122
Long-term investments	12,596,108	20,859,973	—	—
Other noncurrent assets:				
Unrestricted for general capital improvements and operations	129,974,874	111,974,300	—	—
Restricted for self-insurance reserve funds	5,943,911	5,873,073	—	—
Restricted under unearned compensation arrangements	3,528,900	4,111,144	—	—
Restricted under revenue bond indenture agreements	7,400,170	7,399,706	—	—
	146,847,855	129,358,223	—	—
Less amounts required for current obligations	(28,943,415)	(26,253,859)	—	—
Total other noncurrent assets	117,904,440	103,104,364	—	—
Capital assets:				
Land	13,413,733	13,413,733	—	—
Construction in progress	13,508,462	9,271,433	—	—
Depreciable capital assets, net of accumulated depreciation	321,160,593	325,861,024	1,119,559	1,419,760
Total capital assets	348,082,788	348,546,190	1,119,559	1,419,760
Goodwill, intangible assets and other	3,530,969	4,062,020	—	—
Total assets	$ 670,070,805	635,660,188	3,147,621	3,710,882

(Continued)

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

Statements of Net Position

June 30, 2016 and 2015

Liabilities and Net Position	VMC 2016	VMC 2015	Component unit – IPV 2016	Component unit – IPV 2015
Current liabilities:				
Accounts payable	$ 18,058,274	16,603,976	156,116	195,589
Accrued salaries, wages and benefits	43,180,436	38,848,283	—	22,892
Due to:				
Primary government	—	—	494,984	695,158
Component unit	779,319	932,942	—	—
Other accrued liabilities, including estimated third-party payor settlements	22,414,368	13,682,895	—	—
Interest, patient refunds and other	7,909,239	7,880,259	—	—
Current portion of long-term debt and capital lease obligations	8,500,000	8,185,000	258,944	290,848
Total current liabilities	100,841,636	86,133,355	910,044	1,204,487
Unearned compensation	3,528,900	4,111,144	—	—
Long-term debt and capital lease obligations, net of current portion	299,358,652	307,683,826	344,235	603,180
Total liabilities	403,729,188	397,928,325	1,254,279	1,807,667
Deferred inflows of resources	26,743,735	9,624,694	—	—
Net position:				
Invested in capital assets net of related debt	40,084,447	32,643,761	516,380	525,732
Restricted:				
For debt service	7,400,170	7,399,706	—	—
Expendable for specific operating activities	633,798	611,854	—	—
Unrestricted	191,479,467	187,451,848	1,376,962	1,377,483
Total net position	239,597,882	228,107,169	1,893,342	1,903,215
Total liabilities, deferred inflows, and net position	$ 670,070,805	635,660,188	3,147,621	3,710,882

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 Revenues, Expenses, and Changes in Net Position

Years ended June 30, 2016 and 2015

	VMC		Component unit – IPV	
	2016	2015	2016	2015
Operating revenues:				
Net patient service revenue (net of VMC's provision for uncollectible accounts of $17,361,673 in 2016 and $17,959,918 in 2015)	$ 519,838,301	480,517,818	24,706	497,683
Other operating revenue	36,981,327	35,192,811	9,053,009	9,079,326
Total operating revenues	556,819,628	515,710,629	9,077,715	9,577,009
Operating expenses:				
Salaries and wages	260,139,159	234,262,208	—	190,329
Employee benefits	66,855,584	64,293,867	5,610	63,139
Purchased services	84,702,588	75,040,087	786,828	1,247,071
Supplies and other expenses	110,348,238	97,929,456	262,662	602,185
Depreciation	29,019,640	30,557,407	307,261	653,873
Total operating expenses	551,065,209	502,083,025	1,362,361	2,756,597
Operating income	5,754,419	13,627,604	7,715,354	6,820,412
Nonoperating income (expense):				
Property tax revenue	19,901,659	18,131,543	—	—
Interest income	4,289,732	3,778,753	—	—
Interest and amortization expense	(17,698,019)	(18,059,758)	(21,394)	(34,699)
Investment gain (loss), net	376,632	(375,385)	—	—
Other, net	(1,133,710)	(888,665)	—	—
Distributions to members	—	—	(7,703,833)	(7,382,760)
Net nonoperating income (expense)	5,736,294	2,586,488	(7,725,227)	(7,417,459)
Increase (decrease) in net position	11,490,713	16,214,092	(9,873)	(597,047)
Net position, beginning of year	228,107,169	211,893,077	1,903,215	2,500,262
Net position, end of year	$ 239,597,882	228,107,169	1,893,342	1,903,215

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, 2016 and 2015

	VMC		Component unit – IPV	
	2016	2015	2016	2015
Cash flows from operating activities:				
Receipts from and on behalf of patients	$ 521,386,176	482,501,624	224,722	181,192
Payments to suppliers and contractors	(202,856,005)	(170,425,416)	(1,031,115)	(1,692,253)
Payments to employees	(323,244,834)	(297,639,954)	(28,502)	(252,198)
Other cash receipts	30,818,260	29,286,603	9,053,009	9,079,326
Net cash provided by operating activities	26,103,597	43,722,857	8,218,114	7,316,067
Cash flows from noncapital financing activities:				
Cash received from tax levy	19,935,953	18,167,720	—	—
Distribution to Valley Medical Center	—	—	(6,363,241)	(5,415,096)
Distribution to noncontrolling member of Imaging Partners at Valley, LLC	—	—	(1,590,810)	(1,372,887)
Other	21,944	198,011	—	—
Net cash provided (used in) by noncapital financing activities	19,957,897	18,365,731	(7,954,051)	(6,787,983)
Cash flows from capital and related financing activities:				
Principal payments on long-term debt and capital lease obligations	(8,185,000)	(7,968,374)	(290,849)	(450,256)
Interest paid, net of amounts capitalized	(17,015,780)	(17,255,669)	(21,394)	(34,699)
Purchases of capital assets	(29,054,188)	(12,362,067)	(7,279)	—
Purchase of Snow Building	—	(2,397,810)	—	—
Sale of Auburn property by VMC and capital assets by IPV	—	1,287,699	—	89,680
Sale of medical office building	18,500,000	—	—	—
Other	(112,750)	140,927	(32)	—
Net cash used in capital and related financing activities	(35,867,718)	(38,555,294)	(319,554)	(395,275)
Cash flows from investing activities:				
Distributions from joint venture	6,363,241	5,415,096	—	—
Sale of investments and noncurrent assets	26,477,077	33,558,763	—	—
Purchases of investments and noncurrent assets	(29,174,029)	(76,491,924)	—	—
Investment and interest income, net of amounts capitalized	4,289,732	3,778,753	—	—
Net cash provided by (used in) investing activities	7,956,021	(33,739,312)	—	—
Net increase (decrease) in cash and cash equivalents	18,149,797	(10,206,018)	(55,491)	132,809
Cash and cash equivalents, beginning of year	25,904,764	36,110,782	1,272,511	1,139,702
Cash and cash equivalents, end of year	$ 44,054,561	25,904,764	1,217,020	1,272,511

(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, 2016 and 2015

	VMC		Component unit – IPV	
	2016	2015	2016	2015
Reconciliation of operating income to net cash from operating activities:				
Operating income	$ 5,754,419	13,627,604	7,715,354	6,820,412
Adjustments to reconcile operating income to net cash from operating activities:				
Depreciation	29,019,640	30,557,407	307,261	653,873
Provision for uncollectible accounts	17,361,673	17,959,918	(47,116)	(73,290)
Income recognized from joint venture	(6,163,067)	(5,906,208)	—	—
Loss on sale of capital assets	—	—	251	120,940
Changes in assets and liabilities:				
Accounts receivable	(23,132,719)	(22,999,462)	93,509	147,799
Due from:				
Primary government	—	—	153,623	(391,000)
Supplies inventory	(420,409)	(698,214)	—	—
Prepaid expenses and other assets	(7,503,253)	(643,240)	7,553	3,791
Accounts payable	(1,193,066)	4,735,141	10,571	32,272
Accrued salaries, wages, and benefits	4,332,153	553,936	(22,892)	1,270
Due to:				
Component unit	(153,623)	391,000	—	—
Other accrued liabilities and estimated third-party payor settlements	8,731,473	7,023,350	—	—
Other liabilities	52,619	(1,240,560)	—	—
Unearned compensation	(582,244)	362,185	—	—
Net cash provided by operating activities	$ 26,103,596	43,722,857	8,218,114	7,316,067
Supplemental disclosure of noncash investing, capital, and financing activities:				
Increase in capital assets included in accounts payable	$ 2,647,364	28,971	—	—

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 2016 were:

Donna Russell, Chair
Gary Kohlwes, Vice Chair
Bernie Dochnahl
Tamara Sleeter, M.D. (President of Board of Commissioners)
Julia Patterson
Cindy Hecker
Mike Miller
Barbara Drennen (Commissioner)
Peter Evans
Paul Joos, M.D. (Commissioner)
Chris Monson, M.D. (Commissioner)
Lisa Jensen
Lawton Montgomery, (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 and IPV's financial statements have been prepared using the accrual basis of accounting with the economic resources measurement focus. Under this method of accounting, revenues are recognized when earned and expenses are recorded when liabilities are incurred without regard to receipt or disbursement of cash.

(c) Use of Estimates

The preparation of financial statements in conformity with U.S. 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.

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, 2016 and 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.

(Continued)

(f) Investments

VMC holds investments, as allowed by State law, in the form of bankers' acceptances, repurchase agreements, obligations secured by the U.S. Treasury, other obligations of the United States or its agencies, and certificates of deposit with financial institutions in accordance with state guidelines. Investments are for the funding of future capital improvements, self-insurance 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 $5,000 or greater and a useful life of at least three years, are stated at cost at acquisition or if acquired by gift, at fair 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 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 term or useful life

(Continued)

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 2016 and 2015 was $276,245 and $301,909, respectively.

(i) Goodwill, Intangible Assets, and Other

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

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

(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, 2016 and 2015 was $15.7 million and $14.6 million, respectively. Sick leave accrued as of June 30, 2016 and 2015 was $4.7 million and $4.3 million, respectively.

(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 other accrued liabilities, including estimated third-party payor settlements in the accompanying primary government statements of net position.

(l) Classification of Revenues and Expenses

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

Operating expenses are all expenses, other than financing costs, incurred by 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 formed an accountable care network (ACN) with other health care organizations and healthcare professionals to share financial and clinical responsibility for the healthcare of particular populations of patients. VMC, as party of UW Medicine is a network member of the UW Medicine ACN and as such shares in any risk contract surplus or deficits based on agreed upon contractual terms. Since its inception, the ACN has entered into various contracts which include provisions for shared risk as well as shared savings based on achieving certain quality and financial benchmarks. VMC, as part of UW Medicine and the other network members share in the financial risk or savings. At June 30, 2016 and 2015, VMC recorded a liability of $2,394,000 and $925,000, respectively for its portion of the estimated liability related to these risk-sharing arrangements which is reflected in other accrued liabilities, including estimated third-party payor settlements in the accompanying statements of net position.

(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 $7,423,000 and $8,672,000 respectively, for the years ended June 30, 2016 and 2015.

VMC estimates the cost of charity care using its cost to charge ratio of 26.1% and 27.1% for the fiscal years ended June 30, 2016 and 2015, respectively. Applying VMC's cost to charge ratio of 26.1% to total charity of $7,423,000 results in a cost of charity care of approximately $1,937,000 for the fiscal year ended June 30, 2016. Applying VMC's cost to charge ratio of 27.1% to total charity of $8,672,000 results in a cost of charity care of approximately $2,350,000 for the fiscal year ended June 30, 2015.

(o) Federal Income Taxes

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

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, 2016 and 2015.

(p) New Accounting Pronouncements

In February 2015 the GASB issued Statement No. 72, *Fair Value Measurement and Application*, which is 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. VMC adopted this statement in 2016.

(q) Correction of an Immaterial Error

During the year ended June 30, 2016, there was an error identified related to classification in the IPV fiscal year 2015 statement of cash flows. As a result, the 2015 financial statements have been corrected to reclassify cash distributions to members of $6,787,983 as cash flows from noncapital financing activities instead of cash flows from investing activities.

(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 2016 and 2015, net patient service revenue includes approximately $2,375,000 and $4,044,000, 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, 2016 and 2015:

	VMC	
	2016	**2015**
Gross patient service revenue	$ 1,686,484,731	1,550,749,311
Less adjustments to patient service revenue:		
Charity	(7,423,198)	(8,671,895)
Contractual discounts	(1,141,861,559)	(1,043,599,680)
Provision for uncollectible accounts	(17,361,673)	(17,959,918)
Total adjustments to patient service revenue	(1,166,646,430)	(1,070,231,493)
Net patient service revenue	$ 519,838,301	480,517,818

	Component unit – IPV	
	2016	**2015**
Gross patient service revenue	$ —	1,235,175
Less adjustments to patient service revenue:		
Charity	(504)	(4,866)
Contractual discounts	(21,906)	(805,916)
Provision for uncollectible accounts	47,116	73,290
Total adjustments to patient service revenue	24,706	(737,492)
Net patient service revenue	$ 24,706	497,683

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 and accounts receivable from significant payers as of and for the years ended June 30, 2016 and 2015 were as follows:

	2016	
	VMC	
	Patient service charges	**Accounts receivable**
Medicare	34%	30%
Medicaid	24	23
Commercial and other	40	41
Self pay	1	4
Exchange (HIX)	1	2
Total	100%	100%

(Continued)

	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%

(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 $8,663,726 and $9,677,830 under this program for the years ended June 30, 2016 and 2015, 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 $17,887,524 and $15,064,812 in DSH funding under this program for the years ended June 30, 2016 and 2015, 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, 2016 or 2015. Claims payments and DSH payments are included in net patient service revenues in the statements of revenues, expenses, and changes in net position.

(Continued)

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 and 2007 CPE program years have 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, 2016 and 2015, for fiscal years 2006 through 2015 VMC had an estimated payable of $19.6 million and $12.3 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.

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 $290,703 and $244,148 for the years ended June 30, 2016 and 2015, respectively, in supplemental payments, via Intergovernmental Transfers (IGTs) to WSHCA related to professional claims paid for the PSSP program. Those amounts are included in net patient service revenue in the statements of revenues, expenses, and changes in net position.

WSHCA used the federal match funds to make professional services payments to VMC. VMC received $823,147 and $712,912 in supplemental payments for the years ended June 30, 2016 and 2015, respectively. These payments are included in net patient service revenues in the statements of revenue, expenses, and changes in net position.

VMC recorded $2,274,997 and $624,378 for the years ended June 30, 2016 and 2015, respectively, in supplemental payment, via Intergovernmental Transfers (IGTs) to WSHCA related to professional claims paid for the PAP program. Those amounts are included in the net patient service revenue in the statements of revenues, expenses, and changes in net position.

WSHCA used the federal match funds to make professional services payments to VMC for the PAP program. VMC received $6,076,087 and $742,239 in supplemental payments for the years ended June 30, 2016 and 2015, respectively. 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 non-Medicare patient days. Under the HSNA program, PPS hospitals receive supplemental Medicaid payments, Critical Access Hospitals receive disproportionate share payments and CPE hospitals receive state grants. CMS approved the most recent program in 2015. The program has an expiration date of June 30, 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 $2.2 million and $1.6 million for the years ended June 30, 2016 and 2015 respectively, which 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 $2,336,643 and $3,050,943 for the years ended June 30, 2016 and 2015, 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 2016 and January 2015, 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, 2015 and 2014. 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.

For the calendar year 2016, as a result of this required rate recalculation, the District's tax levy rate was decreased from $0.53 per assessed $1,000 in property value pursuant to the District's authorized tax levy in November 2015, to $0.50 per assessed $1,000 in property value, resulting in a revised tax levy of $20,692,016.

For calendar year 2015, due to the 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.

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, 2016 and 2015 was $10,129,253 and $9,442,095, respectively, and is shown as a current asset in the statements of net position.

Revenues received from taxation was $19,901,659 and $18,131,543, for the fiscal 2016 and 2015 years, respectively, and is recorded as nonoperating revenue in the statements of revenues, expenses and changes in net position.

The District has pledged its future tax revenues, as well as operating revenues, to repay its limited tax general obligation and revenue bonds issued in 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, 2016 and 2015 is set forth below:

	Balance June 30, 2015	Additions	Transfers	Retirements	Balance June 30, 2016
Nondepreciable capital assets:					
Land	$ 13,413,733	—	—	—	13,413,733
Construction in progress	9,271,433	31,701,552	(27,464,523)	—	13,508,462
Total capital assets, not being depreciated	22,685,166	31,701,552	(27,464,523)	—	26,922,195
Capital assets, being depreciated:					
Land improvements	18,489,709	—	141,054	(14,849)	18,615,914
Buildings, renovations and furnishings	422,923,515	—	12,479,471	(9,034,752)	426,368,234
Fixed equipment	24,550,795	—	—	(946,012)	23,604,783
Movable equipment	180,758,217	—	10,001,855	(2,698,976)	188,061,096
Minor equipment	14,825,257	—	4,842,143	(284,071)	19,383,329
Total capital assets, being depreciated	661,547,493	—	27,464,523	(12,978,660)	676,033,356
Total capital assets at historical cost	684,232,659	31,701,552	—	(12,978,660)	702,955,551
Less accumulated depreciation for:					
Land improvements	(11,012,560)	(374,749)	—	12,292	(11,375,017)
Buildings, renovations and furnishings	(159,602,461)	(13,066,203)	—	6,613,690	(166,054,974)
Fixed equipment	(21,720,238)	(431,127)	—	707,929	(21,443,436)
Movable equipment	(132,438,335)	(14,134,162)	—	2,658,309	(143,914,188)
Minor equipment	(10,912,875)	(1,403,929)	—	231,656	(12,085,148)
Total accumulated depreciation	(335,686,469)	(29,410,170)	—	10,223,876	(354,872,763)
Total capital assets, net	$ 348,546,190	2,291,382	—	(2,754,784)	348,082,788

(Continued)

	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

Included in major movable equipment at June 30, 2016 and 2015 is $4,589,162 and $4,619,239, respectively, of equipment under capital lease. Accumulated amortization of the equipment under capital lease totaling $4,589,162 and $4,619,239 is included in accumulated depreciation at June 30, 2016 and 2015, respectively.

Depreciation expense was $29,410,170 and $30,948,103 for the years ended June 30, 2016 and 2015, respectively, includes $390,530 and $390,696 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, $29,019,640 and $30,557,407 in depreciation expense is reflected in operating expenses in the statements of revenues, expenses, and changes in net position for the years ended June 30, 2016 and 2015, respectively.

During 2016, VMC entered into a transaction involving the sale of a medical office building, and then entered into an operating lease with the purchaser to occupy certain floors of the building with terms ranging from eight to twelve years. The building sold for $18,500,000 and the gain on sale of $16,643,000 has been included as a component of deferred inflows of resources in the accompanying statements of net position and is being amortized to nonoperating income over the life of the lease.

(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, 2016 is as follows:

	Balance June 30, 2015	Additions	Transfers	Retirements	Balance June 30, 2016
Buildings, renovations and furnishings	$ 270,350	—	—	—	270,350
Fixed equipment	—	—	—	—	—
Movable equipment	7,257,163	7,279	—	(1,277,274)	5,987,168
Total capital assets, being depreciated	7,527,513	7,279	—	(1,277,274)	6,257,518
Total capital assets at historical cost	7,527,513	7,279	—	(1,277,274)	6,257,518
Less accumulated depreciation for:					
Land improvements	—	—	—	—	—
Buildings, renovations and furnishings	(60,968)	(7,694)	—	—	(68,662)
Fixed equipment	—	—	—	—	—
Movable equipment	(6,046,785)	(299,567)	—	1,277,055	(5,069,297)
Total accumulated depreciation	(6,107,753)	(307,261)	—	1,277,055	(5,137,959)
Total capital assets, net	$ 1,419,760	(299,982)	—	(219)	1,119,559

(Continued)

	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
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

(Continued)

(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, 2016 and 2015, deposits and investments of VMC consist of the following:

	2016	2015
Unrestricted cash	$ 6,619,186	8,711,791
Unrestricted investments and cash equivalents:		
U.S. Treasury securities and bonds	156,888,546	152,230,146
Money market mutual funds	362,553	62,639
U.S. government mutual funds	218,034	217,921
Investment pools	36,217,804	16,300,614
Municipal bonds	1,165,809	550,968
Tax-exempt issues	890,262	2,578,980
	195,743,008	171,941,268
Restricted assets:		
Cash and cash equivalents	636,984	611,799
Money market mutual funds	1,753,664	1,752,762
U.S. government mutual funds	11,590,417	11,520,017
Other assets	3,528,900	4,111,144
	17,509,965	17,995,722
	$ 219,872,159	198,648,781

Interest income included in nonoperating revenue totaled $4,289,732 and $3,778,753 for the years ended June 30, 2016 and 2015, respectively. Investment income includes realized and unrealized gains and losses. VMC recognized net gains/(losses) of $376,632 and $(375,385) for the years ended June 30, 2016 and 2015, respectively. VMC's net change in unrealized gains/(losses) on investments during the years ended June 30, 2016 and 2015 are approximately $192,000 and $(274,000), respectively.

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

(a) Credit Risk

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

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

According to GASB 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, 2016 and 2015, 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.

The composition of investments, reported at fair value by investment type and rating at June 30, 2016 and excluding unrestricted and restricted cash balances of $7,256,170, is as follows:

Investment type		Quoted prices in active markets for identical assets (Level 1)	Ratings	Percentage of totals
Money market mutual fund	$	2,116,217	AAA	1.0%
U.S. Treasury		69,357,243	Not rated	32.6
U.S. agency securities		56,413,308	AAA	26.5
U.S. agency mortgages		31,117,995	AAA	14.6
Tax-exempt issues		890,262	AAA	0.4
Municipal bonds		1,165,809	AAA	0.6
Mutual funds invested in U.S. government securities		11,808,451	AAA	5.6
King County investment pool		36,217,804	Not rated	17.0
Other assets		3,528,900	Not rated	1.7
Total investments by fair value level	$	212,615,989		100.0%

(Continued)

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

Investment type		Quoted prices in active markets for identical assets (Level 1)	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%

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, 2016 and 2015, for those investments that require composition disclosure, VMC holds investments in U.S. government-sponsored entities totaling 8% and 11% of its total investments in Federal National Mortgage Association securities, 12% and 7% of its total investments in Federal Home Loan Mortgage Corporation securities, and 12% and 11%, 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
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.

2016		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	$ 2,116,217	2,116,217	—	—	—
U.S. Treasury	69,357,243	7,612,588	24,893,157	33,797,692	3,053,806
U.S. agency securities	56,413,308	7,055,958	19,757,556	21,266,429	8,333,365
U.S. agency mortgages	31,117,995	302,794	1,331,115	4,325,889	25,158,197
Tax-exempt issues	890,262	—	—	890,262	—
Mutual funds invested in U.S. government securities	11,808,451	—	11,590,417	218,034	—
King county investment pool	36,217,804	—	36,217,804	—	—
Municipal bonds	1,165,809	1,063,066	—	102,743	—
Other assets	3,528,900	—	—	—	3,528,900
	$ 212,615,989	18,150,623	93,790,049	60,601,049	40,074,268

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

(Continued)

(7) Long-Term Debt and Capital Lease Obligations

(a) Primary Government's Long-Term Debt

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

	2016	2015
Limited tax general obligation bonds:		
2011 term bond, 2.19%, due in June and December, in yearly amounts from $2,185,000 in fiscal year 2016 to $2,035,517 in fiscal year 2022, plus interest due semiannually, net of unamortized loss on refinance of $331,853	$ 19,239,559	21,311,765
2008 series A and B, 4.0% to 5.25%, due serially on December 1, in amounts from $3,175,000 in fiscal year 2016 to $17,365,000 in fiscal year 2038, plus interest due semiannually, net of unamortized premium of $70,504 and unamortized loss on refinancing of $2,298,959	209,046,544	212,312,247
2004 series, 3.75% to 4.25%, due serially on December 1, in amounts from $1,175,000 in fiscal year 2016 to $1,260,000 in fiscal year 2018, plus interest due semiannually, net of unamortized premiums of $2,901 and unamortized loss on refinance of $19,360	2,458,541	3,607,901
Revenue bonds:		
2010 series A, 3.00% to 5.125%, due serially in June, in amounts from $1,650,000 in 2016 to $2,395,000 in 2024, plus interest due semiannually, net of unamortized discount of $109,573, and unamortized loss on refinance of $161,419	15,959,008	17,481,913
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	307,858,652	315,868,826
Total long-term debt	307,858,652	315,868,826
Less current portion	(8,500,000)	(8,185,000)
Total long-term debt, net of current portion	$ 299,358,652	307,683,826

(Continued)

(i) Long-term Debt Overview

Series 2011 Bond Issue

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

Series 2010 Revenue Bond Issue

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

The Series 2010B term BAB bonds were issued to construct, renovate, remodel, and equip projects at VMC and satellite facilities, including completion of the top floors of VMC's 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, 2016 and 2015, the District received $1,590,266 and $1,581,734, respectively, in subsidy payments, which are recorded in other nonoperating revenues in the statements of revenues, expenses, and changes in net position.

Series 2008 Bond Issue

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

Series 2008A is insured by a rated bond insurer.

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

The District has pledged tax revenues to secure the bonds.

(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, 2016 and 2015.

(iii) Long-Term Debt Maturities

The following schedule shows debt service requirements for the next five years and thereafter, as of June 30, 2016, for both principal and interest:

		Principal	Interest	Total
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		8,071,198	15,715,385	23,786,583
2022–2026		50,965,517	72,003,696	122,969,213
2027–2031		70,930,000	54,444,275	125,374,275
2032–2036		91,365,000	31,333,994	122,698,994
2037–2040		54,200,000	5,931,470	60,131,470
Total payments	$	310,706,412	245,405,760	556,112,172

(Continued)

(iv) Change in Noncurrent Liabilities

Changes in noncurrent liabilities during the fiscal years ended June 30, 2016 and 2015 are summarized below:

	Balance June 30, 2015	Increases	Decreases	Balance June 30, 2016	Due within one year
Limited tax general obligation bonds:					
2011 series	$ 21,311,765	—	(2,072,206)	19,239,559	2,720,000
2008 series	212,312,247	—	(3,265,703)	209,046,544	2,845,000
2004 series	3,607,901	—	(1,149,360)	2,458,541	1,215,000
Revenue bonds:					
2010 Series A	17,481,913	—	(1,522,905)	15,959,008	1,720,000
Build America bonds:					
2010 Series B	61,155,000	—	—	61,155,000	—
Total long-term debt and capital lease obligations	315,868,826	—	(8,010,174)	307,858,652	8,500,000
Unearned compensation	4,111,144	—	(582,244)	3,528,900	—
Total noncurrent liabilities	$ 319,979,970	—	(8,592,418)	311,387,552	8,500,000

	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

(Continued)

(b) Discretely Presented Component Unit's Capital Lease Obligations

The capital lease obligation as of June 30, 2016 and 2015 consists of an equipment lease with a present value of $603,179 and $894,048, with total monthly payments of $22,691, including imputed interest of 2.37%, maturing in 2018.

The schedule of changes in capital leases is as follows:

	Balance June 30, 2015	Increases	Decreases	Balance June 30, 2016	Due within one year
Capital lease obligations	$ 894,028	—	(290,849)	603,179	258,944

	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

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

	June 30, 2016
Fiscal year ending June 30:	
2017	$ 272,292
2018	272,292
2019	78,480
Total minimum lease payments	623,064
Less amount representing interest	(19,885)
Net	603,179
Less current portion	(258,944)
Present value of capital lease, net of current portion	$ 344,235

(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.

(b) 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, 2016 and 2015 are noted below:

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
Incurred claims and changes in estimates		60,000
Claims payments		—
Reserve at June 30, 2016	$	1,380,000

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

(c) Employee Medical

VMC is self-insured for medical and dental benefits. The accrued liabilities for the self-insured component of the plan include the unpaid portion of claims that have been reported and estimates for claims that have been incurred but not reported. VMC also carries stop-loss coverage for claims in excess of the $225,000 specific deductible and $122,000 aggregating specific deductible for 2016 and 2015. VMC has recorded an actuarially estimated liability for health claims that have been incurred but not reported of $2,486,235 and $2,353,192 as of June 30, 2016 and 2015, 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, 2016 and 2015 is based on undiscounted calculations.

(d) 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 2016 and 2015. 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 $4,897,685 and $4,587,490 at June 30, 2016 and 2015, 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, 2016 and 2015 is based on undiscounted calculations.

(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 $13,407,366 and $11,569,482 for the years ended June 30, 2016 and 2015, respectively. The deferred compensation is payable to employees upon termination, retirement, death, or unforeseen emergency.

VMC contributes a 5% employer contribution into the 403(b) plan for all employee groups with a 2% 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 403(b) plan were incorporated into their respective collectively bargained agreements or executed memorandum of understanding.

Employer contributions into the 403(b) plan totaled $13,390,601 and $15,602,996 for the years ended June 30, 2016 and 2015, respectively.

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

investment selections. By making the selections, enrollees accept and assume all risks that pertain to the plan and its administration.

In accordance with the Internal Revenue Service code, and accounted for in accordance with GASB 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 $9,004,000 and $3,737,000 was paid by VMC to divisions of the University for the years ended June 30, 2016 and 2015, 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 $573,000 and $477,000 in revenue from related parties for the years ended June 30, 2016 and 2015, respectively.

(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 $343,041 and $788,532 for the years ended June 30, 2016 and 2015, respectively. The leases expire in December 2019, and April 2020, respectively. The component unit has $1,730,925 in total outstanding minimum lease payments due to VMC.

Operational Services

During the years ended June 30, 2016 and 2015, IPV provided radiology services on behalf of VMC, which reimburses IPV for those services. VMC pays IPV for services rendered, which is represented by the $6,163,067 and $5,906,208 in other operating revenue for 2016 and 2015 respectively.

(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, 2016 was $6,945,922 and $343,041 for VMC and the discretely presented component unit, respectively. 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.

The following schedule shows future minimum lease payments by fiscal year for VMC and the discretely presented component unit as of June 30, 2016:

		VMC	Component unit
2017	$	7,996,330	346,185
2018		7,707,646	346,185
2019		7,065,585	346,185
2020		6,134,299	346,185
2021		5,765,702	346,185
Thereafter		15,954,101	—
Total minimum lease payments	$	50,623,663	1,730,925

(b) Construction Commitments

VMC has current commitments at June 30, 2016 of $18,314,603 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 3,039 employees. Of this total, approximately 71% and 71% are covered collective bargaining agreements as of June 30, 2016 and 2015, 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 expire on June 30, 2019. OPEIU, UFCW, and IUOE Operating Engineers expire on June 30, 2017; March 31, 2017 and October 31, 2016, respectively.

(12) Subsequent Event

On August 15, 2016 and August 18, 2016, respectively, the Board of Trustees and the Board of Commissioners passed resolutions authorizing the advance refunding of the District's 2008 series outstanding limited tax obligation bonds. The advance refunding, which includes no new debt, is scheduled for issuance in October 2016.

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, 2016

Assets	VMC	Component unit-IPV	Eliminations	Aggregated
Current assets:				
Cash and cash equivalents	$ 44,054,561	1,217,020	—	45,271,581
Short-term investments	16,373,635	—	—	16,373,635
Accounts receivable, less allowance for uncollectible accounts	68,896,343	—	—	68,896,343
Property tax receivable	10,129,253	—	—	10,129,253
Due from:				
Primary government	—	779,319	(779,319)	—
Component unit	494,984	—	(494,984)	—
Noncurrent assets, required for current obligations	28,943,415	—	—	28,943,415
Supplies inventory	5,201,606	—	—	5,201,606
Prepaid expenses and other assets	13,862,703	31,723	—	13,894,426
Total current assets	187,956,500	2,028,062	(1,274,303)	188,710,259
Long-term investments	12,596,108	—	—	12,596,108
Other noncurrent assets:				
Unrestricted for general capital improvements and operations	129,974,874	—	—	129,974,874
Restricted for self-insurance reserve funds	5,943,911	—	—	5,943,911
Restricted under unearned compensation arrangements	3,528,900	—	—	3,528,900
Restricted under revenue bond indenture agreements	7,400,170	—	—	7,400,170
	146,847,855	—	—	146,847,855
Less amounts required for current obligations	(28,943,415)	—	—	(28,943,415)
Total other noncurrent assets	117,904,440	—	—	117,904,440
Capital assets:				
Land	13,413,733	—	—	13,413,733
Construction in progress	13,508,462	—	—	13,508,462
Depreciable capital assets, net of accumulated depreciation	321,160,593	1,119,559	—	322,280,152
Total capital assets	348,082,788	1,119,559	—	349,202,347
Goodwill, intangible assets and other	3,530,969	—	—	3,530,969
Total assets	$ 670,070,805	3,147,621	(1,274,303)	671,944,123

(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, 2016

Liabilities and Net Position	VMC	Component unit-IPV	Eliminations	Aggregated
Current liabilities:				
Accounts payable	$ 18,058,274	156,116	—	18,214,390
Accrued salaries, wages and benefits	43,180,436	—	—	43,180,436
Due to:				
Primary government	—	494,984	(494,984)	—
Component unit	779,319	—	(779,319)	—
Other accrued liabilities, including estimated third-party payor settlements	22,414,368	—	—	22,414,368
Interest, patient refunds and other	7,909,239	—	—	7,909,239
Current portion of long-term debt and capital lease obligations	8,500,000	258,944	—	8,758,944
Total current liabilities	100,841,636	910,044	(1,274,303)	100,477,377
Unearned compensation	3,528,900	—	—	3,528,900
Long-term debt and capital lease obligations, net of current portion	299,358,652	344,235	—	299,702,887
Total liabilities	403,729,188	1,254,279	(1,274,303)	403,709,164
Deferred inflows of resources	26,743,735	—	—	26,743,735
Net position:				
Invested in capital assets net of related debt	40,084,447	516,380	—	40,600,827
Restricted:				
For debt service	7,400,170	—	—	7,400,170
Expendable for specific operating activities	633,798	—	—	633,798
Unrestricted	191,479,467	1,376,962	—	192,856,429
Total net position	239,597,882	1,893,342	—	241,491,224
Total liabilities, deferred inflows, and net position	$ 670,070,805	3,147,621	(1,274,303)	671,944,123

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 Revenues, Expenses, and Changes in Net Position

Year ended June 30, 2016

	VMC	Component unit-IPV	Eliminations	Aggregated
Operating revenues:				
Net patient service revenue (net of provision for uncollectible accounts of $17,361,673 for VMC)	$ 519,838,301	24,706	—	519,863,007
Other operating revenue	36,981,327	9,053,009	(15,554,784)	30,479,552
Total operating revenues	556,819,628	9,077,715	(15,554,784)	550,342,559
Operating expenses:				
Salaries and wages	260,139,159	—	—	260,139,159
Employee benefits	66,855,584	5,610	—	66,861,194
Purchased services	84,702,588	786,828	(9,391,717)	76,097,699
Supplies and other expenses	110,348,238	262,662	—	110,610,900
Depreciation	29,019,640	307,261	—	29,326,901
Total operating expenses	551,065,209	1,362,361	(9,391,717)	543,035,853
Operating income	5,754,419	7,715,354	(6,163,067)	7,306,706
Nonoperating income (expense):				
Property tax revenue	19,901,659	—	—	19,901,659
Interest income	4,289,732	—	—	4,289,732
Interest and amortization expense	(17,698,019)	(21,394)	—	(17,719,413)
Investment loss	376,632	—	—	376,632
Other, net	(1,133,710)	—	—	(1,133,710)
Members' cash distributions	—	(7,703,833)	6,163,067	(1,540,766)
Net nonoperating income (expense)	5,736,294	(7,725,227)	6,163,067	4,174,134
Increase (decrease) in net position	11,490,713	(9,873)	—	11,480,840
Net position, beginning of year	228,107,169	1,903,215	—	230,010,384
Net position, end of year	$ 239,597,882	1,893,342	—	241,491,224

See accompanying notes to financial statements.