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, 2017 and 2016

(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, 2017 and 2016, 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 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, 2017 and 2016, 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 3–19 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 audits 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 audits were conducted for the purpose of forming opinions on the financial statements that collectively comprise the Medical Center's basic financial statements. The accompanying aggregating schedules are presented for purposes of additional analysis and are not a required part of the basic financial statements.

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

KPMG LLP

Seattle, Washington
September 22, 2017

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, 2017 and 2016

(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, 2017, 2016 and 2015. 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 Governmental Accounting Standards Board 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 2017

VMC recorded $27.8 million in net operating loss for fiscal year 2017; this is a change of $33.6 million from the net operating income of $5.8 million in 2016. In 2017 VMC's net position decreased by $22.2 million to $217.4 million from $239.6 million. The net operating loss in 2017 primarily relates to lower reimbursement from payers; a shift in payer mix from Commercial to Medicare; the implementation of voluntary early retirement and early separation programs; higher pharmaceutical costs; and higher premium wages due to growth in both inpatient and outpatient volumes, including ambulatory outpatient hospital visits, and primary, urgent, and specialty care visits.

	2017	2016	2015
		(In thousands)	
Total operating revenues	$ 582,978	556,819	515,711
Total operating expenses	610,809	551,065	502,083
Operating income (loss)	(27,831)	5,754	13,628
Property tax revenue	21,490	19,902	18,131
Interest income	4,417	4,290	3,779
Interest and amortization expense	(17,696)	(17,698)	(18,060)
Investment income (loss)	(2,868)	377	(375)
Other, net	290	(1,134)	(889)
Nonoperating income	5,633	5,737	2,586
Change in net position	(22,198)	11,491	16,214
Net position, beginning of year	239,598	228,107	211,893
Net position, end of year	$ 217,400	239,598	228,107

- In January 2014, the Washington State Medicaid program was expanded which significantly increased the number of Medicaid enrollees receiving benefits. Fiscal year 2017 was the third full year of that expansion. With the increase of eligible Medicaid enrollees, VMC has experienced a decline in the number of charity care applicants as some of these individuals are now eligible for Medicaid. In FY17, VMC revised our charity care policy from a sliding scale to 100% write off. As a result, the charity write offs amount increased significantly compared to FY2016.
- Inpatient days increased 3% 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 management implemented significant cost saving initiatives in the second half of the fiscal year, focusing on labor productivity, detailed revenue cycle process improvement initiatives, continued standardization of high dollar medical supplies and equipment, and reductions in purchased services.

(Continued)

- VMC continued to invest in information technology.
- As a measure to reduce costs due to the continued payer shift from commercial to Medicare, VMC management offered one-time voluntary early retirement and voluntary early separation programs to eligible employees. 127 employees accepted the offer, resulting in additional expenses of $12.6M in FY17. VMC expects to see the return on this initiative within 12-24 months.

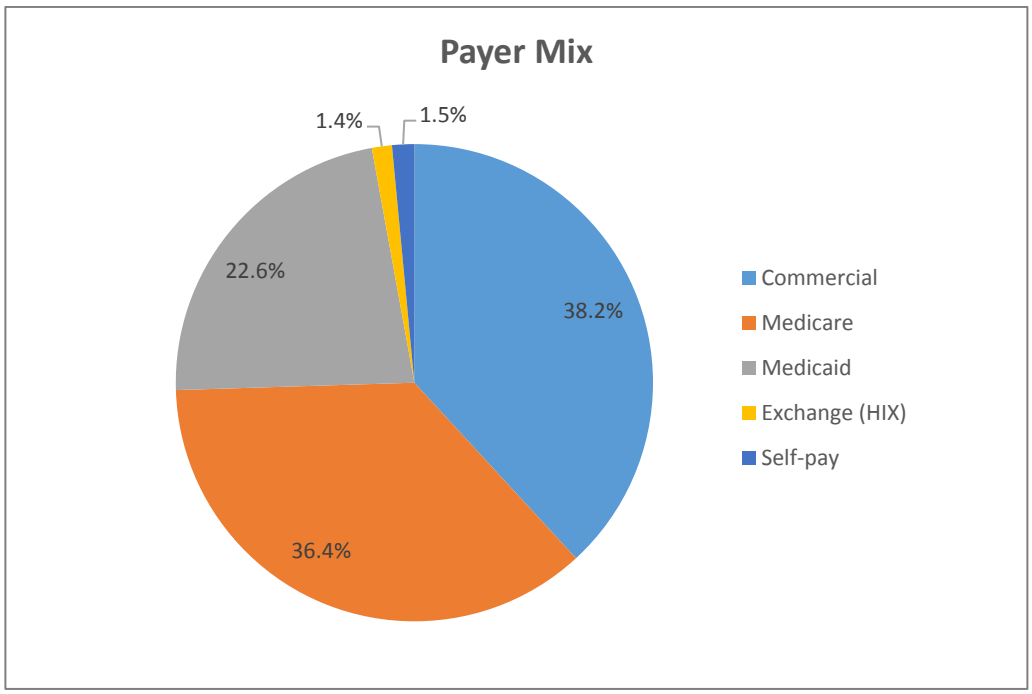
The chart below represents the key performance statistics for the last three years.

	2017	2016	2015
Available beds	295	283	283
Discharges	18,153	17,518	17,174
Patient days	72,541	70,148	65,792
Average length of stay	4.00	4.00	4.00
Occupancy	67 %	68 %	64 %
Case mix index (CMI)	1.49	1.48	1.45
Surgery cases	12,617	12,665	12,006
Emergency room visits	83,907	83,067	81,250
Primary care clinic visits	193,596	185,154	177,612
Specialty/Urgent care clinic visits	335,496	314,660	294,168
Full time equivalents (FTEs)	3,051	2,813	2,599
Births	3,742	3,809	3,776

Total Operating Revenues

Total operating revenues consist primarily of net patient service revenue and other operating revenues. Net patient service revenues are recorded based on standard 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 gross payer mix for 2017. For the years ended June 30, 2017, 2016, and 2015, Medicaid revenue represented 23%, 24%, and 24%, respectively. This increase in Medicaid revenue in 2016 and 2015 was a direct result of the expansion of the Medicaid program in Washington State as part of the Affordable Care Act. There was a slight decrease in Medicaid revenue in 2017. For the years ended June 30, 2017, 2016, and 2015, Medicare revenue represented 36%, 34%, and 34%, respectively. The shift in payer mix was from Commercial to Medicare and primarily due to the aging population within the district, as well as likely migration into the district. The payer mix shift resulted in an estimated negative $18 million reimbursement impact for FY2017.

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 in future years.

For the years ended June 30, 2017, 2016, and 2015, VMC's total operating revenues were $583.0 million, $556.8 million, and $515.7 million composed of $544.7 million, $519.8 million, and $480.5 million in net patient service revenues and $38.3 million, $37.0 million, and $35.2 million in other operating revenue, respectively.

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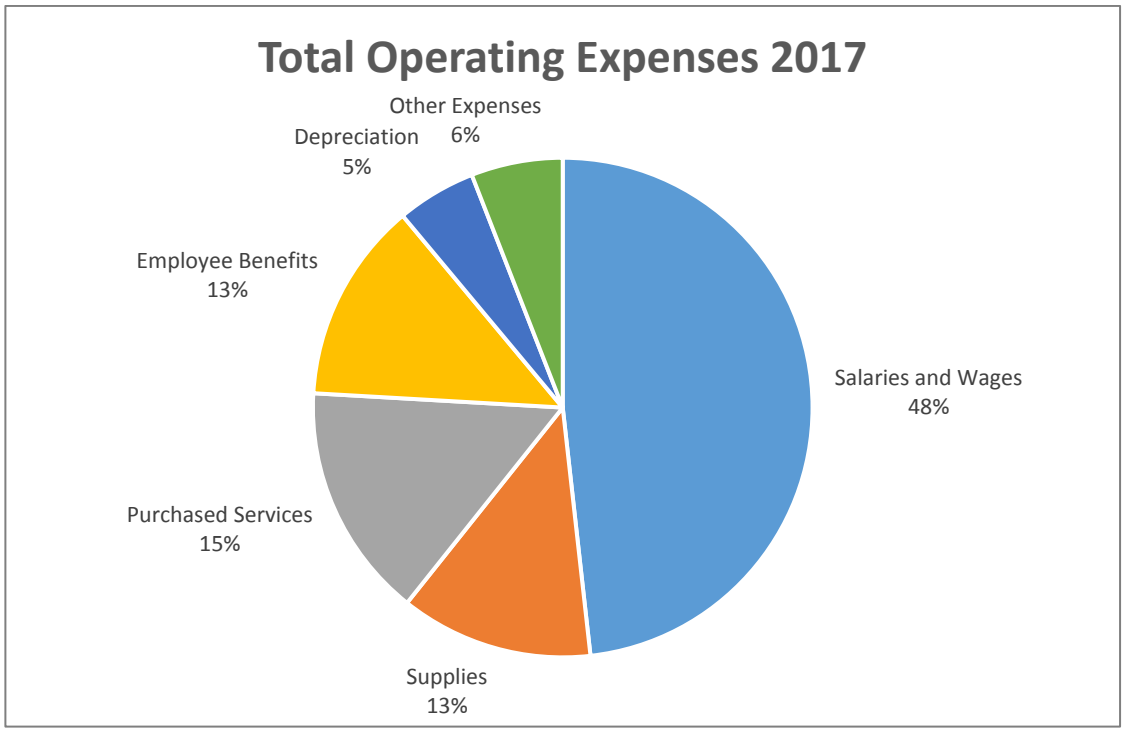
In 2017 and 2016, the increase in operating revenue is due to growth in inpatient volumes, growth in outpatient volumes across the clinic network (primary, specialty, and urgent care), and continued increases in outpatient surgical procedures. The increase in other operating revenue is attributed to increases in the radiology imaging service line, and in outpatient and contract pharmaceutical volumes.

Total Operating Expenses

Total operating expenses were $610.8 million for the year ended June 30, 2017 compared to $551.1 million for the year ended June 30, 2016. The composition of fiscal year 2017 operating expenses is illustrated in the pie chart below.



Salaries and wages increased $34.3 million from $260.1 million in fiscal year 2016 to $294.5 million in fiscal year 2017. The increase was primarily related to contractually agreed upon wage increases; continued addition of providers in the clinic network's services in primary, urgent and specialty care, growth in certain hospital inpatient and outpatient departments, and the voluntary one-time early retirement and early separation programs.

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.

Employee benefits increased $12.8 million from $66.9 million in fiscal year 2016 to $79.7 million in fiscal year 2017 and decreased increased $2.6 million from $64.3 million in fiscal year 2015 to $66.9 million in fiscal year 2016. Employee benefit costs are a function of employment. In fiscal year 2017, benefits increased by 19%, while salaries and wages increased by 13%. The higher benefits increase was related to more medical claims in volumes and more high cost medical claims.

Purchased services expense, which consists of professional and consulting fees, increased $8.1 million from $84.7 million in fiscal year 2016 to $92.8 million in fiscal year 2017 and increased $9.7 million from $75.0 million in fiscal year 2015 to $84.7 million in fiscal year 2016. The increase between fiscal year 2016 and 2017 is attributed to additional physician fees and contracted services agreements from growth in volumes. The increase between fiscal year 2015 and 2016 is attributed to additional physician fees and contracted services agreements from growth in volumes.

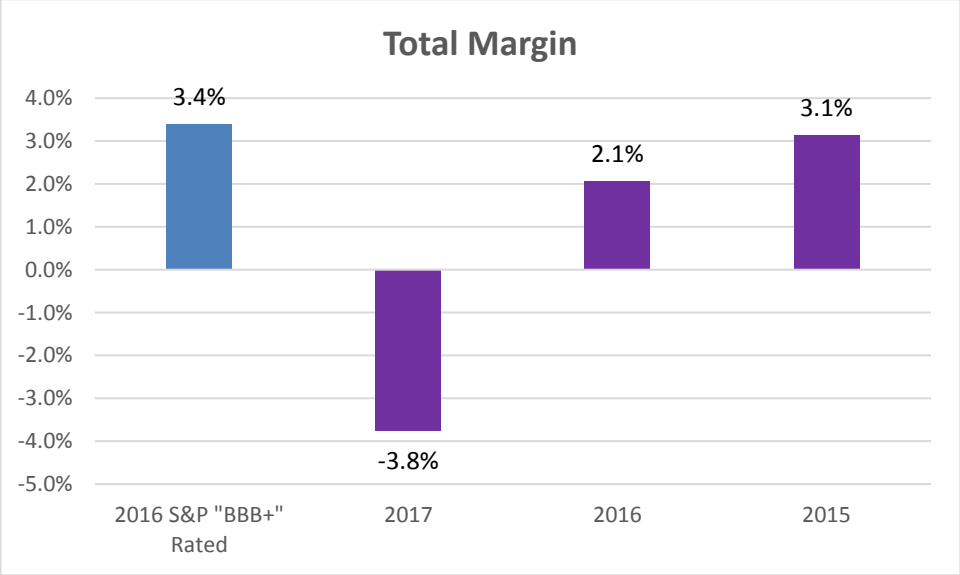
Supplies and other expense include medical and surgical supplies, pharmaceutical supplies, insurance, taxes, and other expenses. In total, these expenses increased $2.1 million from $110.3 million in fiscal year 2016 to $112.4 million in fiscal year 2017. The slight increase is primarily as a result of price inflation with medical and pharmaceutical supplies. Supplies and other expense increased $12.4 million from $97.9 million in fiscal year 2015 to $110.3 million in fiscal year 2016 as medical supplies expense increased is due to increased volumes, particularly surgery volumes. Medical and pharmaceutical expense increased as a result of price inflation.

Depreciation expense increased $2.3 million from $29.0 million in fiscal year 2016 to $31.4 million in fiscal year 2017 due to the capitalization of various projects into fixed assets and decreased $1.6 million from $30.6 million in fiscal year 2015 to $29.0 million in fiscal year 2016 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 decreased $0.1 million between fiscal years 2017 and 2016, primarily due to the increase in revenue from taxation, an increase in interest income and investment losses in 2017. 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.

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 2017, 2016 and 2015 compared to the industry median for Standard & Poor's (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 statements of net position as of June 30, 2017, 2016 and 2015.

		2017	2016	2015
			(In thousands)	
Current assets	$	219,753	187,957	159,088
Noncurrent assets:				
Capital assets, net		362,569	348,083	348,546
Noncurrent assets		93,658	117,904	103,104
Long-term investments		2,053	12,596	20,860
Other		3,163	3,531	4,062
Total assets		681,196	670,071	635,660
Deferred outflow of resources		13,242	—	—
Total assets and deferred outflows	$	694,438	670,071	635,660
Current liabilities	$	124,067	100,842	86,133
Noncurrent liabilities		310,254	302,887	311,795
Total liabilities		434,321	403,729	397,928
Total deferred inflows of resources		42,717	26,744	9,625
Net position	$	217,400	239,598	228,107

Total assets were $681.2 million at June 30, 2017 compared to $670.1 million at June 30, 2016, an increase of $11.1 million, and $635.7 million at June 30, 2015, an increase of $34.4 million between 2015 and 2016. The majority of the change between 2016 and 2017 is attributed to an increase in capital assets.

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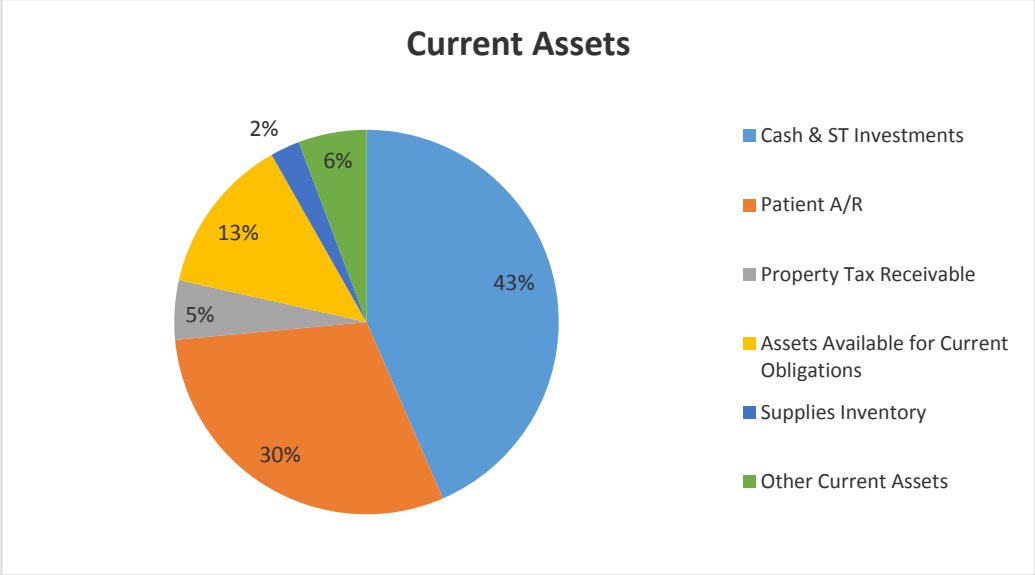
Current Assets

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 $219.8 million at fiscal year-end 2017, compared to $188.0 million at year-end 2016. Fiscal year 2017 composition of current assets is illustrated in the pie chart below.



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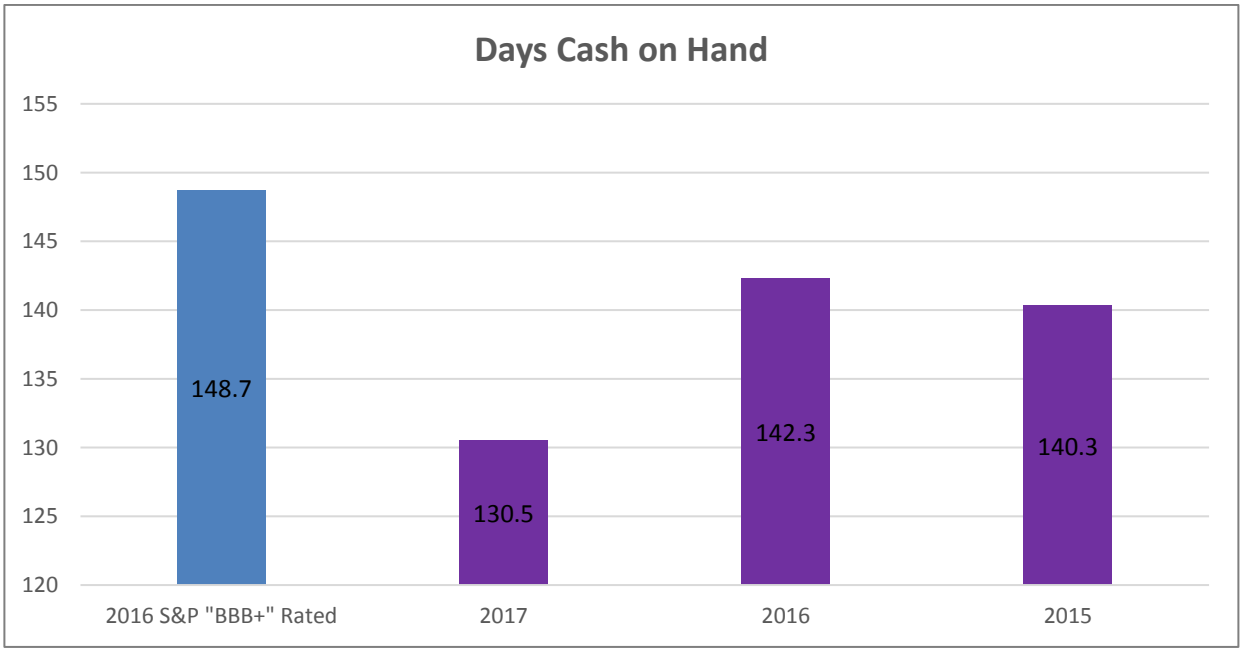
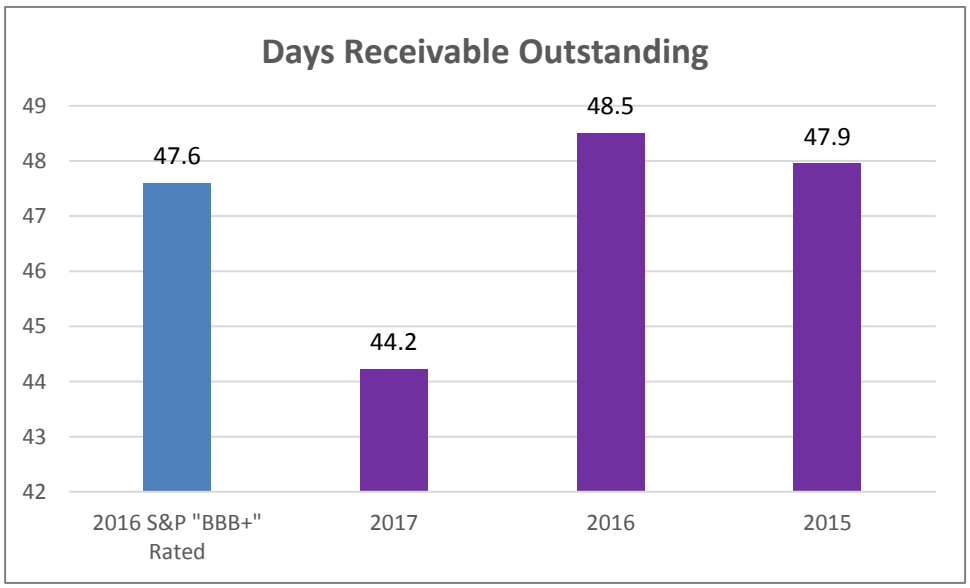
Cash and short-term investments held by VMC consist of cash, cash equivalents and investments expected to mature in 12 months or less. Cash and short-term investments increased $35.1 million in 2017 from $60.4 million at June 30, 2016 to $95.6 million at June 30, 2017. The increase in 2017 was attributed to tax collections not being moved into long term investments and $16.5 million received as a deposit for the expected sale of VMC's interest in Paclab. 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. 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 2017, 2016 and 2015 are illustrated in the graph below.



VMC's total days cash on hand, including short and long-term investments and board designated assets for general capital improvements and operations, decreased 11.8 days from 142.3 days at June 30, 2016 to 130.5 days at June 30, 2017 and increased 2 days from 140.3 days at June 30, 2015 to 142.3 days at June 30, 2016. The decrease between 2016 and 2017 was primarily due to more capital spending and weaker financial performance.

Net patient accounts receivable was $66.0 million as of June 30, 2017, compared to $68.9 million at June 30, 2016. The decrease of $2.9 million was primarily due to process improvement initiatives within revenue cycles processes. Net patient accounts receivable at June 30, 2016 and 2015 were $68.9 million and $63.1 million, respectively. The increase of $5.8 million was driven by growth in revenue and industry trends regarding payer strategy for cost containment and contract management.

Days receivable outstanding illustrates an organization's ability to convert patient service revenue to cash. Days receivable outstanding as of June 30 for fiscal years 2017, 2016 and 2015 are illustrated in the graph below.



VMC's total net days receivable outstanding decreased 4.3 days from 48.5 days at June 30, 2016 to 44.2 days at June 30, 2017, and increased 0.6 days from 47.9 days at June 30, 2015 to 48.5 days at June 30, 2016. The decrease from 2016 to 2017 was primarily due to strong revenue cycle management. The increase from 2015 to 2016 was primarily due to ICD10 conversion.

As of June 30, 2017 and 2016, 40% and 41% of the patient accounts receivable balance is due from commercial payers, 54% and 53% is due from governmental payers Medicare and Medicaid, 5% and 4% from self-pay patients, and 1% and 2% is due from health exchange insured patients. As of June 30, 2015, 43% of patient accounts receivable balance is due from commercial payers, 51% is due from governmental payers Medicare and Medicaid, 4% from self-pay patients and 2% from health exchange insured patients. On January 1, 2014, the Washington State Medicaid program was expanded which significantly increased the number of eligible Medicaid enrollees receiving benefits. The population growth in the district has been disproportionately from aging people that are eligible for Medicare benefits. Due to these two factors, VMC has seen an increase in Medicare and Medicaid gross patient accounts receivable and a decrease in commercial gross accounts receivable at June 30, 2017, when compared to years prior to 2016.

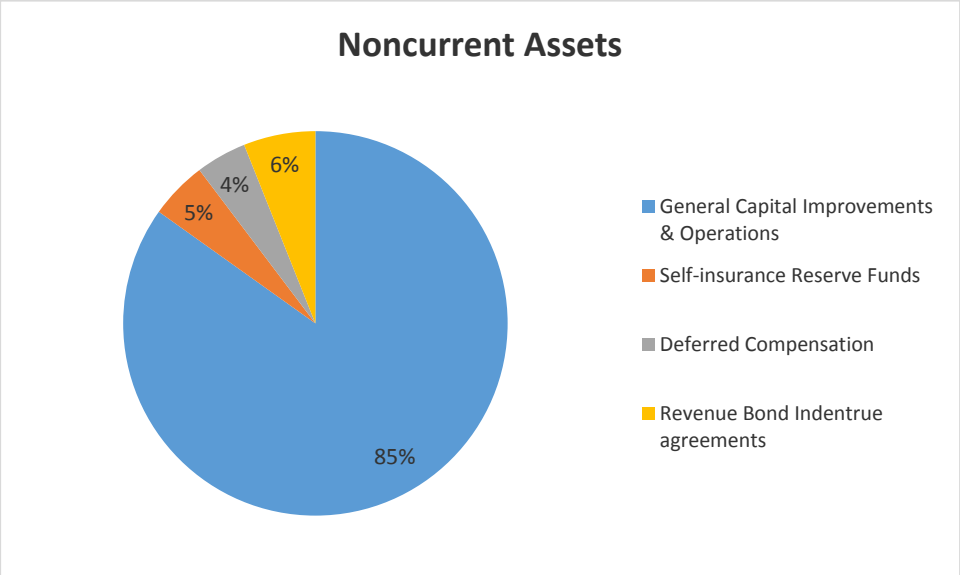
Property tax receivable increased $0.8 million from $10.1 million at June 30, 2016 to $11.0 million at June 30, 2017 and is primarily reflective of increased property values. In 2016, property tax receivable increased $0.7 million for the same reasons.

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 $28.9 million at June 30, 2016 to $29.2 million at June 30, 2017. The $0.2 million increase in 2017 and the $2.6 million increase in 2016 are both due to higher Construction-in-Progress liabilities.

Noncurrent Assets

Long-term investments represent unrestricted and undesignated investments with greater than one year to maturity. Long-term investments decreased $10.5 million from $12.6 million at June 30, 2016 to $2.1 million at June 30, 2017 and decreased $8.3 million from $20.9 million at June 30, 2015 to $12.6 million at June 30, 2016. 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 decreased from $117.9 million at June 30, 2016 to $93.7 million at June 30, 2017. The decrease in 2017 is related to decreased unrestricted assets and investments to be utilized for general capital improvements and operations. Total noncurrent assets increased $14.8 million between fiscal years 2015 and 2016 from $103.1 million to $117.9 million.

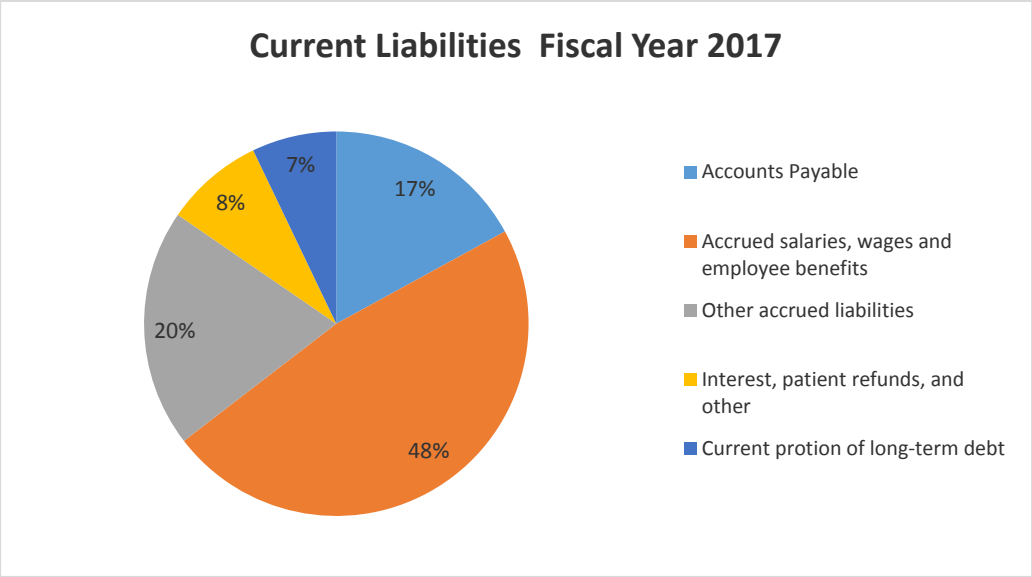
Capital assets increased $14.5 million during fiscal year 2017 from $348.1 million at June 30, 2016 to $362.6 million at June 30, 2017, and decreased $0.5 million during fiscal year 2016 from $348.6 million at June 30, 2015 to $348.1 million at June 30, 2016.

(Continued)

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 $124.1 million at June 30, 2017, compared to $100.8 million at June 30, 2016. Fiscal year 2017 composition of current liabilities is illustrated in the pie chart below.



Accounts payable increased $2.0 million between June 30, 2016 and June 30, 2017 from $18.1 million to $20.0 million and increased $1.5 million between June 30, 2015 and June 30, 2016 from $16.6 million to $18.1 million. 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, 2017 and 2016 were amounts accrued for capital related expenditures of $5.0 million and $3.8 million, respectively.

Accrued salaries, wages and employee benefits increased $15.9 million from $43.2 million at June 30, 2016 to $59.1 million at June 30, 2017 and increased $4.4 million from $38.8 million at June 30, 2015 to $43.2 million at June 30, 2016. Changes in accrued salaries, wages and employee benefits are also related to timing of payments to employees, as well as the overall growth in FTEs due to volume growth and expansion. The primary factor that caused the 2017 increase was a $12.6 million accrual for the voluntary early retirement and early separation programs.

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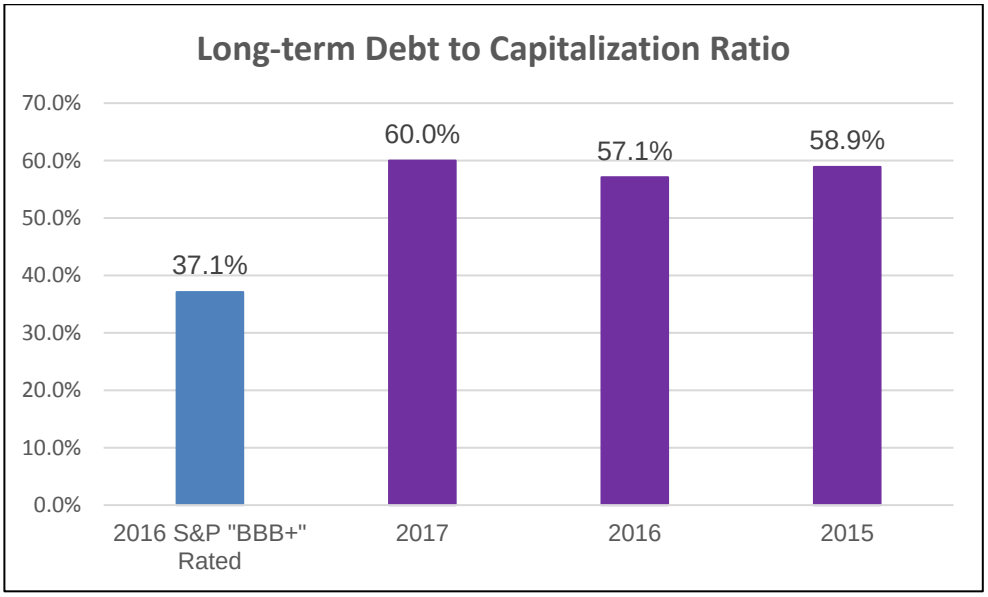
Other accrued liabilities, including estimated third-party payer settlements increased $2.4 million from $22.4 million at June 30, 2016 to $24.8 million at June 30, 2017 primarily due to estimated final Certified Public Expenditure cost settlements for fiscal years 2010-2017, as well as a payable to the University of Washington.

Noncurrent Liabilities

Noncurrent liabilities consist of long-term debt and other noncurrent liabilities. Total noncurrent liabilities were $310.3 million at June 30, 2017, compared to $302.9 million at June 30, 2016.

Long-term debt increased from $299.4 million at June 30, 2016 to $305.1 million at June 30, 2017 and decreased from $307.7 million at June 30, 2015 to $299.4 million at June 30, 2016. The increase in 2017 was due to a bond issuance made to refinance older bonds. The decrease in 2016 was 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 2017, 2016 and 2015 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.

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Deferred Outflows and Inflows of Resources

Deferred outflows of resources increased by $13.2 million in 2017 due to a debt refinancing.

Deferred inflows of resources increased $16.0 million from $26.7 million at June 30, 2016 to $42.7 million at June 30, 2017. The increase between June 30, 2016 and June 30, 2017 was due to a $16.5 million deposit received in May 2017 related to the expected sale of the joint venture lab. 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.

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.

UW Medicine/MultiCare Alliance

In July 2017, UW Medicine and MultiCare Health System (MultiCare) announced that they have formed a new alliance that will expand access to high-quality healthcare and allow the two organizations to engage in joint activities to further the mission of each organization. Through the alliance, UW Medicine and MultiCare will provide cost-effective and clinically integrated healthcare in communities throughout the Puget Sound region while supporting the education of the next generation of clinicians and advancing research. The parties joint activities will be guided by four core principles: the provision of high-quality, patient-centered care; a commitment to teaching and research; ensuring strong financial stewardship to deliver value to the payers of healthcare services; and a focus on improving the health of populations served by the alliance.

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.

- **Economic Uncertainty Facing the Healthcare Industry** – The healthcare industry, in general, and the acute care hospital business, in particular, are experiencing significant regulatory uncertainty based, in large part, on legislative efforts to significantly modify or repeal and potentially replace the Patient Protection and Affordable Care Act, as amended by the Health Care and Education Reconciliation Act of 2010 (Affordable Care Act or ACA). It is difficult to predict the full impact of these actions on our future revenues and operations. However, we believe that our ultimate success in increasing our profitability depends in part on our success in executing our strategies. In general, these strategies are intended to improve our financial performance through the reduction of costs and the streamlining of how we provide clinical care, as well as mitigate the recent negative reimbursement trends being experienced within our market with a continued focus on patient volumes that are shifting from inpatient to outpatient settings due to technological advancements and demand for care that is more convenient, affordable and accessible, and the industry is migrating to value-based payment models with government and private payers shifting risk to providers.

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, 2017 and 2016

Assets	VMC 2017	VMC 2016	Component unit – IPV 2017	Component unit – IPV 2016
Current assets:				
Cash and cash equivalents	$ 73,647,468	44,054,561	1,178,983	1,217,020
Short-term investments	21,919,763	16,373,635	—	—
Accounts receivable, less allowance for uncollectible accounts of $16,225,082 in 2017 and $13,576,934 in 2016	65,997,321	68,896,343	—	—
Property tax receivable	10,950,936	10,129,253	—	—
Due from:				
Primary government	—	—	1,076,366	779,319
Component unit	685,359	494,984	—	—
Noncurrent assets, required for current obligations	29,188,098	28,943,415	—	—
Supplies inventory	5,457,376	5,201,606	—	—
Prepaid expenses and other assets	11,906,673	13,862,703	61,168	31,723
Total current assets	219,752,994	187,956,500	2,316,517	2,028,062
Long-term investments	2,052,571	12,596,108	—	—
Other noncurrent assets:				
Unrestricted for general capital improvements and operations	104,246,434	129,974,874	—	—
Restricted for self-insurance reserve funds	5,940,792	5,943,911	—	—
Restricted under unearned compensation arrangements	5,233,273	3,528,900	—	—
Restricted under revenue bond indenture agreements	7,425,645	7,400,170	—	—
	122,846,144	146,847,855	—	—
Less amounts required for current obligations	(29,188,098)	(28,943,415)	—	—
Total other noncurrent assets	93,658,046	117,904,440	—	—
Capital assets:				
Land	13,413,733	13,413,733	—	—
Construction in progress	29,776,963	13,508,462	—	—
Depreciable capital assets, net of accumulated depreciation	319,378,730	321,160,593	1,040,684	1,119,559
Total capital assets	362,569,426	348,082,788	1,040,684	1,119,559
Goodwill, intangible assets and other	3,163,252	3,530,969	—	—
Total assets	681,196,289	670,070,805	3,357,201	3,147,621
Deferred outflow of resources	13,242,056	—	—	—
Total assets and deferred outflows	$ 694,438,345	670,070,805	3,357,201	3,147,621

(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, 2017 and 2016

Liabilities and Net Position	VMC 2017	VMC 2016	Component unit – IPV 2017	Component unit – IPV 2016
Current liabilities:				
Accounts payable	$ 20,016,539	18,058,274	187,777	156,116
Accrued salaries, wages and benefits	59,093,014	43,180,436	—	—
Due to:				
Primary government	—	—	685,359	494,984
Component unit	1,076,366	779,319	—	—
Other accrued liabilities, including estimated third-party payor settlements	24,789,495	22,414,368	—	—
Interest, patient refunds and other	10,281,182	7,909,239	—	—
Current portion of long-term debt and capital lease obligations	8,810,000	8,500,000	244,258	258,944
Total current liabilities	124,066,596	100,841,636	1,117,394	910,044
Unearned compensation	5,233,273	3,528,900	—	—
Long-term debt and capital lease obligations, net of current portion	305,021,605	299,358,652	78,076	344,235
Total liabilities	434,321,474	403,729,188	1,195,470	1,254,279
Deferred inflows of resources	42,717,299	26,743,735	—	—
Net position:				
Invested in capital assets net of related debt	61,299,666	40,084,447	718,350	516,380
Restricted:				
For debt service	7,425,645	7,400,170	—	—
Expendable for specific operating activities	615,447	633,798	—	—
Unrestricted	148,058,814	191,479,467	1,443,381	1,376,962
Total net position	217,399,572	239,597,882	2,161,731	1,893,342
Total liabilities, deferred inflows, and net position	$ 694,438,345	670,070,805	3,357,201	3,147,621

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, 2017 and 2016

	VMC		Component unit – IPV	
	2017	2016	2017	2016
Operating revenues:				
Net patient service revenue (net of VMC's provision for uncollectible accounts of $13,108,798 in 2017 and $17,361,673 in 2016)	$ 544,658,032	519,838,301	16,139	24,706
Other operating revenue	38,319,621	36,981,327	9,695,279	9,053,009
Total operating revenues	582,977,653	556,819,628	9,711,418	9,077,715
Operating expenses:				
Salaries and wages	294,461,660	260,139,159	—	—
Employee benefits	79,722,001	66,855,584	—	5,610
Purchased services	92,837,144	84,702,588	762,983	786,828
Supplies and other expenses	112,421,456	110,348,238	217,714	262,662
Depreciation	31,366,538	29,019,640	194,722	307,261
Total operating expenses	610,808,799	551,065,209	1,175,419	1,362,361
Operating income (loss)	(27,831,146)	5,754,419	8,535,999	7,715,354
Nonoperating income (expense):				
Property tax revenue	21,490,047	19,901,659	—	—
Interest income	4,416,830	4,289,732	—	—
Interest and amortization expense	(17,696,582)	(17,698,019)	(14,150)	(21,394)
Investment gain (loss), net	(2,867,644)	376,632	—	—
Other, net	290,185	(1,133,710)	—	—
Distributions to members	—	—	(8,253,460)	(7,703,833)
Net nonoperating income (expense)	5,632,836	5,736,294	(8,267,610)	(7,725,227)
Increase (decrease) in net position	(22,198,310)	11,490,713	268,389	(9,873)
Net position, beginning of year	239,597,882	228,107,169	1,893,342	1,903,215
Net position, end of year	$ 217,399,572	239,597,882	2,161,731	1,893,342

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, 2017 and 2016

	VMC		Component unit – IPV	
	2017	2016	2017	2016
Cash flows from operating activities:				
Receipts from and on behalf of patients	$ 549,932,181	521,386,176	16,139	224,722
Payments to suppliers and contractors	(199,956,907)	(202,856,005)	(1,026,075)	(1,031,115)
Payments to employees	(356,566,710)	(323,244,834)	—	(28,502)
Other cash receipts	31,716,855	30,818,260	9,398,232	9,053,009
Net cash provided by operating activities	25,125,419	26,103,597	8,388,296	8,218,114
Cash flows from noncapital financing activities:				
Cash received from tax levy	21,550,408	19,935,953	—	—
Distribution to Valley Medical Center	—	—	(6,412,391)	(6,363,241)
Distribution to noncontrolling member of Imaging Partners at Valley, LLC	—	—	(1,603,100)	(1,590,810)
Other	(18,351)	21,944	—	—
Net cash provided by (used in) noncapital financing activities	21,532,057	19,957,897	(8,015,491)	(7,954,051)
Cash flows from capital and related financing activities:				
Proceeds from issuance of refunding bonds	193,900,000	—	—	—
Proceeds from premium on refunding bonds	21,623,594	—	—	—
Payment to refunding bond escrow agent	(215,425,369)	—	—	—
Cash paid for bond issuance	(1,234,621)	—	—	—
Principal payments on long-term debt and capital lease obligations	(8,500,000)	(8,185,000)	(280,845)	(290,849)
Interest paid, net of amounts capitalized	(15,055,406)	(17,015,780)	(14,150)	(21,394)
Purchases of capital assets	(45,092,722)	(29,054,188)	(115,847)	(7,279)
Sale of medical office building	—	18,500,000	—	—
Other	(763,228)	(112,750)	—	(32)
Net cash used in capital and related financing activities	(70,547,752)	(35,867,718)	(410,842)	(319,554)
Cash flows from investing activities:				
Distributions from joint venture	6,412,391	6,363,241	—	—
Deposit from expected sale of joint venture lab	16,522,486	—	—	—
Sale of investments and noncurrent assets	101,886,788	26,477,077	—	—
Purchases of investments and noncurrent assets	(75,755,312)	(29,174,029)	—	—
Investment and interest income, net of amounts capitalized	4,416,830	4,289,732	—	—
Net cash provided by investing activities	53,483,183	7,956,021	—	—
Net increase (decrease) in cash and cash equivalents	29,592,907	18,149,797	(38,037)	(55,491)
Cash and cash equivalents, beginning of year	44,054,561	25,904,764	1,217,020	1,272,511
Cash and cash equivalents, end of year	$ 73,647,468	44,054,561	1,178,983	1,217,020

(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, 2017 and 2016

	VMC		Component unit – IPV	
	2017	2016	2017	2016
Reconciliation of operating income (loss) to net cash provided by operating activities:				
Operating income (loss)	$ (27,831,146)	5,754,419	8,535,999	7,715,354
Adjustments to reconcile operating income to net cash provided by operating activities:				
Depreciation	31,366,538	29,019,640	194,722	307,261
Provision for uncollectible accounts	13,108,798	17,361,673	—	(47,116)
Income recognized from joint venture	(6,602,766)	(6,163,067)	—	—
Loss on sale of capital assets	—	—	—	251
Changes in assets and liabilities:				
Accounts receivable	(10,209,776)	(23,132,719)	—	93,509
Due from:				
Primary government	—	—	(297,047)	153,623
Supplies inventory	(255,770)	(420,409)	—	—
Prepaid expenses and other assets	1,956,030	(7,503,253)	(29,445)	7,553
Accounts payable	838,610	(1,193,066)	(15,933)	10,571
Accrued salaries, wages, and benefits	15,912,578	4,332,153	—	(22,892)
Due to:				
Component unit	297,047	(153,623)	—	—
Other accrued liabilities and estimated third-party payor settlements	2,375,127	8,731,473	—	—
Other liabilities	2,465,776	52,620	—	—
Unearned compensation	1,704,373	(582,244)	—	—
Net cash provided by operating activities	$ 25,125,419	26,103,597	8,388,296	8,218,114
Supplemental disclosure of noncash investing, capital, and financing activities:				
Increase in capital assets included in accounts payable	$ 1,119,655	2,647,364	—	—

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.

The District, dba Valley Medical Center (VMC), and the University of Washington (the University) participate in a Strategic Alliance Agreement. Under this agreement, VMC is 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 2017 were:

Donna Russell, Chair
Gary Kohlwes, Vice Chair
Bernie Dochnahl
Tamara Sleeter, M.D. (President of Board of Commissioners)
Julia Patterson
Brian Goldstein
Mike Miller
Barbara Drennen (Commissioner)
Peter Evans
Paul Joos, M.D. (Commissioner)
Chris Monson, M.D. (Commissioner)
Vicki Orrico
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, dba VMC, is comprised of a 321 licensed bed hospital and a network of primary care, specialty care and behavioral health clinics. The district health system 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 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).

VMC reported a decrease in net position of $22.0 million for fiscal year 2017. This amount includes the cost of the voluntary one-time early retirement and early separation programs that resulted in additional expenses of $12.6 million. The programs were designed as part of a larger cost containment initiative to address the operating pressures resulting from continued payer shift from commercial to Medicare. VMC expects to see the return on this initiative within 12-24 months.

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 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 Governmental Accounting Standards Board (GASB) pronouncements and interpretations. VMC uses proprietary fund accounting.

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

(b) Basis of Accounting

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

(c) Use of Estimates

The preparation of financial statements in conformity with U.S. 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' or Board of Trustees' resolutions. Certain accounts maintained separately on the books of VMC have been combined for financial statements presentation.

(i) Operating Account

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

(ii) Plant and Construction Accounts

These account for land, buildings, and equipment; and the proceeds of the 2004, 2008, 2011, and 2016 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.

(iii) Bond Account

Principal and interest payments on the Series 2004, 2008, 2011, and 2016 bonds are made from this account.

(iv) Revenue Bond Account

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

(v) 2010 Refundable Credits Account

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

(vi) Restricted Accounts

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

(e) Cash and Cash Equivalents

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

Custodial credit risk for deposits is the risk that in the event of a financial institution failure, the deposits may not be returned to the depositor. The Federal Deposit Insurance Corporation (FDIC) provides insurance to depositors to guard against custodial credit risk. Under FDIC insurance coverage is provided for account balances up to $250,000 per depositor, per insured bank. As of June 30, 2017 and 2016, VMC had no bank balances subject to custodial credit risk as any deposits in excess of $250,000 were covered by collateral held in a multi financial institution collateral pool administered by the Washington Public Deposit Protection Commission.

(f) Investments

VMC holds investments, as allowed by State law, in the form of bankers' acceptances, repurchase agreements, obligations secured by the U.S. Treasury, other obligations of the United States or its agencies, and certificates of deposit with financial institutions in accordance with state guidelines. Investments are for the funding of future capital improvements, self-insurance 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

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 2017 and 2016 was $453,933 and $276,245, 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 both June 30, 2017 and 2016 was $15.7 million. Sick leave accrued as of June 30, 2017 and 2016 was $5.1 million and $4.7 million, respectively.

(Continued)

(k) Third Party Payor Settlements, Net

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

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

(i) Medicare

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

(ii) Medicaid

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

(iii) Commercial

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

(iv) UW Medicine Accountable Care Network

UW Medicine has formed an accountable care network (ACN) with other health care organizations and healthcare professionals to share financial and clinical responsibility for the healthcare of particular populations of patients. VMC is a network member of the UW Medicine ACN and as such shares in any risk contract surplus or deficits based on agreed upon contractual terms. Since its inception, the ACN has entered into various contracts which include provisions for shared risk as well as shared savings based on achieving certain quality and financial benchmarks. VMC and the other network members share in the financial risk or savings. At June 30, 2017 and 2016, VMC recorded liabilities of $5,534,000 and $2,394,000, respectively for its portion of the estimated liability related to these risk-sharing arrangements. These amounts are reflected in other accrued liabilities, including estimated third-party 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 $21,407,000 and $7,423,000 respectively, for the years ended June 30, 2017 and 2016.

VMC estimates the cost of charity care using its cost to charge ratio of 25.8% and 26.1% for the fiscal years ended June 30, 2017 and 2016, respectively. Applying VMC's cost to charge ratio of 25.8% to total charity of $21,407,000 results in a cost of charity care of approximately $5,523,000 for the fiscal year ended June 30, 2017. 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.

(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, 2017 and 2016.

(p) Deferred Outflows and Inflows of Resources

Deferred outflows of resources consist of the excess of the reacquisition price over the carrying amount of bonds refinanced in fiscal year 2017. This balance is amortized to interest expense through 2038.

Deferred inflows of resources consist of property tax revenue, deferred gain from the sale of Valley Professional Center North (VPCN) and a deposit related to the expected sale of a lab joint venture. The following are the components of deferred inflows of resources for the as of June 30, 2017 and 2016:

	VMC	
	2017	**2016**
Property tax revenue	$ 11,228,190	10,346,146
Deferred gain on sale of VPCN	14,966,623	16,397,589
Deposit from sale of lab joint venture	16,522,486	—
Total deferred inflows of resources	$ 42,717,299	26,743,735

(Continued)

(q) Recently Adopted and Upcoming Accounting Pronouncements

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

(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 2017 and 2016, net patient service revenue includes approximately $1,570,000 and $2,375,000, 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, 2017 and 2016:

	VMC	
	2017	**2016**
Gross patient service revenue	$ 1,831,406,708	1,686,484,731
Less adjustments to patient service revenue:		
Charity	(21,407,021)	(7,423,198)
Contractual discounts	(1,252,232,857)	(1,141,861,559)
Provision for uncollectible accounts	(13,108,798)	(17,361,673)
Total adjustments to patient service revenue	(1,286,748,676)	(1,166,646,430)
Net patient service revenue	$ 544,658,032	519,838,301

(Continued)

	Component unit – IPV	
	2017	**2016**
Gross patient service revenue	$ 21,633	—
Less adjustments to patient service revenue:		
Charity	—	(504)
Contractual discounts	(5,494)	(21,906)
Recovery	—	47,116
Total adjustments to patient service revenue	(5,494)	24,706
Net patient service revenue	$ 16,139	24,706

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, 2017 and 2016 were as follows:

	2017	
	VMC	
	Patient service charges	**Accounts receivable**
Medicare	36 %	33 %
Medicaid	23	21
Commercial and other	38	40
Self pay	2	5
Exchange (HIX)	1	1
Total	100 %	100 %

	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)

(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 $6,174,712 and $8,663,726 under this program for the years ended June 30, 2017 and 2016, 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 $17,215,167 and $17,887,524 in DSH funding under this program for the years ended June 30, 2017 and 2016, 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, 2017 or 2016. Claims payments and DSH payments are included in net patient service revenues in the statements of revenues, expenses, and changes in net position.

CPE payments are subject to retrospective determination of actual costs once VMC's Medicare Cost Report is audited by Centers for Medicare and Medicaid Services (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, 2007, 2008 and 2009 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 reports 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, 2017 and 2016, for fiscal years 2006 through 2017 VMC had estimated payables of $18.0 million and $19.6 million, respectively, which are included as liabilities in other accrued liabilities, including estimated third-party payer settlements in the accompanying statements of net position.

(b) Professional Services Supplemental Payment (PSSP) Program

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

Under the 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 $240,063 and $290,703 for the years ended June 30, 2017 and 2016, 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 $596,893 and $823,147 in supplemental payments for the years ended June 30, 2017 and 2016, respectively. These payments are included in net patient service revenues in the statements of revenues, expenses, and changes in net position.

VMC recorded $3,250,273 and $2,274,997 for the years ended June 30, 2017 and 2016, 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 $13,694,003 and $6,076,087 in supplemental payments for the years ended June 30, 2017 and 2016, respectively. These payments are included in net patient service revenue in the statements of revenues, expense, and changes in net position.

(c) Hospital Safety Net Program

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

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

VMC received grant funding of $2.2 million for each of the years ended June 30, 2017 and 2016 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 $655,776 and $2,336,643 for the years ended June 30, 2017 and 2016, 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 late January 2016 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 year ended December 31, 2015. 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 2017, the District's tax levy rate was $0.50 per assessed $1,000 in property value pursuant to the District's authorized tax levy in November 2016 resulting in a tax levy of $22,453,903.

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.

Property taxes are recorded as receivables when levied. Because State law allows for the sale of property for failure to pay taxes, no estimate of uncollectible taxes is made. Given property taxes are recorded on a calendar-year basis, the property tax receivable balances at June 30, 2017 and 2016 are $10,950,936 and $10,129,253, respectively, and are shown as current assets in the statements of net position.

Revenues from taxation are $21,490,047 and $19,901,659, for the fiscal 2017 and 2016 years, respectively, and are recorded as nonoperating revenue in the statements of revenues, expenses and changes in net position.

The District has pledged its future tax revenues, as well as operating revenues, to repay its limited tax general obligation and revenue bonds issued in 2004, 2008, 2010, 2011, and 2016 to finance construction, other capital improvements, medical equipment and technology, and information technology systems.

(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, 2017 and 2016 is set forth below:

	Balance June 30, 2016	Additions	Transfers	Retirements	Balance June 30, 2017
Nondepreciable capital assets:					
Land	$ 13,413,733	—	—	—	13,413,733
Construction in progress	13,508,462	46,212,377	(29,943,876)	—	29,776,963
Total capital assets, not being depreciated	26,922,195	46,212,377	(29,943,876)	—	43,190,696
Capital assets, being depreciated:					
Land improvements	18,615,914	—	236,390	—	18,852,304
Buildings, renovations and furnishings	426,368,234	—	11,549,666	(89,547)	437,828,353
Fixed equipment	23,604,783	—	27,782	—	23,632,565
Movable equipment	188,061,096	—	15,526,828	(22,972,764)	180,615,160
Minor equipment	19,383,329	—	2,603,210	(63,757)	21,922,782
Total capital assets, being depreciated	676,033,356	—	29,943,876	(23,126,068)	682,851,164
Total capital assets at historical cost	702,955,551	46,212,377	—	(23,126,068)	726,041,860

	Balance June 30, 2016	Additions	Transfers	Retirements	Balance June 30, 2017
Less accumulated depreciation for:					
Land improvements	$ (11,375,017)	(409,382)	—	—	(11,784,399)
Buildings, renovations and furnishings	(166,054,974)	(13,522,457)	—	89,547	(179,487,884)
Fixed equipment	(21,443,436)	(343,250)	—	—	(21,786,686)
Movable equipment	(143,914,188)	(15,583,030)	—	22,902,216	(136,595,002)
Minor equipment	(12,085,148)	(1,791,756)	—	58,441	(13,818,463)
Total accumulated depreciation	(354,872,763)	(31,649,875)	—	23,050,204	(363,472,434)
Total capital assets, net	$ 348,082,788	14,562,502	—	(75,864)	362,569,426

(Continued)

	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

	Balance June 30, 2015	Additions	Transfers	Retirements	Balance June 30, 2016
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

Included in major movable equipment at June 30, 2017 and 2016 is $4,589,162 and $4,589,162, respectively, of equipment under capital lease. Accumulated amortization of the equipment under capital lease totaling $4,589,162 and $4,589,162 is included in accumulated depreciation at June 30, 2017 and 2016, respectively.

(Continued)

Depreciation expense was $31,649,875 and $29,410,170 for the years ended June 30, 2017 and 2016, respectively, includes $283,337 and $390,530 of nonoperating depreciation expense. This nonoperating expense is associated with medical office buildings rented or leased to physician practices and others and, therefore, are not considered within the operations of VMC. Therefore, $31,366,538 and $29,019,640 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, 2017 and 2016, 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 gain on sale of the building is 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, 2017 is as follows:

	Balance June 30, 2016	Additions	Transfers	Retirements	Balance June 30, 2017
Buildings, renovations and furnishings	$ 270,350	—	—	—	270,350
Fixed equipment	—	—	—	—	—
Movable equipment	5,987,168	115,847	—	(235,770)	5,867,245
Total capital assets, being depreciated	6,257,518	115,847	—	(235,770)	6,137,595
Total capital assets at historical cost	6,257,518	115,847	—	(235,770)	6,137,595
Less accumulated depreciation for:					
Land improvements	—	—	—	—	—
Buildings, renovations and furnishings	(68,662)	(7,657)	—	—	(76,319)
Fixed equipment	—	—	—	—	—
Movable equipment	(5,069,297)	(187,065)	—	235,770	(5,020,592)
Total accumulated depreciation	(5,137,959)	(194,722)	—	235,770	(5,096,911)
Total capital assets, net	$ 1,119,559	(78,875)	—	—	1,040,684

(Continued)

	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

(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.

(Continued)

At June 30, 2017 and 2016, deposits and investments of VMC consist of the following:

	2017	2016
Unrestricted cash	$ 24,123,439	6,619,186
Unrestricted investments and cash equivalents:		
U.S. Treasury securities and bonds	127,764,795	156,888,546
Money market mutual funds	—	362,553
U.S. government mutual funds	—	218,034
Investment pools	49,178,676	36,217,804
Municipal bonds	182,978	1,165,809
Tax-exempt issues	—	890,262
	177,126,449	195,743,008
Restricted assets:		
Cash and cash equivalents	687,920	636,984
U.S. Treasury securities and bonds	12,140,023	—
Municipal bonds	1,154,842	—
Money market mutual funds	—	1,753,664
U.S. government mutual funds	—	11,590,417
Other assets	5,233,273	3,528,900
	19,216,058	17,509,965
	$ 220,465,946	219,872,159

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.

(Continued)

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

According to GASB Statement No. 40, *Deposit and Investment Risk Disclosures – 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, 2017 and 2016, VMC's investment in the Pool was not rated by a NRSRO. In compliance with state statutes, Pool policies authorize investments in U.S. Treasury securities, U.S. agency and mortgage-backed securities, municipal securities (rated at least A by two NRSROs), commercial paper (rated at least the equivalent of A-1 by two NRSROs), certificates of deposit issued by qualified public depositories, repurchase agreements, and the LGIP managed by the Washington State Treasurer's Office.

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

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

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

Level 3 – Unobservable inputs for an asset or liability

The composition of investments, reported at fair value by investment type and rating at June 30, 2017 and excluding unrestricted and restricted cash balances of $24,811,359, is as follows:

Investment type		Quoted prices in active markets for identical assets (Level 1)	Ratings	Percentage of total
U.S. Treasury	$	58,088,225	AA+/A-1+	39.7 %
U.S. agency securities		61,828,044	AA+/A-1+	42.2
U.S. agency mortgages		19,988,549	AA+	13.6
Municipal bonds		1,337,820	Various	0.9
Other assets		5,233,273	Not rated	3.6
Total investments by fair value level	$	146,475,911		100.0 %

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 total
Money market mutual fund	$	2,116,217	AAA	1.2 %
U.S. Treasury		69,357,243	Not rated	39.3
U.S. agency securities		56,413,308	AAA	32.0
U.S. agency mortgages		31,117,995	AAA	17.6
Tax-exempt issues		890,262	AAA	0.5
Municipal bonds		1,165,809	AAA	0.7
Mutual funds invested in U.S. government securities		11,808,451	AAA	6.7
Other assets		3,528,900	Not rated	2.0
Total investments by fair value level	$	176,398,185		100.0 %

(Continued)

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, 2017 and 2016, for those investments that require composition disclosure, VMC holds investments in U.S. government-sponsored entities totaling 20% and 8% of its total investments in Federal National Mortgage Association securities, 16% and 12% of its total investments in Federal Home Loan Mortgage Corporation securities, and 10% and 12%, 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.

2017		Remaining maturity (in months)			
Investment type	Fair value	12 months or less	13 to 24 months	25 to 48 months	More than 48 months
U.S. Treasury	$ 58,088,225	12,857,913	10,228,461	34,263,787	738,064
U.S. agency securities	61,828,044	15,058,967	16,286,165	21,584,581	8,898,331
U.S. agency mortgages	19,988,549	538,476	1,280,097	2,100,568	16,069,408
King County investment pool	49,178,676	—	49,178,676	—	—
Municipal bonds	1,337,820	40,162	426,700	200,958	670,000
Other assets	5,233,273	—	—	—	5,233,273
	$ 195,654,587	28,495,518	77,400,099	58,149,894	31,609,076

(Continued)

2016 Investment type	Fair value	Remaining maturity (in months) 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

(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:

	2017	2016
Limited tax general obligation bonds:		
2016 series, 4% to 5%, due serially on December 1, in amounts from $2,750,000 in 2020 to $16,455,000 in 2038, plus interest due semiannually, including unamortized premium of $20,839,853	$ 214,739,853	—
2011 term bond, 2.19%, due in June and December, in yearly amounts from $2,720,000 in 2017 to $2,035,517 in 2022, plus interest due semiannually, net of unamortized loss on refinance of $230,833	16,620,579	19,239,559
2008 term bond, 5%, due serially on December 1, in amounts from $2,845,000 in 2017 to $3,320,000 in 2019, plus interest due semiannually, net of unamortized discount of $230 and unamortized loss on refinancing of $39,556	5,740,214	209,046,544
2004 series, 3.75% to 4.25%, due serially on December 1, in amounts from $1,215,000 in 2017 to $1,260,000 in 2018, plus interest due semiannually, including unamortized premium of $597 and net of unamortized loss on refinance of $2,875	1,257,722	2,458,541

(Continued)

	2017	2016
Revenue bonds:		
2010 series A, 3.00% to 5.125%, due serially in June, in amounts from $1,720,000 in 2017 to $2,395,000 in 2024, plus interest due semiannually, net of unamortized discount of $84,265, and unamortized loss on refinance of $107,498	$ 14,318,237	15,959,008
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
Total long-term debt	313,831,605	307,858,652
Less current portion	(8,810,000)	(8,500,000)
Total long-term debt, net of current portion	$ 305,021,605	299,358,652

(i) Long-term Debt Overview

Series 2016 Bond Issue

The 2016 Limited Tax General Obligation Refunding Bond was issued for $193,900,000. These proceeds were used to refund the majority of the 2008 bonds. The District has pledged tax revenues to secure the bonds. The difference between the cash flows required to service the old debt and the cash flows required to service the new debt and complete the refunding was $19,917,231. The economic gain was $13,289,849.

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.

(Continued)

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, 2017 and 2016, the District received $1,588,559 and $1,590,266, 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 budgeting for making annual levies of taxes, within constitutional and statutory tax limitations provided by law upon on all property within the District subject to taxation, together with any other money legally available, to be sufficient to pay the principal and interest of the LTGO bonds.

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

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

Management is not aware of any violations with its debt covenants for the years ended June 30, 2017 and 2016.

(iii) Long-Term Debt Maturities

The following schedule shows debt service requirements for the next five years and thereafter, as of June 30, 2017, for both principal and interest:

	Principal	Interest	Total
2018	$ 8,810,000	15,815,343	24,625,343
2019	10,129,509	15,488,277	25,617,786
2020	7,615,188	15,184,237	22,799,425
2021	7,916,198	14,929,604	22,845,802
2022	5,765,517	14,656,583	20,422,100
2023–2027	56,440,000	65,716,551	122,156,551
2028–2032	72,220,000	47,960,650	120,180,650
2033–2037	92,475,000	24,885,375	117,360,375
2038–2041	32,085,000	2,955,775	35,040,775
Total payments	$ 293,456,412	217,592,395	511,048,807

(iv) Change in Total Liabilities

Changes in total liabilities during the fiscal years ended June 30, 2017 and 2016 are summarized below:

	Balance June 30, 2016	Increases	Decreases	Balance June 30, 2017	Due within one year
Limited tax general obligation bonds:					
2016 series	$ —	215,523,593	(783,740)	214,739,853	—
2011 series	19,239,559	—	(2,618,980)	16,620,579	3,300,000
2008 series	209,046,544	—	(203,306,330)	5,740,214	2,460,000
2004 series	2,458,541	—	(1,200,819)	1,257,722	1,260,000
Revenue bond:					
2010 Series A	15,959,008	—	(1,640,771)	14,318,237	1,790,000
Build America bonds:					
2010 Series B	61,155,000	—	—	61,155,000	—
Total long-term debt and capital lease obligations	307,858,652	215,523,593	(209,550,640)	313,831,605	8,810,000
Unearned compensation	3,528,900	1,738,848	(34,475)	5,233,273	—
Total liabilities	$ 311,387,552	217,262,441	(209,585,115)	319,064,878	8,810,000

(Continued)

	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 liabilities	$ 319,979,970	—	(8,592,418)	311,387,552	8,500,000

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

The capital lease obligations as of June 30, 2017 and 2016 consist of equipment leases with a present value of $322,334 and $603,179, with total monthly payments of $22,691, including imputed interest of 2.37%, maturing in 2019.

The schedule of changes in capital leases is as follows:

	Balance June 30, 2016	Increases	Decreases	Balance June 30, 2017	Due within one year
Capital lease obligations	$ 603,179	—	(280,845)	322,334	244,258

	Balance June 30, 2015	Increases	Decreases	Balance June 30, 2017	Due within one year
Capital lease obligations	$ 894,028	—	(290,849)	603,179	258,944

(Continued)

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

Fiscal year ending June 30:		
2018	$	249,601
2019		78,480
Total minimum lease payments		328,081
Less amount representing interest		(5,747)
Net		322,334
Less current portion		(244,258)
Present value of capital lease, net of current portion	$	78,076

(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 Statement No. 10, *Accounting and Financial Reporting for Risk Financing and Related Insurance Issues*, which requires that a liability for claims be reported if information prior to the issuance of the financial statements indicates that it is probable that a liability has been incurred at the date of the financial statements and the amount of the loss can be reasonably estimated. The 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, 2017 and 2016 are noted below:

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
Incurred claims and changes in estimates		60,000
Claims payments		—
Reserve at June 30, 2017	$	1,440,000

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

(c) Employee Medical

VMC is self-insured for medical and dental benefits. The accrued liabilities for the self-insured component of the plan include the unpaid portion of claims that have been reported and estimates for claims that have been incurred but not reported. VMC also carries stop-loss coverage for claims in excess of the $275,000 and $225,000 specific deductible for calendar year 2017 and 2016 respectively, and $122,000 aggregating specific deductible for calendar year 2017 and 2016. VMC has recorded an actuarially estimated liability for health claims that have been incurred but not reported of $2,828,073 and $2,486,235 as of June 30, 2017 and 2016, 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, 2017 and 2016 is based on undiscounted calculations.

(Continued)

(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 2017 and 2016. 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 $5,218,091 and $4,897,685 at June 30, 2017 and 2016, respectively, which are included in accrued salaries, wages, and benefits in the accompanying VMC statements of net position. The workers' compensation reserve at June 30, 2017 and 2016 is based on undiscounted calculations.

(9) Retirement Plans

VMC offers its employees two deferred compensation plans created in accordance with Internal Revenue Code Sections 403(b) and 457. The plans, available to all employees, permit them to defer a portion of their salary until future years. Employee contributions to the plans totaled $16,011,686 and $13,407,366 for the years ended June 30, 2017 and 2016, 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.

Employer contributions into the 403(b) plan totaled $14,431,965 and $13,390,601 for the years ended June 30, 2017 and 2016, respectively.

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

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

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

(10) Related-Party Transactions

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

(a) University of Washington

A total of $9,564,000 and $9,004,000 was paid by VMC to divisions of the University for the years ended June 30, 2017 and 2016, respectively, for transactions primarily related to reference laboratory work, providing contracted nursing assistance with the Valley Nurse Line, and management assistance within various departments. VMC received $732,000 and $573,000 in revenue from related parties for the years ended June 30, 2017 and 2016, 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.

(i) Lease of Medical Office Space

The component unit has several lease agreements with VMC. Office space for two different locations is leased from VMC for $351,581 and $343,041 for the years ended June 30, 2017 and 2016, respectively. The leases expire in December 2019, and April 2020, respectively. The component unit has $1,776,180 in total outstanding minimum lease payments due to VMC.

(ii) Operational Services

During the years ended June 30, 2017 and 2016, IPV provided radiology services on behalf of VMC, which reimburses IPV for those services. VMC pays IPV for services rendered, which is represented by $6,602,766 and $6,163,067 in IPV's other operating revenue for 2017 and 2016 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, 2017 was $8,567,950 and $351,581 for VMC and the discretely presented component unit, respectively. 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.

The following schedule shows future minimum lease payments by fiscal year for VMC and the discretely presented component unit as of June 30, 2017:

	VMC	Component unit
2018	$ 8,641,825	355,236
2019	7,935,034	355,236
2020	6,915,249	355,236
2021	6,273,521	355,236
2022	6,095,820	355,236
Thereafter	11,501,342	—
Total minimum lease payments	$ 47,362,791	1,776,180

(b) Construction Commitments

VMC has current commitments at June 30, 2017 of $35,391,892 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.

(Continued)

(e) Collective Bargaining Agreements

VMC has a total of approximately 3,246 employees. Of this total, approximately 70% and 71% are covered collective bargaining agreements as of June 30, 2017 and 2016, respectively. Nurses are represented by Service Employees International Union (SEIU) 1199 and other healthcare and support workers are represented by Office and Professional Employees International Union (OPEIU), United Food and Commercial Workers (UFCW), and International Union of Operating Engineers (IUOE) Operating Engineers. The collective bargaining agreements with SEIU 1199 expire on June 30, 2019. OPEIU, UFCW, and IUOE Operating Engineers expire on June 30, 2017; March 31, 2020 and October 31, 2020, respectively.

(12) Subsequent Events

In May of 2017, VMC received a $16.5 million deposit related to the expected sale of VMC's interest in a lab joint venture and reported the receipts as deferred inflows of resources on the statement of net position as of June 30, 2017. VMC expects the sale to be finalized and that a gain will be recognized during fiscal year 2018.

The UW Medicine ACN entered into an agreement to provide health care services to nonunion employees of a large local employer with coverage that began January 1, 2015. VMC is a member of the network and recorded $5.5 million in liabilities as of June 30, 2017. Subsequent to year end, the ACN renegotiated the contract terms with the employer and the amendments were signed in August 2017. The impact to the recorded liabilities from the contract amendments will be reflected in the fiscal year 2018 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 Statement of Net Position

June 30, 2017

Assets	VMC	Component unit – IPV	Eliminations	Aggregated
Current assets:				
Cash and cash equivalents	$ 73,647,468	1,178,983	—	74,826,451
Short-term investments	21,919,763	—	—	21,919,763
Accounts receivable, less allowance for uncollectible accounts	65,997,321	—	—	65,997,321
Property tax receivable	10,950,936	—	—	10,950,936
Due from:				
Primary government	—	1,076,366	(1,076,366)	—
Component unit	685,359	—	(685,359)	—
Noncurrent assets, required for current obligations	29,188,098	—	—	29,188,098
Supplies inventory	5,457,376	—	—	5,457,376
Prepaid expenses and other assets	11,906,673	61,168	—	11,967,841
Total current assets	219,752,994	2,316,517	(1,761,725)	220,307,786
Long-term investments	2,052,571	—	—	2,052,571
Other noncurrent assets:				
Unrestricted for general capital improvements and operations	104,246,434	—	—	104,246,434
Restricted for self-insurance reserve funds	5,940,792	—	—	5,940,792
Restricted under unearned compensation arrangements	5,233,273	—	—	5,233,273
Restricted under revenue bond indenture agreements	7,425,645	—	—	7,425,645
	122,846,144	—	—	122,846,144
Less amounts required for current obligations	(29,188,098)	—	—	(29,188,098)
Total other noncurrent assets	93,658,046	—	—	93,658,046
Capital assets:				
Land	13,413,733	—	—	13,413,733
Construction in progress	29,776,963	—	—	29,776,963
Depreciable capital assets, net of accumulated depreciation	319,378,730	1,040,684	—	320,419,414
Total capital assets	362,569,426	1,040,684	—	363,610,110
Goodwill, intangible assets and other	3,163,252	—	—	3,163,252
Total assets	681,196,289	3,357,201	(1,761,725)	682,791,765
Deferred outflow of resources	13,242,056	—	—	13,242,056
Total assets and deferred outflows	$ 694,438,345	3,357,201	(1,761,725)	696,033,821

(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 Statement of Net Position

June 30, 2017

Liabilities and Net Position	VMC	Component unit – IPV	Eliminations	Aggregated
Current liabilities:				
Accounts payable	$ 20,016,539	187,777	—	20,204,316
Accrued salaries, wages and benefits	59,093,014	—	—	59,093,014
Due to:				
Primary government	—	685,359	(685,359)	—
Component unit	1,076,366	—	(1,076,366)	—
Other accrued liabilities, including estimated third-party payor settlements	24,789,495	—	—	24,789,495
Interest, patient refunds and other	10,281,182	—	—	10,281,182
Current portion of long-term debt and capital lease obligations	8,810,000	244,258	—	9,054,258
Total current liabilities	124,066,596	1,117,394	(1,761,725)	123,422,265
Unearned compensation	5,233,273	—	—	5,233,273
Long-term debt and capital lease obligations, net of current portion	305,021,605	78,076	—	305,099,681
Total liabilities	434,321,474	1,195,470	(1,761,725)	433,755,219
Deferred inflows of resources	42,717,299	—	—	42,717,299
Net position:				
Invested in capital assets net of related debt	61,299,666	718,351	—	62,018,017
Restricted:				
For debt service	7,425,645	—	—	7,425,645
Expendable for specific operating activities	615,447	—	—	615,447
Unrestricted	148,058,814	1,443,380	—	149,502,194
Total net position	217,399,572	2,161,731	—	219,561,303
Total liabilities, deferred inflows, and net position	$ 694,438,345	3,357,201	(1,761,725)	696,033,821

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, 2017

	VMC	Component unit – IPV	Eliminations	Aggregated
Operating revenues:				
Net patient service revenue (net of provision for uncollectible accounts of $13,108,798 for VMC)	$ 544,658,032	16,139	—	544,674,171
Other operating revenue	38,319,621	9,695,279	(16,646,955)	31,367,945
Total operating revenues	582,977,653	9,711,418	(16,646,955)	576,042,116
Operating expenses:				
Salaries and wages	294,461,660	—	—	294,461,660
Employee benefits	79,722,001	—	—	79,722,001
Purchased services	92,837,144	762,983	(10,044,189)	83,555,938
Supplies and other expenses	112,421,456	217,714	—	112,639,170
Depreciation	31,366,538	194,722	—	31,561,260
Total operating expenses	610,808,799	1,175,419	(10,044,189)	601,940,029
Operating income (loss)	(27,831,146)	8,535,999	(6,602,766)	(25,897,913)
Nonoperating income (expense):				
Property tax revenue	21,490,047	—	—	21,490,047
Interest income	4,416,830	—	—	4,416,830
Interest and amortization expense	(17,696,582)	(14,150)	—	(17,710,732)
Investment loss	(2,867,644)	—	—	(2,867,644)
Other, net	290,185	—	—	290,185
Members' cash distributions	—	(8,253,460)	6,602,766	(1,650,694)
Net nonoperation income (expense)	5,632,836	(8,267,610)	6,602,766	3,967,992
Increase (decrease) in net position	(22,198,310)	268,389	—	(21,929,921)
Net position, beginning of year	239,597,882	1,893,342	—	241,491,224
Net position, end of year	$ 217,399,572	2,161,731	—	219,561,303

See accompanying notes to financial statements.