



KING COUNTY PUBLIC HOSPITAL DISTRICT NO. 2
(d/b/a EvergreenHealth)

Financial Statements

December 31, 2017 and 2016

(With Independent Auditors' Report Thereon)

KING COUNTY PUBLIC HOSPITAL DISTRICT NO. 2
(d/b/a EvergreenHealth)

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KPMG LLP
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Independent Auditors' Report

The Board of Commissioners
King County Public Hospital District No. 2
d/b/a EvergreenHealth:

Report on the Financial Statements

We have audited the accompanying financial statements of King County Public Hospital District No. 2, d/b/a EvergreenHealth, which comprise the statements of net position as of December 31, 2017 and 2016, and the related statements of revenue, expenses, and changes in net position, and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

Our responsibility is to express opinions on these financial statements based on our audits. We did not audit the financial statements of Public Hospital District No. 1, Snohomish County, Washington, d/b/a EvergreenHealth Monroe, a component unit, which statements reflect total assets constituting 100% of total assets at December 31, 2017 and 2016, respectively, and total revenue constituting 100% of total revenue of the discretely presented component unit for the years then ended. Those statements were audited by other auditors, whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for EvergreenHealth Monroe, is based solely on the report of the other auditors. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

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

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



Opinion

In our opinion, based on our audits and the report of the other auditors, the financial statements referred to above present fairly, in all material respects, the financial position of King County Public Hospital District No. 2, d/b/a EvergreenHealth, as of December 31, 2017 and 2016, and the results of their operations and their cash flows for the years then ended, in accordance with U.S. generally accepted accounting principles.

Emphasis of Matter

During 2017, EvergreenHealth Monroe adopted GASB Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*, effective January 1, 2016. As a result of the implementation of this standard, EvergreenHealth Monroe reported a prior year adjustment for the change in accounting principle (see note 1). Our opinion is not modified with respect to this matter.

Other Matters

Required Supplementary Information

U.S. generally accepted accounting principles require that the management's discussion and analysis on pages 3 through 18 be presented to supplement the 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 financial statements, and other knowledge we obtained during our audits of the 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.

KPMG LLP

Seattle, Washington
July 25, 2018

KING COUNTY PUBLIC HOSPITAL DISTRICT NO. 2
(d/b/a EvergreenHealth)

Management's Discussion and Analysis (Unaudited)

December 31, 2017 and 2016

This discussion and analysis of King County Public Hospital District No. 2, d/b/a EvergreenHealth (the District) provides an overview of the District's financial activities for the years ended December 31, 2017 and 2016. Please read it in conjunction with the District's financial statements, which follow this analysis.

The District is a municipal corporation of the State of Washington formed under the provisions of Chapter 70.44 of the Revised Code of Washington. The District is considered a political subdivision of the State of Washington and is allowed by law to be its own Treasurer.

The District includes the incorporated cities of Kirkland, Redmond, Woodinville, Kenmore, and Duvall, portions of Bothell, Sammamish, and Carnation, as well as adjacent unincorporated areas.

The District's primary operations include Evergreen Hospital Medical Center (the Medical Center), an acute care hospital with 318 licensed beds and a 15-bed freestanding inpatient hospice care center, representing the 9th largest provider in the Puget Sound.

Type of beds	Number of beds	License category
Critical care	20	Acute
Family maternity	36	Acute
Acute rehabilitation	14	Acute rehab
Medical/surgical	205	Acute
Neonatal intensive care unit	43	Acute/newborn
Hospice	15	Hospice
Total beds	333	

The Medical Center is accredited by the Joint Commission, a nonprofit organization that accredits more than 21,000 healthcare organizations and programs in the United States. The Medical Center provides clinical excellence in primary care and over 80 specialties, including, heart and vascular care, 24-hour level III trauma emergency care, cancer care, diabetes care, musculoskeletal and spine care, sleep services, oncology, surgical care, orthopedics, neurosciences, women's and children's services, and pulmonary care. Home care & hospice services cover both King & Snohomish counties as the largest provider in the Puget Sound.

The employed physician practices comprise 81 and 61 primary care providers in 2017 and 2016, respectively, and 237 and 215 specialty care providers in 2017 and 2016, respectively. Since 1972, the District's patient and family centered care philosophy, combined with its commitment to advancing medical solutions, has enabled the District to focus on providing excellent patient care.

The District is governed by a board of seven publicly elected commissioners, each elected by district residents to serve a six-year term in accordance with the laws of the State of Washington. The commissioners have delegated day-to-day operations of the District and the Medical Center to the chief executive officer/superintendent.

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Utilization Statistics

Historical patient utilization data of the District's facilities is shown in the following table:

<u>Utilization statistics</u>	<u>2017</u>	<u>2016</u>	<u>2015</u>
Licensed beds	333	333	333
Acute care admissions	15,281	15,672	15,184
Acute care adjusted admissions	34,539	33,125	32,753
Acute care patient days	61,154	62,133	60,266
Acute care adjusted patient days	137,937	131,248	129,945
Acute care average length of stay	4.0	4.0	4.0
Occupancy (based on acute care licensed beds)	52.7%	53.5%	51.9%
Observation Days	2,810	1,607	1,336
Inpatient surgeries	3,522	3,391	3,248
Outpatient surgeries	15,321	14,437	13,991
Home health episodes and admissions	9,954	9,878	10,137
Home Hospice program days	180,472	204,343	181,232
Emergency room visits	57,669	56,660	56,946
Primary care work relative value units (wRVUs)	297,695	199,443	193,046
Specialty care wRVUs	744,453	688,552	549,648

Economic Factors Affecting the Current Environment and Future Direction of the District

The future direction of EvergreenHealth is guided by its Vision to "create an inclusive community health system that is the most trusted source for healthcare solutions." The District takes a long-term, strategic view on the future of healthcare in the community and responds with plans that consider that perspective. Challenges and opportunities that face the District are similar to those that face the healthcare industry across the country. Among those issues are:

- **Financial Performance:** The District continues to implement service enhancement and growth plans, discussed below, which require significant capital outlays. The investment in new and expanded facilities may put initial financial constraints on the organization; however, management believes the District is positioned to better serve the needs of the community.
- **Competition:** The Puget Sound has experienced increased market consolidation and collaboration between healthcare providers over the past several years. In addition, competitors have opened traditional and non-traditional healthcare facilities both within and around the District boundaries with the intention of drawing patients from the service area.
- **Operating Costs:** Several key volume indicators, including overall admissions and surgeries, were higher than 2016. The District has continued working to manage its operating costs in line with volumes. Labor is the most significant operating cost for the District, representing over 65% of annual expenses. During 2017 and 2016, the District continued to implement various cost saving initiatives including supply chain standardization and improved labor productivity management.

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- **Regulatory Environment:** Continued focus by regulatory agencies on the healthcare industry may impact the District.
- **Labor Availability:** Throughout 2017, the District continued its RN Residency and New-to-specialty programs in order to decrease reliance on RN agency personnel and to address RN retirement. Labor shortages continued for various positions. Approximately 49% of the District's 4,511 employees are members of one of four labor unions. In January 2016, the District began negotiations of a new labor contract with Service Employees International Union (SEIU) Healthcare 1199NW for the organization's Social Worker, Case Manager and Chaplain bargaining unit, which represents approximately 90 employees, and in November 2016, the District began negotiations of its labor contract with SEIU Healthcare 1199NW for the organization's service workers, which represents approximately 830 employees. Both of these negotiations were completed in July 2017. In May 2018, the District began and completed negotiations of its labor contract with International Union of Operating Engineers (IUOE), which represents approximately 20 Plant Operations employees. In fall 2018, the District will begin negotiations of its labor contract with the Washington State Nurses Association (WSNA), which represents approximately 1,080 Registered Nurses. That contract expires on October 31, 2018.
- **Contracting/Risk-Sharing Arrangements:** The District has three pay-for-performance contracts currently in effect with payors. In addition, EvergreenHealth Partners, a physician-led organization formed in 2013, in which the District is the sole LLC member, has its own two value-based contracts (similar to an Accountable Care Organization) that includes the District and is financially supported by the District, including participation in the Puget Sound High Value Network. All of these contracts are "layered" on top of existing fee for service arrangements between the District and those payors and provides for incentives based upon efficiency and quality performance. EvergreenHealth's recent partnership with Overlake Medical Center via the Eastside Health Network has entered into its own set of four value-based contracts with others under development. See additional discussion under alliances.
- **Payor Reimbursement:** Reimbursement for patient services from federal, state, and private insurance payors continues to be a concern as healthcare costs continue to rise. The District monitors reimbursement closely and works with payors in an effort to balance payment levels and increases in the movement towards value-based reimbursement models in the context for operating cost increases.
- **Partnerships:** During 2017 and 2016, the District continued to develop its strategic alliances with Seattle Cancer Care Alliance (SCCA), EvergreenHealth Monroe (EHM) and Overlake Medical Center.

Overlake Medical Center – In 2016, the Boards of the District and Overlake Medical Center approved the exploration of a joint venture called *Eastside Health Alliance*. In November 2016, a letter of intent to form the joint venture was signed by the District and Overlake Medical Center. The joint venture, which is designed to advance the shared mission of improving the health of Puget Sound's Eastside community, was subsequently approved by both Boards in January 2017. Eastside Health Alliance has been focusing on three specific areas guided by a joint venture Board, comprising three board members and the CEO from each organization. The three areas include:

- A coordinated quality and safety program
- An Eastside-focused clinically integrated network, Eastside Health Network, that combined the Overlake Provider Network and EvergreenHealth Partners, LLC
- Service line collaborations in cardiac services and neurosciences

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SCCA – The Halvorson Cancer Center, in collaboration with SCCA, has a shared vision to provide the highest quality, patient-centered, innovative and integrated care for cancer patients at EvergreenHealth. The partnership connects patients to promising new treatments with on-site access to the innovative research programs and breakthrough clinical trials of SCCA. Since the launch of the Cancer Center in 2012, the annual growth of cancer cases served by the partnership has grown 7%, with over 1,100 cases in 2017.

EvergreenHealth Monroe (EHM) – The District's partnership with EHM continues to grow. EHM is governed by the Alliance Governance Board. Both organizations remain independently and separately governed, licensed, and accredited. The purpose of the affiliation is to provide EHM the ability to better serve its community through enhanced clinical services and to adopt the District's approaches to clinical outcomes, patient safety, and patient experience. Governmental Accounting Standards Board (GASB) No. 14 establishes that financial statements of the reporting entity generally should allow the users to distinguish between the primary government and its component units. EHM is reported within the District's financial statements as a discretely presented component unit in accordance with government accounting standards.

- Other substantial changes are anticipated in the U.S. healthcare system including numerous provisions affecting the delivery of healthcare services, the financing of healthcare costs, the Affordable Care Act and uncertainty surrounding the act, reimbursement of healthcare providers, and the legal obligations of health insurers, providers, and employers. Increasing patient obligations through high deductible plans and increased premiums has the potential for higher bad debt experience. Management will continue evaluating how it will respond to various healthcare reform components as they develop.
- The District recognizes that providing the community with high-quality healthcare goes beyond offering outstanding programs and services. As the community continues to grow and age, the District must keep pace with the need for more types of services. The 2017 population within the District's boundaries is estimated to be 317,005. Population is projected to grow 7.8% over the next five years and reach 341,743 in 2022 according to Claritas. The most recent version of the District's Master Campus Plan, filed with the City of Kirkland in February 2017, includes facility and service expansions based on projected needs.
- In 2017, the District initiated or completed the following related projects:
 - Formed the Eastside Health Alliance cardiac/cardio-thoracic joint venture between EvergreenHealth and Overlake
 - Integrated EvergreenHealth Partners into the Eastside Health Network to form a combined Eastside Clinical Integrated Network with Overlake
 - Wireless telemetry for remote patient monitoring
 - Implemented Cerner Capacity Management system to enhance the ability to efficiently manage patient flow in the hospital
 - Completed the planning for a Transition Care Unit – a short stay observational unit
 - Opened Eye Care Practices in Kirkland and Mill Creek
 - Acquired Lakeshore Totem Lake and Lakeshore Bothell primary care clinics

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- Opened the following locations or services:
 - Kenmore Primary and Urgent Care
 - Mill Creek Urgent Care
 - Sammamish Urgent Care
 - Neuroscience, Spine & Orthopedics Institute
 - Two new acute floors in the Silver Tower for a Progressive Care Unit and a Cardiovascular and Neurosurgical Unit

- Launched an online scheduling app for all the Urgent Care Clinic locations

Overview of the Financial Statements

The District's financial statements consist of three components: statements of net position; statements of revenue, expenses, and changes in net position; and statements of cash flows. The activities of EvergreenHealth Foundation (the Foundation) are included with the District's financial statements as a blended component unit. These financial statements and related notes provide information about the activities of the District, including resources held by the District designated for specific purposes. The statements of net position includes all the District's assets and liabilities, using the accrual basis of accounting, as well as an indication about which assets can be utilized for general purposes and which are restricted for a specific purpose. The statements of revenue, expenses, and changes in net position report all of the revenue, expenses, and changes in net position during the time periods indicated. The statements of cash flows report the cash provided by the District's operating activities, as well as other cash sources such as investment income and issuance of new debt, and use of cash such as cash payments for capital asset additions and improvements and repayment of debt.

On March 1, 2015, the District entered into a Strategic Alliance Agreement with EHM. Governmental Accounting Standards Board standards require that this entity be presented as a discrete component unit; therefore, its financial position at December 31, 2017 and 2016 and the results of its operations for the years ended December 31, 2017 and 2016 are included with the District in a separate column for financial statement presentation purposes (note 1 to the financial statements).

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The analysis presented below represents the District and its blended component unit (the Foundation), but excludes the financial position and results of operations of its discrete component unit (EHM), unless otherwise noted.

Summary of Statements of Net Position

(In thousands)

	<u>2017</u>	<u>2016</u>	<u>2015</u>
Cash and cash equivalents	\$ 43,503	22,290	18,677
Patient accounts receivable, less allowance for uncollectible accounts	82,519	77,659	69,942
Other current assets	<u>28,656</u>	<u>23,943</u>	<u>26,968</u>
Total current assets	154,678	123,892	115,587
Assets limited as to use, less current portion of amounts required for current liabilities	147,130	183,495	192,523
Capital assets, net	327,097	310,926	302,508
Other assets	<u>32,420</u>	<u>29,380</u>	<u>28,276</u>
Total assets	661,325	647,693	638,894
Deferred outflows of resource:			
Deferred loss on refunding	<u>3,645</u>	<u>4,278</u>	<u>5,125</u>
Total assets and deferred outflows of resources	<u>\$ 664,970</u>	<u>651,971</u>	<u>644,019</u>

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Summary of Statements of Net Position

(In thousands)

	<u>2017</u>	<u>2016</u>	<u>2015</u>
Current portion of long-term debt and capital lease obligations	\$ 13,101	12,440	11,868
Other current liabilities	<u>73,348</u>	<u>80,095</u>	<u>74,259</u>
Total current liabilities	86,449	92,535	86,127
Long-term liabilities	<u>215,997</u>	<u>230,887</u>	<u>244,623</u>
Total liabilities	<u>302,446</u>	<u>323,422</u>	<u>330,750</u>
Deferred inflows of resources:			
Deferred proceeds	<u>19,139</u>	<u>—</u>	<u>—</u>
Total deferred inflow of resources	<u>19,139</u>	<u>—</u>	<u>—</u>
Net position:			
Invested in capital assets, net of related debt	105,899	74,838	51,757
Restricted	7,747	8,172	8,018
Unrestricted	<u>229,739</u>	<u>245,539</u>	<u>253,494</u>
Total net position	<u>343,385</u>	<u>328,549</u>	<u>313,269</u>
Total liabilities and net position	<u>\$ 664,970</u>	<u>651,971</u>	<u>644,019</u>

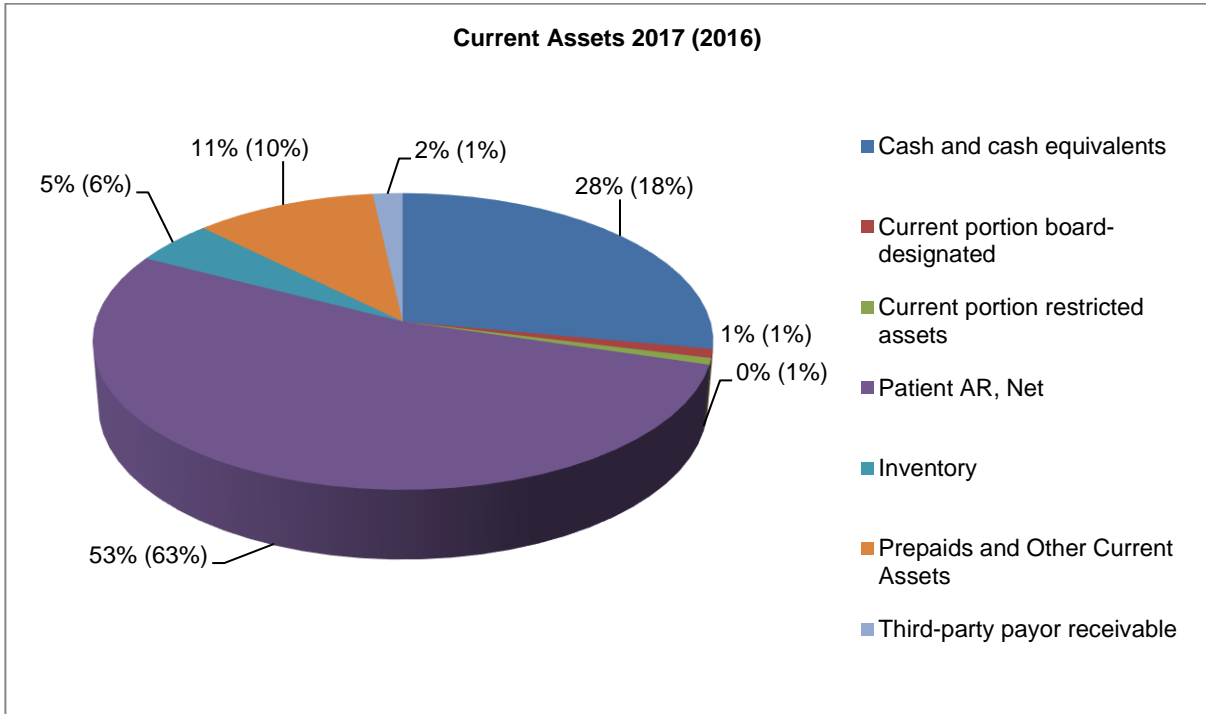
Current Assets

Current assets consist of cash and cash equivalents, current portion of board-designated and restricted assets, and other current assets that are expected to be converted to cash within one year. Current assets also include net patient accounts receivable valued at the estimated net realizable amount due from patients and insurers.

<u>Key Ratios</u>	<u>2017</u>	<u>2016</u>	<u>2015</u>
Current Ratio	1.8	1.3	1.3
Days in AR (Net)	44.7	44.0	42.0
Days Cash on Hand	98.3	91.5	93.3

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December 31, 2017 and 2016

Total current assets were \$154.7 million as of December 31, 2017, compared to \$123.9 million as of December 31, 2016. The composition of 2017 current assets and comparison to prior year are illustrated below.



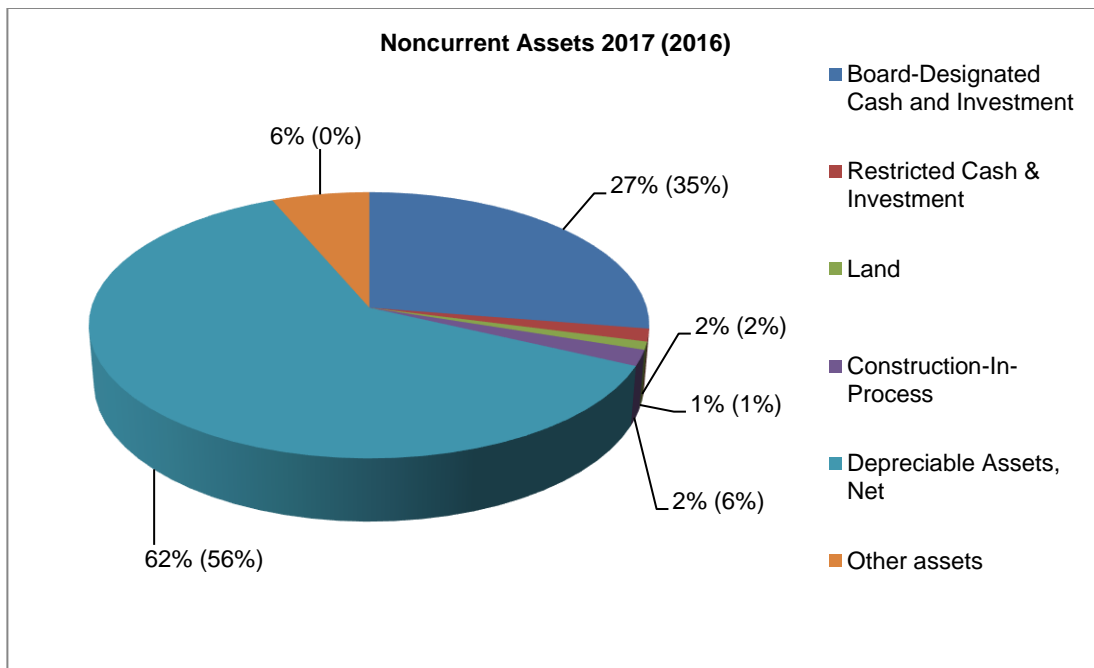
Current assets in 2017 increased by \$30.8 million compared to 2016 primarily due to increases of \$4.8 million in net patient accounts receivable related to price and volume increases, \$21.2 million in cash and cash equivalents primarily related to an advanced payment related to the sale of the District's equity interests in its PacLab joint venture, and \$2.8 million in prepaid expenses and other current assets.

Current assets in 2016 increased by \$8.3 million compared to 2015 primarily due to increases of \$7.7 million in net patient accounts receivable related to price and volume increases, \$3.6 million in cash and cash equivalents and \$0.5 million in prepaid expenses and other current assets. These increases were partially offset by a decrease of \$3.7 million related to third-party payor receivables.

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December 31, 2017 and 2016

Noncurrent Assets

Noncurrent assets consist of restricted and board-designated assets held for debt service, capital improvements, community service programs and other operations. Total noncurrent assets were \$505.7 million as of December 31, 2017, compared to \$523.8 million as of December 31, 2016. The composition of noncurrent assets in 2017 and comparison to prior year are illustrated below.



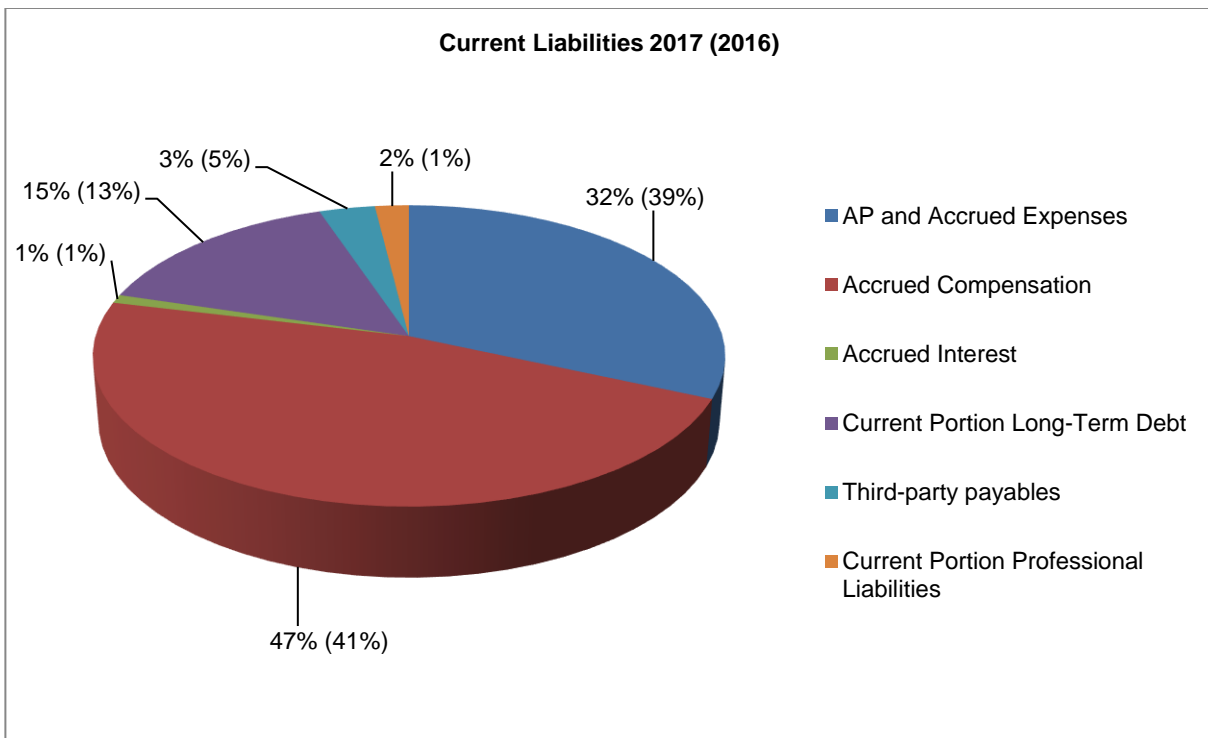
Capital assets, net of accumulated depreciation increased approximately \$16.2 million from 2016 to 2017 and \$8.4 million from 2015 to 2016. The District continues to devote resources for capital projects and improvements, including significant components of the master facility plan. During 2017 and 2016, the District invested approximately \$50.2 million and \$41.0 million, respectively, in buildings, information technology, and equipment. This increase in capital assets was offset by \$34.4 million and \$32.4 million in depreciation expense in 2017 and 2016, respectively.

Restricted and board-designated cash and investments decreased approximately \$36.4 million from 2016 to 2017 and decreased approximately \$9.0 million from 2015 to 2016. The decrease in the current year is primarily due to planned spending of the 2015 Limited Tax General Obligation (LTGO) Series B bond proceeds in accordance with the long-term master facility plan, as approved by the District's Board in July 2015.

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Current Liabilities

Current liabilities consist of accounts payable, accrued compensation and other liabilities that are expected to be paid within one year, including current portion of long-term debt and professional liabilities. Total current liabilities were \$105.6 million as of December 31, 2017, compared to \$92.5 million as of December 31, 2016. 2017 composition of current liabilities and comparison to prior year are illustrated below.

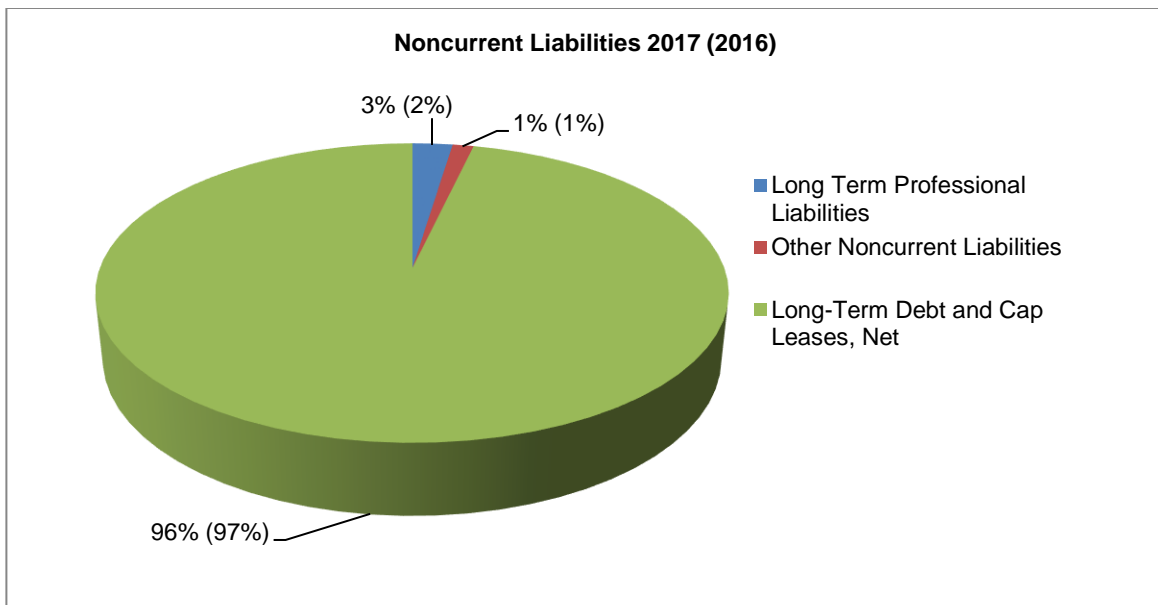


Current liabilities decreased approximately \$6.1 million from 2016 to 2017 and increased approximately \$6.4 million from 2015 to 2016, which is primarily attributable to a decrease in both accounts payable and accrued expenses of \$8.3 million and a decrease in third-party payor payable of \$1.9 million which were offset by a \$3 million increase in accrued compensation. The change in accounts payable and accrued expenses is primarily due to the timing of routine payable cycles.

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Noncurrent Liabilities

Noncurrent liabilities consist of long-term debt, capital lease obligations, and professional liability reserves. Total noncurrent liabilities were \$216.0 million as of December 31, 2017, compared to \$230.9 million as of December 31, 2016. The 2017 composition of noncurrent liabilities and comparison to prior year are illustrated below.



Noncurrent liabilities of \$216.0 million decreased approximately \$14.9 million and \$13.7 million from 2016 to 2017 and 2015 to 2016, respectively, primarily due to debt payments in accordance with the established debt service schedule.

Net Position

Investment in capital assets, net of related debt increased approximately \$31.1 million, or 41.5%, from 2016 to 2017 and increased approximately \$23.1 million, or 44.6%, from 2015 to 2016. The current year increase is attributable to an increase in net property, plant, and equipment of approximately \$16.2 million as well as a decrease in related debt obligations of approximately \$14.9 million due to debt payments in accordance with amortization schedules.

Restricted net position (expendable and nonexpendable), representing resources with temporary or permanent donor restrictions, remained relatively consistent from 2015 to 2016 and 2016 to 2017.

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Unrestricted net position, which includes other funds available to the District that do not meet the definition of restricted or net investment in capital assets, decreased approximately \$15.8 million, or 6.4%, from 2016 to 2017 and decreased approximately \$8.0 million, or 3.1%, from 2015 to 2016. The current year decrease is driven by net income and capital grants and contributions of approximately \$14.8 million, offset by net increases of approximately \$30.6 million to fund 2017 capital projects. The \$8.0 million decrease from 2015 to 2016 was driven by 2016 net income and capital grants and contributions of approximately \$15.3 million, offset by net increases of approximately \$23.1 million, which are accounted for in the net investment in capital asset and restricted categories discussed above.

Summary of Revenue, Expenses, and Changes in Net Position
(In thousands)

	<u>2017</u>	<u>2016</u>	<u>2015</u>
Operating revenue:			
Net patient service revenue	\$ 627,360	597,304	565,832
Other operating revenue	<u>41,906</u>	<u>42,817</u>	<u>37,074</u>
Total operating revenue	<u>669,266</u>	<u>640,121</u>	<u>602,906</u>
Operating expenses:			
Labor and employee benefits	443,499	417,823	389,330
Supplies, purchased services, and other	195,888	194,232	178,538
Depreciation and amortization	<u>34,229</u>	<u>32,019</u>	<u>31,192</u>
Total operating expenses	<u>673,616</u>	<u>644,074</u>	<u>599,060</u>
Deficit of revenue over expenses from operations	<u>(4,350)</u>	<u>(3,953)</u>	<u>3,846</u>
Nonoperating income, net of expenses:			
Property taxes	25,731	25,201	24,825
Interest and amortization expense	(8,490)	(8,914)	(7,503)
Investment income	1,404	1,882	706
Other, net	<u>319</u>	<u>(163)</u>	<u>(834)</u>
Net nonoperating income	<u>18,964</u>	<u>18,006</u>	<u>17,194</u>
Excess of revenue over expenses	14,614	14,053	21,040
Capital grants and contributions	<u>222</u>	<u>1,227</u>	<u>212</u>
Total change in net position	14,836	15,280	21,252
Net position, beginning of year	<u>328,549</u>	<u>313,269</u>	<u>292,017</u>
Net position, end of year	\$ <u><u>343,385</u></u>	<u><u>328,549</u></u>	<u><u>313,269</u></u>

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Financial Highlights

Revenue

Sources of Patient Revenue

The District derives a substantial portion of its operating revenue from federal and state programs and insurance plans that pay for all or a portion of the healthcare services provided to its patients. As a consequence, the District's operating revenue depends to a great extent on the availability and level of reimbursement or payment under those programs and contracts.

The following table sets forth the percentages of the District's hospital gross patient revenue applicable to various programs and plans for the fiscal years ended December 31, 2017, 2016, and 2015.

	<u>2017</u>	<u>2016</u>	<u>2015</u>
Medicare	39.7%	40.3%	39.1%
Other third-party payors	47.9	47.2	47.6
Medicaid	11.3	11.2	12.1
Patient self-pay	1.1	1.3	1.2

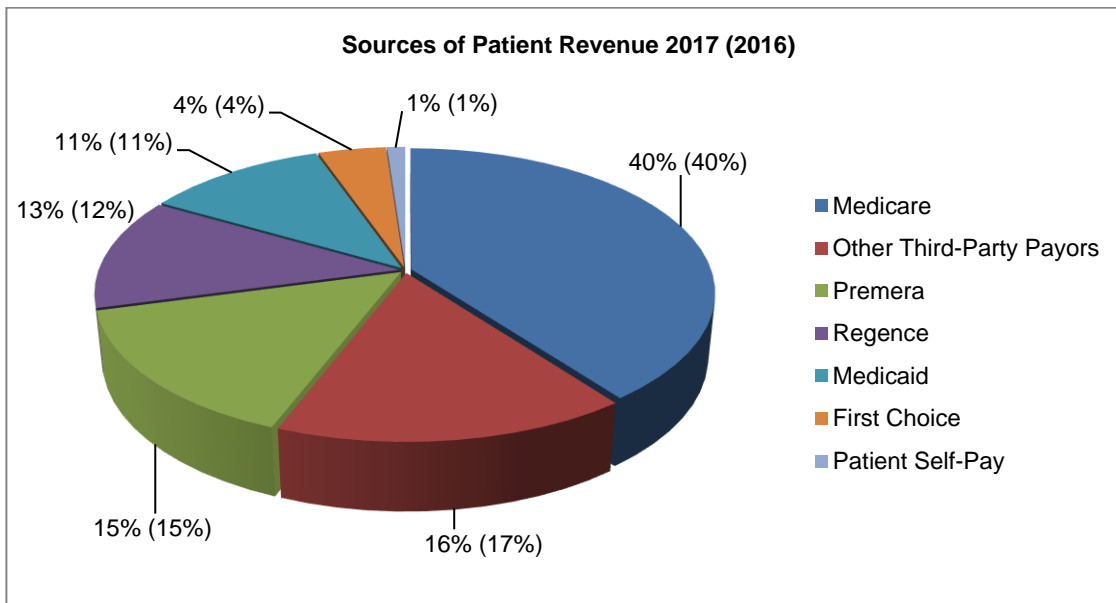
In 2017, gross patient revenue increased by approximately \$125.0 million or 7.4%. Gross patient revenue is the total fees charged to patients for services. Primary care and specialty care revenue increased \$23.9 million, or 53.2%, and \$22.5 million, or 15.2%, respectively. The significant increase in primary care is tied to the acquisition of Lakeshore Totem Lake and Lakeshore Bothell primary care clinics. Also contributing to the gross revenue growth was a targeted rate increase of 2.6% overall implemented on January 1, 2017. Average length of stay remained constant at 4 days. Total surgery cases and home health volume increased 5.7% and 0.8%, respectively, while outpatient hospice volumes decreased 11.7%.

KING COUNTY PUBLIC HOSPITAL DISTRICT NO. 2
(d/b/a EvergreenHealth)

Management's Discussion and Analysis (Unaudited)

December 31, 2017 and 2016

In 2016, gross patient revenue increased by approximately \$166.4 million or 11.0%. Gross patient revenue is the total fees charged to patients for services. Primary care and specialty care revenue increased \$2.4 million, or 7.3%, and \$32.6 million, or 18.4%, respectively. The increase was due to a targeted rate increase of 7.4% overall implemented on January 1, 2016 and increased volumes. The overall gross revenue increase due to volumes was 3.6%. Average length of stay remained constant at 4.0 days. Total surgery cases and outpatient hospice volumes increased 3.4% and 12.8%, respectively, while home health volume decreased 2.6%.



In 2017, net patient service revenue increased by approximately \$30.1 million or 5.0%. Net patient revenue consists of gross patient revenue less contractual adjustments, bad debt, and charity. This increase was driven by the top line growth mentioned above, partially offset by higher bad debt, charity care and administrative adjustment deductions in 2017. Other operating revenue decreased approximately \$1.0 million, or 2.1%, tied to decreased federal grant dollars as a result of several programs that transitioned to the County and State. There is a corresponding decrease in operating expenses as a result of the transition.

In 2016, net patient service revenue increased by approximately \$31.5 million or 5.6%. Net patient revenue consists of gross patient revenue less contractual adjustments, bad debt, and charity. This increase was driven by the top line growth mentioned above along with relatively consistent bad debt, charity care and administrative adjustment deductions in 2016. Other operating revenue increased approximately \$5.7 million, or 15.5%, driven by increases in joint venture revenue and Foundation transfers.

Operating Expenses

Labor, including contract labor, increased approximately \$19.9 million, or 5.8%, and \$23.5 million, or 7.4%, in 2017 and 2016, respectively. These increases are due to employee salary increases as well as the District's growing average employed and contracted full-time equivalents, which increased 3.4% to 3,752 as of December 31, 2017 compared to 3,629 in 2016 and 3,461 in 2015.

KING COUNTY PUBLIC HOSPITAL DISTRICT NO. 2
(d/b/a EvergreenHealth)

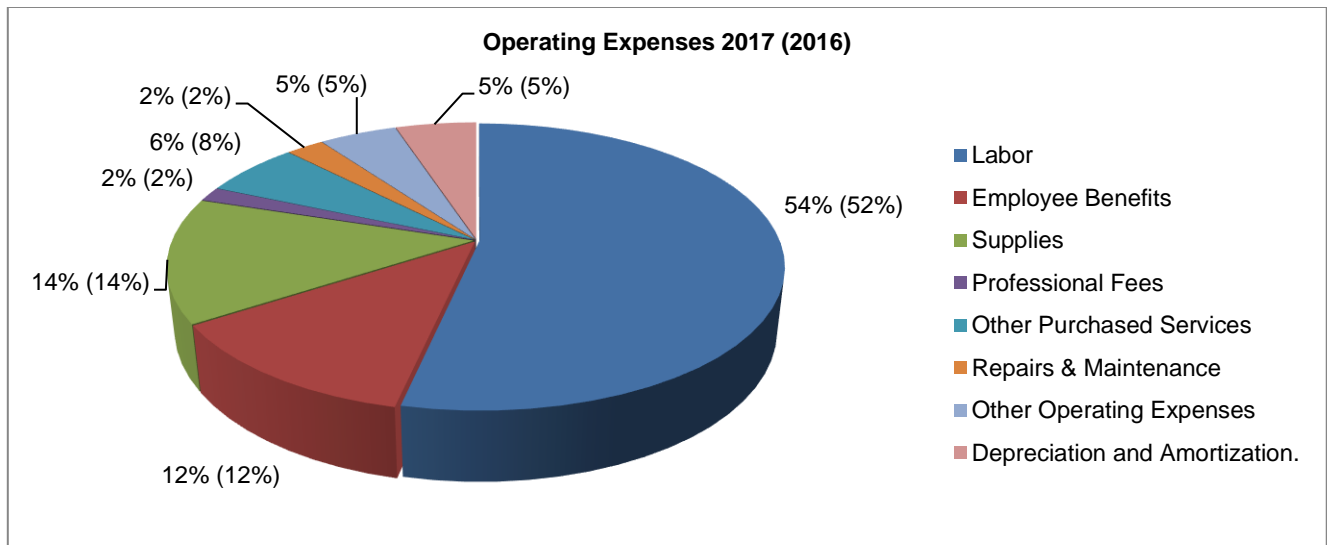
Management's Discussion and Analysis (Unaudited)

December 31, 2017 and 2016

Employee benefit expenses increased \$5.8 million, or 7.4%, and \$5.0 million, or 6.9%, in 2017 and 2016, respectively. This was primarily due to increased medical plan, social security and retirement plan costs, driven by growth in employed full-time equivalents.

Supplies, purchased services, repairs and maintenance services and other increased approximately \$1.7 million, or 0.9%, and \$15.6 million, or 8.3%, in 2017 and 2016, respectively. The year over year consistency is a result of expense management initiatives. The prior year over year increase is due to overall hospital growth, including medical supply costs as well as costs associated with various clinic acquisitions and asset purchases.

Total operating expenses in 2017 and 2016 of \$673.6 million and \$644.1 million, respectively, include expenses related to tax-supported community programs for which the offsetting revenue is included in nonoperating income.



KING COUNTY PUBLIC HOSPITAL DISTRICT NO. 2
(d/b/a EvergreenHealth)

Management's Discussion and Analysis (Unaudited)

December 31, 2017 and 2016

Nonoperating Income, Net of Expenses

In 2017, nonoperating income net of expenses increased \$1.0 million, or 5.6%, from \$18.0 million in 2016 to \$19.0 million in 2017. The increase is largely driven by an increase of \$0.5 million in property tax revenue, which increased the amount of funding available for community programs over prior year.

In 2016, nonoperating income net of expenses increased \$0.8 million, or 4.7%, from \$17.2 million in 2015 to \$18.0 million in 2016. The increase is largely driven by increases of \$1.4 million in interest expense related to the 2015 LTGO debt issuance in late 2015 as well as \$1.2 million in investment income.

Contacting the District's Financial Management

This financial report provides the reader with a general overview of the District's finances and operations. If you have questions about this report or need additional financial information, please contact the Chief Financial Officer or Director of Financial Reporting at EvergreenHealth, 12040 NE 128th Street, Kirkland, Washington 98034.

KING COUNTY PUBLIC HOSPITAL DISTRICT NO. 2

(d/b/a EvergreenHealth)

Statements of Net Position

December 31, 2017 and 2016

(In thousands)

Assets	2017		2016	
	District	Component unit EHM	District	Component unit EHM (as restated)
Current assets:				
Cash and cash equivalents	\$ 43,503	733	22,290	909
Current portion board-designated assets	1,479	—	1,318	—
Current portion of assets restricted as to use	1,098	—	1,153	—
Patient accounts receivable, less allowance for uncollectible accounts of \$16,993 and \$895 in 2017 and \$17,716 and \$884 in 2016, respectively	82,519	5,989	77,659	6,051
Inventory	7,448	1,025	7,220	911
Prepaid expenses and other current assets	15,867	941	13,111	1,007
Third-party payor receivable	2,764	1,210	1,141	—
Total current assets	<u>154,678</u>	<u>9,898</u>	<u>123,892</u>	<u>8,878</u>
Assets limited as to use, less current portion of amounts required for current liabilities:				
Board-designated cash and investments	139,393	—	175,761	—
Restricted cash and investments	7,737	—	7,734	—
	<u>147,130</u>	<u>—</u>	<u>183,495</u>	<u>—</u>
Capital assets:				
Land	4,914	1,879	4,914	1,879
Construction in progress	9,699	880	30,152	905
Depreciable capital assets, net of accumulated depreciation	312,484	11,494	275,860	10,759
	<u>327,097</u>	<u>14,253</u>	<u>310,926</u>	<u>13,543</u>
Other assets	<u>32,420</u>	<u>—</u>	<u>29,380</u>	<u>—</u>
Total assets	<u>661,325</u>	<u>24,151</u>	<u>647,693</u>	<u>22,421</u>
Deferred outflows of resources:				
Deferred loss on refunding	3,645	39	4,278	78
Related to Other Postemployment Benefits	—	365	—	—
Total assets and deferred outflows of resources	<u>\$ 664,970</u>	<u>24,555</u>	<u>651,971</u>	<u>22,499</u>

KING COUNTY PUBLIC HOSPITAL DISTRICT NO. 2

(d/b/a EvergreenHealth)

Statements of Net Position

December 31, 2017 and 2016

(In thousands)

Liabilities and Net Position	2017		2016	
	District	Component unit EHM	District	Component unit EHM (as restated)
Current liabilities:				
Accounts payable and accrued expenses	\$ 27,311	5,037	35,618	3,902
Accrued compensation and related liabilities	40,753	2,491	37,703	2,561
Accrued interest payable	781	77	828	79
Current portion of long-term debt and capital lease obligations	13,101	761	12,440	795
Third-party payor payable	2,807	—	4,677	37
Estimated current portion of professional liability	1,696	—	1,269	—
Other accrued liabilities	—	213	—	364
Total current liabilities	86,449	8,579	92,535	7,738
Long-term estimated professional liability	5,178	—	5,020	—
Other noncurrent liabilities	2,723	1,988	2,220	988
Long-term debt and capital lease obligations, net of current portion	208,096	17,598	223,647	18,054
Net Other Postemployment Benefits Liability	—	6,083	—	5,099
Total liabilities	302,446	34,248	323,422	31,879
Deferred Inflows of Resources				
Deferred Proceeds (Current)	19,139	—	—	—
Related to Other Postemployment Benefits	—	176	—	201
Net position:				
Investment in capital assets, net of related debt	105,899	(4,106)	74,838	(5,306)
Restricted:				
Expendable for specific activities	5,316	—	5,723	—
Expendable for debt service	715	250	742	260
Nonexpendable permanent endowments	1,716	—	1,707	—
Unrestricted	229,739	(6,013)	245,539	(4,535)
Total net position	343,385	(9,869)	328,549	(9,581)
Total liabilities and net position	\$ 664,970	24,555	651,971	22,499

See accompanying notes to financial statements.

KING COUNTY PUBLIC HOSPITAL DISTRICT NO. 2
(d/b/a EvergreenHealth)

Statements of Revenue, Expenses, and Changes in Net Position

Years ended December 31, 2017 and 2016

(In thousands)

	2017		2016	
	District	Component unit EHM	District	Component unit EHM (as restated)
Net patient service revenue (net of provision for bad debts of \$23,449 and \$4,797 in 2017 and \$22,219 and \$4,763 in 2016, respectively)	\$ 627,360	41,773	597,304	40,461
Other operating revenue	41,906	2,030	42,817	2,575
Total operating revenue	<u>669,266</u>	<u>43,803</u>	<u>640,121</u>	<u>43,036</u>
Expenses:				
Labor	360,209	19,333	340,307	17,698
Employee benefits	83,290	8,515	77,516	7,964
Supplies	94,837	5,763	91,870	5,737
Professional fees	10,787	4,398	12,323	4,280
Other purchased services	41,357	3,854	41,505	3,952
Repairs and maintenance	15,926	967	14,527	954
Other operating expenses	32,981	3,041	34,007	3,155
Depreciation and amortization	34,229	2,007	32,019	2,039
Total operating expenses	<u>673,616</u>	<u>47,878</u>	<u>644,074</u>	<u>45,779</u>
Deficit of revenue over expenses from operations	<u>(4,350)</u>	<u>(4,075)</u>	<u>(3,953)</u>	<u>(2,743)</u>
Nonoperating income, net of expenses:				
Property taxes	25,731	4,648	25,201	4,412
Interest and amortization expense	(8,490)	(1,070)	(8,914)	(1,102)
Investment income	1,404	—	1,882	—
Other, net	319	—	(163)	1
Net nonoperating income	<u>18,964</u>	<u>3,578</u>	<u>18,006</u>	<u>3,311</u>
Excess (deficit) of revenue over expenses	<u>14,614</u>	<u>(497)</u>	<u>14,053</u>	<u>568</u>
Capital grants and contributions	<u>222</u>	<u>209</u>	<u>1,227</u>	<u>120</u>
Total change in net position	<u>14,836</u>	<u>(288)</u>	<u>15,280</u>	<u>688</u>
Net position, beginning of year	328,549	(9,581)	313,269	(5,514)
Restatement for January 1, 2016, OPEB Liability and Related Expense	—	—	—	(4,755)
Net position, end of year	<u>\$ 343,385</u>	<u>(9,869)</u>	<u>328,549</u>	<u>(9,581)</u>

See accompanying notes to financial statements.

KING COUNTY PUBLIC HOSPITAL DISTRICT NO. 2

(d/b/a EvergreenHealth)

Statements of Cash Flows

Years ended December 31, 2017 and 2016

(In thousands)

	2017		2016	
	District	Component unit EHM	District	Component unit EHM (as restated)
Cash flows from operating activities:				
Cash received from and on behalf of patients	\$ 620,943	40,587	594,500	39,239
Payments to suppliers and contractors	(214,677)	(16,166)	(197,650)	(17,156)
Payments to employees	(440,449)	(27,254)	(408,947)	(24,647)
Distributions received from joint ventures	8,664	—	8,686	—
Other cash receipts	31,306	2,093	35,869	2,060
Net cash provided by (used in) operating activities	<u>5,787</u>	<u>(740)</u>	<u>32,458</u>	<u>(504)</u>
Cash flows from noncapital financing activity:				
Property taxes received for community programs	4,343	4,648	3,860	4,391
Net cash provided by noncapital financing activity	<u>4,343</u>	<u>4,648</u>	<u>3,860</u>	<u>4,391</u>
Cash flows from capital and related financing activities:				
Purchases of capital assets	(44,346)	(2,717)	(42,331)	(2,287)
Proceeds from sale of capital assets	34	—	12	—
Principal payments on long-term debt and capital lease obligations	(12,442)	(891)	(11,869)	(802)
Payments for interest on long-term debt	(10,354)	(1,072)	(10,899)	(1,051)
Proceeds from issuance of long-term debt	—	387	—	—
Payment of issuance costs	—	—	—	—
Capital Contributions	—	209	—	—
Proceeds from property taxes related to debt service	21,388	—	21,341	—
Net cash used in capital and related financing activities	<u>(45,720)</u>	<u>(4,084)</u>	<u>(43,746)</u>	<u>(4,140)</u>
Cash flows from investing activities:				
Purchases of board-designated assets and assets restricted as to use	1,678	—	(25,337)	—
Proceeds from sale of board-designated assets and assets restricted as to use	34,580	—	34,496	—
Investment income	1,406	—	1,882	—
Other	19,139	—	—	—
Net cash provided by investing activities	<u>56,803</u>	<u>—</u>	<u>11,041</u>	<u>—</u>
Net increase (decrease) in cash and cash equivalents	21,213	(176)	3,613	(253)
Cash and cash equivalents, beginning of year	22,290	909	18,677	1,162
Cash and cash equivalents, end of year	<u>\$ 43,503</u>	<u>733</u>	<u>22,290</u>	<u>909</u>

KING COUNTY PUBLIC HOSPITAL DISTRICT NO. 2

(d/b/a EvergreenHealth)

Statements of Cash Flows

Years ended December 31, 2017 and 2016

(In thousands)

	2017		2016	
	District	Component Unit EHM	District	Component unit EHM (as restated)
Reconciliation of deficit of revenue over expenses from operations to net cash provided by (used in) operating activities:				
Deficit of revenue over expenses from operations	\$ (4,350)	(4,075)	(3,953)	(2,742)
Adjustments to reconcile deficit of revenue over expenses from operations to net cash provided by (used in) operating activities:				
Depreciation and amortization	34,229	2,060	32,019	2,092
Provision for bad debts	23,449	4,797	22,219	4,763
Other	(90)	—	(984)	(1)
Changes in operating assets and liabilities:				
Patient accounts receivable, less provision for bad debt	(28,309)	(4,736)	(29,936)	(6,145)
Inventory	(227)	(111)	(310)	(176)
Prepaid expenses and other assets	(5,650)	(302)	(707)	(515)
Accounts payable and accrued expenses, net of amounts related to construction in progress	(14,271)	2,135	9,001	1,326
Accrued compensation and related liabilities	3,050	739	(1,201)	734
Third-party payor settlements, net	(3,493)	(1,247)	4,601	160
Professional liability and other noncurrent liabilities	1,449	—	1,709	—
Net cash provided by (used in) operating activities	\$ 5,787	(740)	32,458	(504)
Supplemental disclosures of noncash investing, capital, and financing activities:				
Change in capital asset additions included in accounts payable and accrued expenses	\$ (5,963)	—	2,697	22
Capital lease additions	—	387	—	—

See accompanying notes to financial statements.

KING COUNTY PUBLIC HOSPITAL DISTRICT NO. 2
(d/b/a EvergreenHealth)

Notes to Financial Statements

December 31, 2017 and 2016

(1) Organization and Summary of Significant Accounting Policies

(a) Organization

King County Public Hospital District No. 2, King County, Washington, d/b/a EvergreenHealth (the District) is a municipal corporation established under Chapter 70.44 of the Revised Code of the State of Washington (RCW). The purpose of the District is to own and operate hospitals and other healthcare facilities and provide healthcare services to area residents. The District's primary operations include Evergreen Hospital Medical Center (the Medical Center), an acute care hospital; Evergreen Home Health Services, a home health agency; Evergreen Hospice Services, a program serving the terminally ill; EvergreenHealth Medical Group, a multispecialty practice group consisting of family practice physicians, physician assistants, and certified nurse practitioners; and EvergreenHealth Foundation (the Foundation). Affiliated organizations are evaluated for inclusion in the reporting entity as component units based on the significance of their relationship with the District.

(i) Blended Component Unit

The Foundation is a separate nonprofit foundation. The purpose of the Foundation is to (a) receive grants, bequests, donations, and contributions on behalf of; (b) provide fund-raising and other support to; and (c) make contributions to the District. Consequently, the net financial position and the results of operations of the Foundation are included in the accompanying financial statements. For the years ended December 31, 2017 and 2016, the Foundation raised approximately \$2.2 million and \$3.4 million in contributions (included in other operating revenue) and its assets comprises of 1.4% and 1.5% of total assets of the District in 2017 and 2016, respectively.

(ii) Discrete Component Unit

The District and EHM, a 72-bed semirural community hospital (together with a 40-bed residential treatment facility license), entered into a Strategic Alliance Agreement effective March 1, 2015. EHM is located in Monroe, Washington and is a separate legal entity governed by the Alliance Governance Board (AGB). The AGB comprises five directors, consisting of two commissioners of the District, two commissioners of EHM, and the District CEO. The audited financial statements of EHM are available by contacting EHM at 14701 179th Avenue SE, Monroe, Washington 98272 or online at the following address:

www.evergreenhealthmonroe.com/governance-and-leadership-monroe

(b) Basis of Presentation

The financial statements have been prepared on the accrual basis of accounting. Under this method of accounting, revenue is recognized when earned and expenses are recorded when liabilities are incurred without regard to receipt or disbursement of cash.

The District 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.

KING COUNTY PUBLIC HOSPITAL DISTRICT NO. 2
(d/b/a EvergreenHealth)

Notes to Financial Statements

December 31, 2017 and 2016

(c) Financial Reporting Entity

As required by accounting principles generally accepted in the United States of America (GAAP), these financial statements present the District, the primary government, and its component units, the Foundation and EHM.

Component units are legally separate organizations for which the District is financially accountable. These entities may be reported in the financial statements of the primary government in one of two ways: the component units' amounts may be blended with the amounts reported by the primary government, or they may be shown in a separate column, depending on the application of the criteria of GASB Statement No. 61, *The Financial Reporting Entity: Omnibus*. The Foundation meets the criteria of a blended component unit and has been included in the financial statements. EHM does not meet the criteria of a blended component unit and has been reported as a discretely presented component unit in a separate column of the financial statements.

(d) Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates. Significant estimates in the District's financial statements include patient accounts receivable allowances, third-party payor settlements, professional liabilities, and the fair value of investments.

(e) Cash and Cash Equivalents

Cash and cash equivalents include investments in highly liquid financial instruments with original maturities of three months or less, excluding assets restricted as to use and board-designated assets. Deposits of up to \$250 thousand are covered by the federal deposit insurance corporation and any deposits in excess of \$250 thousand are covered by collateral held in a multifinancial institution collateral pool administered by the Washington Public Deposit Protection Commission.

(f) Patients Accounts Receivable

Receivables arising from revenue for services to patients are reduced by an allowance for contractually and estimated uncollectible accounts based on recent collection experience and other circumstances, which may affect the ability of patients to meet their obligations. There are various factors that can impact the collection trends and the estimation process, such as changes in the economy, the increased burden of copays, and deductibles to be made by patients and business practices related to collection efforts. Accounts deemed uncollectible are charged against this allowance.

KING COUNTY PUBLIC HOSPITAL DISTRICT NO. 2
(d/b/a EvergreenHealth)

Notes to Financial Statements

December 31, 2017 and 2016

(g) Assets Limited as to Use

Assets limited as to use include assets designated by the Board of Commissioners (the Board) for capital improvements and community service programs. The Board retains control of the assets and may, at its discretion, subsequently change the use for other purposes. Assets limited as to use include certain assets of the Foundation that are restricted by donor stipulations. Assets limited as to use also include unexpended proceeds and income generated from certain outstanding bond series restricted for the payment of principal, interest, and expenditures for construction and equipment costs. The assets of the Supplemental Executive Retirement Plan (SERP) are also recorded as assets limited as to use. The SERP is a postretirement plan covering the executive management team. Amounts required to meet related current liabilities have been classified as current assets in the accompanying statements of net position. These assets are carried at fair value with changes in fair value reported as investment income.

(h) Inventory

Inventory consists of pharmaceutical, medical-surgical, and other supplies used in the operation of the District. Inventory is stated at the lower of cost, determined on a first-in, first-out basis, or net realizable value.

(i) Capital Assets

Capital assets are recorded at cost. In accordance with governmental accounting standards, the District has established a capitalization threshold of \$3 thousand and a life of three years or more above which asset acquisitions are added to the capital asset accounts. Donated items are recorded at fair value at the date of the contribution. Depreciation expense is computed using the straight-line method based on the following estimated useful lives of the assets:

Land improvements	10–20 Years
Buildings	25–40 Years
Equipment	3–20 Years

Maintenance and repairs are expensed as incurred. Expenditures that materially increase values, change capacities, or extend useful lives of plant and equipment are capitalized.

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

(j) Compensated Absences

The District's employees earn vacation days at varying rates depending on years of service. Accrued vacation is reported as a current liability as employees utilize their vacation days within the following year.

KING COUNTY PUBLIC HOSPITAL DISTRICT NO. 2
(d/b/a EvergreenHealth)

Notes to Financial Statements

December 31, 2017 and 2016

(k) Net Position

Net position of the District is classified in five components. Investment in capital assets, net of related debt consists of capital assets, net of accumulated depreciation, reduced by the balances of any outstanding borrowings used to finance the purchase or construction of those assets. Restricted expendable net position includes expendable for specific activities and expendable for debt service and must be used for a particular purpose, as specified by grantors or contributors external to the District. Restricted nonexpendable net position equals the principal portion of permanent endowments. Unrestricted net position does not meet the definition of investment in capital, net of related debt or restricted. The District will first apply restricted resources when an expense is incurred for purposes for which both unrestricted and restricted net position are available.

(l) Operating Revenue and Expenses

The District's statements of revenue, expenses, and changes in net position distinguish between operating and nonoperating revenue and expenses. Operating revenue results from exchange transactions associated with providing healthcare services — the District's principal activity. Nonoperating income includes property taxes received or grants and contributions received for purposes other than capital asset acquisition. Operating expenses are all expenses incurred to provide healthcare services.

Other operating revenue includes tenant lease receipts, distributions from joint ventures, outreach laboratory service revenue, retail revenue such as gift shop and pharmacy, educational offerings, grant funds to support specific programs, restricted donations, and other services.

(m) Net Patient Service Revenue

The District has agreements with third-party payors that provide for payments to the District 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 revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined.

(n) Charity Care

The District accepts all patients regardless of their ability to pay. A patient is classified as a charity patient by reference to an established policy of the District. The estimated cost of charity care is determined by calculating the ratio of operating costs to charges, and then applying this ratio to total charity care charges. The estimated costs of charity care provided by the District were \$3.2 million and \$2.0 million for 2017 and 2016, respectively. Because the District does not pursue collection of amounts determined to qualify as charity care, associated charges are not included in net patient service revenue.

KING COUNTY PUBLIC HOSPITAL DISTRICT NO. 2
(d/b/a EvergreenHealth)

Notes to Financial Statements

December 31, 2017 and 2016

(o) Nonoperating Income, Net of Expenses

The District received property taxes of approximately \$25.7 million and \$25.2 million in 2017 and 2016, respectively. These property taxes represented regular levy proceeds and voter approved excess levies. These funds were used as follows:

	December 31	
	2017	2016
	(In thousands)	
Amount used for tax supported programs	\$ 4,343	3,860
Amounts used for debt service on general obligation bonds	21,388	21,341
	\$ 25,731	25,201

Of the amount used for debt service on general obligation bonds, \$9.9 million and \$10.4 million were used for interest payments for the years ended December 31, 2017 and 2016, respectively. The property taxes received are reflected in nonoperating income. Interest expense related to long-term debt is included in nonoperating expenses. All other expenses related to tax supported programs are included in operating expenses.

Investment income includes interest income and unrealized gains and losses on board-designated assets and earnings on cash deposits.

(p) Federal Income Taxes

No provision has been made for federal income taxes, as the District is a municipal corporation exempt from federal tax, under Section 115 of the Internal Revenue Code.

No provision has been made for federal income taxes related to EHM as it is a municipal corporation exempt from federal tax, under Section 115 of the Internal Revenue Code.

The Foundation is an organization exempt from taxation under Section 501(c)(3) of the Internal Revenue Code and is generally not subject to federal income taxes. However, the Foundation is subject to income taxes on any net income that is derived from a trade or business, regularly carried on, and not in furtherance of the purposes for which it was granted exemption. No income tax provision has been recorded as the net income, if any, from any unrelated trade or business, in the opinion of management, is not material to the financial statements taken as a whole.

KING COUNTY PUBLIC HOSPITAL DISTRICT NO. 2
(d/b/a EvergreenHealth)

Notes to Financial Statements

December 31, 2017 and 2016

(q) Recently Adopted Accounting Standards

In June 2015, the GASB issued Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions* (GASB No. 75). This Statement details the recognition and disclosure requirements for employers with payables to defined benefit OPEB plans that are administered through trusts that meet the specified criteria and for employers whose employees are provided with defined contribution OPEB. The requirements of this Statement are effective for financial statements for periods beginning after June 15, 2017. Early adoption is permitted. EHM has adopted and retroactively implemented the statement as of January 1, 2016. The changes in EHM's statements of net position and statements of revenue, expenses, and changes in net position as a result of the retroactive application of GASB No. 75 are as follows (in thousands):

	<u>As previously stated</u>	<u>Prior period adjustment</u>	<u>As restated</u>
Statement of Net Position			
Noncurrent liabilities	\$ 19,042	5,099	24,141
Deferred inflows of resources	—	201	201
Net position	(4,281)	(5,300)	(9,581)
Statement of Revenue, Expenses and Changes in Net Position			
Total operating expenses	\$ 45,234	545	45,779

(2) Net Patient Service Revenue

The District has arrangements with third-party payors that provide for payments to the District at amounts different from its established rates. A summary of the payment arrangements with major third-party payors is as follows:

(a) Medicare

Inpatient acute care services rendered to Medicare program beneficiaries are paid at predetermined, specific rates for each hospital discharge. Discharges are classified according to a list of diagnosis-related groups (DRGs). Each DRG has a payment weight assigned to it, based on the average resources used to treat Medicare patients in that DRG. Inpatient nonacute services and defined capital and medical education costs related to Medicare beneficiaries are paid based on a cost reimbursement methodology. The District is reimbursed for cost reimbursable items at a tentative rate with final settlement determined after submission of annual cost reports by the District and audits thereof by the Medicare fiscal intermediary. The District's cost reports have been reviewed and/or audited by the Medicare fiscal intermediary through 2014. The District recognized interim and final cost report settlements resulting in increased net patient service revenue by \$596 thousand and \$115 thousand in 2017 and 2016, respectively. Most outpatient services to Medicare beneficiaries are paid prospectively based on ambulatory payment classifications (APCs). Centers for Medicare and Medicaid Service (CMS) assigns individual services (Healthcare Common Procedure Coding System codes) to APCs based on similar clinical characteristics and similar costs.

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(b) Medicaid

In the spring of 2005, the Washington State Legislature and CMS approved a Medicaid Certified Public Expenditures (CPE) program for inpatient reimbursement. The CPE program uses public expenditures by certain public hospitals to earn federal matching funds. Certified public expenditures are qualifying expenditures made by the hospital to serve Medicaid eligible or uninsured patients. The program was designed to preserve a significant amount of federal match funding for the State of Washington (the State) and maintain the same level of reimbursement to the affected hospitals that they would have received prior to the implementation of the program.

The CPE program uses three payment mechanisms to reimburse hospitals for inpatient care: inpatient hospital claims payments, disproportionate share (DSH) payments, and state grants. Under the program, hospitals are paid an interim payment based on an estimate of the cost to provide services to Medicaid recipients. For each payment to a hospital in the program, only the federal matching portion of the payment is remitted to the hospital; the state portion is funded through DSH payments and state grants. The American Recovery and Reinvestment Act of 2011 temporarily increased the matching percentage from approximately 50% to approximately 62%.

The intent of the legislature is that hospitals in the program receive no less in combined federal and state payments than the hospital would have received under the methodology that was in place during fiscal year 2005. Any differences between the federal matching and state DSH components on the CPE program payments and this baseline amount are to be paid to the hospitals with state grant funds. To the extent that state grant funds allocated at the start of the year are insufficient to meet the hold harmless provision of the program, additional legislative appropriations may be required.

Interim state payments based on prospectively estimated experience are retrospectively reconciled to "hold harmless" after actual claims are repriced using the applicable methods. This process takes place at least six months after the end of the fiscal year and results in either a payable to, or receivable from, the state Medicaid Program. State inpatient claim and DSH payments are subject to retrospective determination of actual costs once the District's Medicare Cost Report is audited. CPE program payments are not considered final until retrospective cost reconciliation is complete. Final settlement of \$3.5 million has been recognized in 2017 related to state fiscal year 2010 and 2009. Final settlement of \$1.4 million has been recognized in 2016 related to state fiscal year 2008. The District recognized interim settlements resulting in an adjustment to decrease net patient service revenue by \$1.6 million and \$0.08 million in 2017 and 2016, respectively.

Inpatient Medicaid charges represented approximately 11.67% and 11.40% of total inpatient charges for the District in fiscal year 2017 and 2016, respectively.

The Medicaid CPE program continues through the State's fiscal year 2017 and 2016. As of December 31, 2017 and 2016, the District has recorded a payable of \$0.3 million and \$1.5 million for estimated overpayments for state fiscal year 2017 and 2016, respectively, which is included in third-party payor payable in the statements of net position.

Outpatient services are paid on a fee schedule or a percentage of allowed charges based on a ratio of the District's allowable operating expenses to total allowable revenue.

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In the July 2009 legislative session, the Washington State legislature enacted the Hospital Safety Net Assessment to help mitigate an estimated \$400 million reduction in hospital Medicaid payments. Under this law, nongovernmental Washington hospitals are assessed a fee on all non-Medicare patient days. The fees are used to obtain new federal Medicaid matching funds.

The safety net assessment was subject to approval by CMS before it took effect. In 2010, CMS approved the two amendments required to fully enact the safety net assessment program. The initial safety net program expired in June 2013 and the State passed a new safety net assessment program that was approved by CMS in April 2014. The new law is retroactive to July 1, 2013 and will sunset on June 30, 2017. The District is not subject to the assessment but is a recipient of grant dollars through the program. The District received safety net payments totaling \$0.9 million and \$0.8 million for 2017 and 2016, respectively.

(c) Other Third-Party Reimbursement

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

The following are the components of net patient service revenue for the years ended December 31, 2017 and 2016:

	2017	
	District	Component unit
	(In thousands)	
Gross patient service charges	\$ 1,804,111	120,415
Adjustments to patient service charges:		
Contractual adjustments	1,128,527	73,248
Provision for bad debts	23,449	4,797
Charity care	8,635	587
Administrative adjustments	16,140	11
	1,176,751	78,643
Net patient service revenue	\$ 627,360	41,772

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	<u>2016</u>	
	<u>District</u>	<u>Component unit</u>
	(In thousands)	
Gross patient service charges	\$ 1,679,133	114,991
Adjustments to patient service charges:		
Contractual adjustments	1,042,438	69,449
Provision for bad debts	22,219	4,728
Charity care	5,297	318
Administrative adjustments	<u>11,875</u>	<u>35</u>
	<u>1,081,829</u>	<u>74,530</u>
Net patient service revenue	\$ <u><u>597,304</u></u>	<u><u>40,461</u></u>

Percentage of gross hospital patient service charges for the District was as follows:

	<u>2017</u>	<u>2016</u>
Medicare	39.7%	40.3%
Other third-party payors	16.2	16.4
Premera	14.9	15.3
Medicaid	11.3	11.2
Regence	12.6	11.6
First choice	4.2	3.9
Patient self-pay	1.1	1.3

(3) Assets Limited as to Use

Assets limited as to use include board-designated cash and investments and restricted cash and investments.

Board-designated cash and investments represent unrestricted resources that have been designated by the Board for funded depreciation and community service programs. In addition, the Board has the authority to establish a regular property tax levy within statutory restrictions, with the proceeds being used for purposes designated by the Board.

Restricted cash and investments include certain assets of the Foundation that are restricted by donor stipulations, assets related to the postretirement plan covering the executive management team, and other restricted cash and investments.

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Assets limited as to use are carried at fair value. Fair value is based on the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The three levels of the fair value hierarchy under GASB 72, *Fair Value Measurement and Application*, are described below:

- 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 following methods and assumptions were used to estimate the fair value of each class of financial instruments for which it is practicable to estimate that value:

- (a) Cash and Cash Equivalents – The carrying value approximates fair value because of the short maturity of those instruments.
- (b) Long-Term Debt – Long-term debt is carried at amortized cost; however, accounting standards require the District to *disclose* the fair value. The fair value of the District's long-term debt is based on market estimates. The fair value and carrying value of long-term debt are \$218.6 million and \$212.3 million, and \$229.2 million and \$226.2 million as of December 31, 2017 and 2016, respectively.
- (c) Assets Limited as to Use – Fair values are estimated based on quoted market prices for those or similar investments. Maturities for mortgage-backed securities are based on the weighted average maturity date, or reset date for adjustable rate mortgages.

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The following tables present the composition, fair value, ratings and maturity of board-designated cash and investments for the District at December 31, 2017 and 2016:

Board-Designated Assets

December 31, 2017

Investment type	Fair value amount	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Ratings
		(In thousands)		
U.S. Treasuries	\$ 54,717	—	54,717	AAA
U.S. government agencies	32,239	—	32,239	AAA
Mutual fund – bonds	1,598	1,598	—	AAA
Credit	30,165	—	30,165	AAA
Taxable Muni	3,665	—	3,665	AAA
U.S. government agency – mortgage backed	4,787	—	4,787	AAA
King County Investment Pool	1,035	—	1,035	Not rated
Total investments	128,206	\$ 1,598	126,608	
Cash and cash equivalents	9,722			
Total cash and investments	137,928			
Property tax, interest receivable, and other	2,944			
Total board-designated assets	\$ 140,872			

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Board-Designated Assets
December 31, 2017

Investment type	Fair value amount	Investment maturities (in years)	
		Less than 1	1-5
		(In thousands)	
U.S. Treasuries	\$ 54,717	3,295	51,422
U.S. government agencies	32,239	2,698	29,541
Mutual fund – bonds	1,598	1,598	—
Credit	30,165	—	30,165
Taxable Muni	3,665	180	3,485
U.S. government agency – mortgage backed	4,787	2,273	2,514
King County Investment Pool	1,035	1,035	—
Total investments	\$ <u>128,206</u>	<u>11,079</u>	<u>117,127</u>

Board-Designated Assets
December 31, 2016

Investment type	Fair value amount	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Ratings
		(In thousands)		
U.S. Treasuries	\$ 62,420	—	62,420	AAA
U.S. government agencies	45,544	—	45,544	AAA
Mutual fund – bonds	1,074	1,074	—	AAA
U.S. government agency – mortgage backed	5,140	—	5,140	AAA
King County Investment Pool	4,709	—	—	Not rated
Total investments	118,887	\$ <u>1,074</u>	<u>113,104</u>	
Cash and cash equivalents	<u>55,730</u>			
Total cash and investments	174,617			
Property tax, interest receivable, and other	<u>2,462</u>			
Total board-designated assets	\$ <u>177,079</u>			

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**Board-Designated Assets
December 31, 2016**

Investment type	Fair value amount	Investment maturities (in years)	
		Less than 1	1-5
		(In thousands)	
U.S. Treasuries	\$ 62,420	24,575	37,845
U.S. government agencies	45,544	8,961	36,583
Mutual fund – bonds	1,074	1,074	—
U.S. government agency – mortgage backed	5,140	1,371	3,769
King County Investment Pool	4,709	4,709	—
Total investments	\$ <u>118,887</u>	<u>40,690</u>	<u>78,197</u>

The following tables present the composition, fair value, ratings and maturity of restricted cash and investments of the District for the years ended December 31, 2017 and 2016.

**Restricted Cash and Investments
December 31, 2017**

Investment type	Fair value amount	Quoted prices in active markets for identical assets (Level 1)	Ratings	Investment maturities (in years)
				Less than 1
		(In thousands)		
King County Investment Pool	\$ 775	—	Not Rated	775
Mutual fund – bonds	1,149	1,149	AAA	—
Mutual fund – equity	1,833	1,833	AAA	—
Total investments	3,757	\$ <u>2,982</u>		\$ <u>775</u>
Cash and cash equivalents	<u>104</u>			
Total cash and investments	3,861			
Property tax, interest receivable, and other	<u>4,974</u>			
Total assets restricted as to use	\$ <u>8,835</u>			

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Restricted Cash and Investments
December 31, 2016

<u>Investment type</u>	<u>Fair value amount</u>	<u>Quoted prices in active markets for identical assets (Level 1)</u>	<u>Ratings</u>	<u>Investment maturities (in years) Less than 1</u>
		(In thousands)		
King County Investment Pool	\$ 814	—	Not Rated	814
Mutual fund – bonds	1,150	1,150	AAA	1,150
Mutual fund – equity	<u>1,596</u>	<u>1,596</u>	AAA	<u>1,596</u>
Total investments	3,560	\$ <u><u>2,746</u></u>		\$ <u><u>3,560</u></u>
Cash and cash equivalents	<u>105</u>			
Total cash and investments	3,665			
Property tax, interest receivable, and other	<u>5,222</u>			
Total assets restricted as to use	\$ <u><u>8,887</u></u>			

Interest Rate Risk – The District’s investment policy limits investment maturities as a means of managing its exposure to fair value losses arising from changing interest rates. Shares of mutual funds with portfolios consisting of only U.S. government bonds or U.S. government bonds issued by federal agencies must have average maturities of less than four years. Unless matched to a specific cash flow, the District does not invest in securities maturing more than five years from the date of purchase. However, assets whose use is limited may be invested in securities exceeding 10 years if the maturity of such investments is timed to coincide with the expected use of funds.

Credit Risk – Statutes authorize the District to invest in obligations of the U.S. Treasury, agencies, and instrumentalities, public funds investment accounts, state, or local government bonds with one of the three highest credit ratings of a nationally recognized agency, money markets with investments in authorized securities, and mutual funds of only U.S. government bonds and agencies. The U.S. Treasury, agency, and agency mortgage backed are considered to be of high quality; and the U.S. Treasury carry the long-term sovereign rating of the United States of America. The District’s policy requires that all certificates of deposit be collateralized.

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The District utilizes an investment adviser as well as the King County Investment Pool (the Pool), an external investment pool. The Pool is not registered with the Securities and Exchange Commission as an investment company. Oversight of the Pool is provided by the King County Executive Finance Committee pursuant to RCW 36.29.020. Participation in this pool is voluntary. The intent of this policy is to balance reasonable security with reasonable investment return, seeking to maximize both while meeting the daily cash flow requirements of the District and conforming to all applicable laws and regulations governing the investment of public funds.

Concentration of Credit Risk – In October 2017, the District’s Board of Commissioners adopted a revised investment policy, which includes the ability to invest in Commercial Paper and Corporate Notes in accordance with RCW 39.59.040 and Washington State Investment Board policy number 2.05.500.

The following table sets forth the percentages by investment type of the District’s total investment portfolio as of December 31, 2017 and 2016.

	<u>2017</u>	<u>2016</u>
U.S. Treasuries	40%	36%
Mutual fund/U.S. government securities	7	31
Federal National Mortgage Association	7	10
Federal Home Loan Bank	6	8
Federal Home Loan Mortgage Corporation	6	10
Federal Farm Credit Bank	7	2
King County Investment Pool	1	3
Credit	22	—
Taxable Municipal Bonds	3	—
Agencies Other	1	—

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(4) Capital Assets (Tables in thousands)

The schedule of capital asset activity for the years ended December 31, 2017 and 2016 is as follows:

	<u>January 1, 2017</u>	<u>Additions and adjustments</u>	<u>Sales and retirements</u>	<u>Account transfers</u>	<u>December 31, 2017</u>
Assets at cost:					
Nondepreciable capital assets:					
Land	\$ 4,914	—	—	—	4,914
Construction in progress	30,152	50,163	—	(70,616)	9,699
Total nondepreciable capital assets	<u>35,066</u>	<u>50,163</u>	<u>—</u>	<u>(70,616)</u>	<u>14,613</u>
Depreciable capital assets:					
Land improvements	14,642	1	(82)	103	14,664
Buildings	325,908	312	(832)	32,343	357,731
Equipment	374,243	62	(8,804)	38,170	403,671
Equipment and property under capital lease	15,131	—	—	—	15,131
Total depreciable capital assets	<u>729,924</u>	<u>375</u>	<u>(9,718)</u>	<u>70,616</u>	<u>791,197</u>
Less accumulated depreciation:					
Land improvements	11,320	468	(82)	—	11,706
Buildings	154,152	12,344	(832)	—	165,664
Equipment	281,318	20,331	(8,804)	—	292,845
Equipment under capital lease	7,274	1,224	—	—	8,498
Total accumulated depreciation	<u>454,064</u>	<u>34,367</u>	<u>(9,718)</u>	<u>—</u>	<u>478,713</u>
Depreciable capital assets, net	<u>275,860</u>	<u>(33,992)</u>	<u>—</u>	<u>70,616</u>	<u>312,484</u>
Capital assets, net	<u>\$ 310,926</u>	<u>16,171</u>	<u>—</u>	<u>—</u>	<u>327,097</u>

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	<u>January 1, 2016</u>	<u>Additions and adjustments</u>	<u>Sales and retirements</u>	<u>Account transfers</u>	<u>December 31, 2016</u>
Assets at cost:					
Nondepreciable capital assets:					
Land	\$ 4,914	—	—	—	4,914
Construction in progress	10,547	40,512	—	(20,907)	30,152
Total nondepreciable capital assets	15,461	40,512	—	(20,907)	35,066
Depreciable capital assets:					
Land improvements	14,647	—	(71)	66	14,642
Buildings	322,645	131	(150)	3,282	325,908
Equipment	361,493	341	(5,150)	17,559	374,243
Equipment and property under capital lease	17,055	—	(1,924)	—	15,131
Total depreciable capital assets	715,840	472	(7,295)	20,907	729,924
Less accumulated depreciation:					
Land improvements	10,878	512	(70)	—	11,320
Buildings	142,777	11,523	(148)	—	154,152
Equipment	266,963	19,318	(4,963)	—	281,318
Equipment under capital lease	8,175	1,023	(1,924)	—	7,274
Total accumulated depreciation	428,793	32,376	(7,105)	—	454,064
Depreciable capital assets, net	287,047	(31,904)	(190)	20,907	275,860
Capital assets, net	\$ 302,508	8,608	(190)	—	310,926

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The schedule of capital asset activity for EHM for the years ended December 31, 2017 and 2016 is as follows:

	<u>January 1, 2017</u>	<u>Additions and adjustments</u>	<u>Sales and retirements</u>	<u>Account transfers</u>	<u>December 31, 2017</u>
Assets at cost:					
Nondepreciable capital assets:					
Land	\$ 1,879	—	—	—	1,879
Construction in progress	905	1,293	—	(1,318)	880
Total nondepreciable capital assets	<u>2,784</u>	<u>1,293</u>	<u>—</u>	<u>(1,318)</u>	<u>2,759</u>
Depreciable capital assets:					
Land improvements	1,146	—	—	—	1,146
Buildings	25,072	3	—	1,199	26,274
Equipment	16,943	1,406	(366)	107	18,090
Equipment and property under capital lease	2,446	17	—	12	2,475
Total depreciable capital assets	<u>45,607</u>	<u>1,426</u>	<u>(366)</u>	<u>1,318</u>	<u>47,985</u>
Less accumulated depreciation:					
Land improvements	711	55	—	—	766
Buildings	17,879	1,025	—	—	18,904
Equipment	14,098	847	(366)	—	14,579
Equipment under capital lease	2,160	82	—	—	2,242
Total accumulated depreciation	<u>34,848</u>	<u>2,009</u>	<u>(366)</u>	<u>—</u>	<u>36,491</u>
Depreciable capital assets, net	<u>10,759</u>	<u>(583)</u>	<u>—</u>	<u>1,318</u>	<u>11,494</u>
Capital assets, net	\$ <u>13,543</u>	<u>710</u>	<u>—</u>	<u>—</u>	<u>14,253</u>

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	<u>January 1, 2016</u>	<u>Additions and adjustments</u>	<u>Sales and retirements</u>	<u>Account transfers</u>	<u>December 31, 2016</u>
Assets at cost:					
Nondepreciable capital assets:					
Land	\$ 1,879	—	—	—	1,879
Construction in progress	80	839	—	(14)	905
Total nondepreciable capital assets	<u>1,959</u>	<u>839</u>	<u>—</u>	<u>(14)</u>	<u>2,784</u>
Depreciable capital assets:					
Land improvements	1,146	—	—	—	1,146
Buildings	24,524	534	—	14	25,072
Equipment	16,013	930	—	—	16,943
Equipment and property under capital lease	2,451	5	(10)	—	2,446
Total depreciable capital assets	<u>44,134</u>	<u>1,469</u>	<u>(10)</u>	<u>14</u>	<u>45,607</u>
Less accumulated depreciation:					
Land improvements	656	55	—	—	711
Buildings	16,732	1,147	—	—	17,879
Equipment	13,355	743	—	—	14,098
Equipment under capital lease	2,077	92	(9)	—	2,160
Total accumulated depreciation	<u>32,820</u>	<u>2,037</u>	<u>(9)</u>	<u>—</u>	<u>34,848</u>
Depreciable capital assets, net	<u>11,314</u>	<u>(568)</u>	<u>(1)</u>	<u>14</u>	<u>10,759</u>
Capital assets, net	\$ <u><u>13,273</u></u>	<u><u>271</u></u>	<u><u>(1)</u></u>	<u><u>—</u></u>	<u><u>13,543</u></u>

(5) Other Assets

Evergreen Radia, LLC

During 2003, the District formed a limited liability company with a local radiology group for the purpose of providing outpatient diagnostic imaging services to individuals within the community. The District had a 50% interest in this joint venture at December 31, 2017 and 2016, which is accounted for using the equity method of accounting. During the years ended December 31, 2017 and 2016, the District recognized income of \$1.8 million and \$1.5 million, respectively, for its share of the Evergreen Radia, LLC's net income, which is recorded as other operating revenue. The District's recorded investment in Evergreen Radia, LLC was \$5.4 million and \$5.3 million as of December 31, 2017 and 2016, respectively, and is included in other assets in the District's statements of net position.

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PacLab, LLC

Effective January 1, 2004, the District became a member in PacLab, LLC to provide outreach laboratory and testing services in order to further its own congruent mission of providing accurate, timely, and integrated laboratory testing series for patients, physicians, and other healthcare professionals in the community. The District's ownership interest was approximately 11% as of December 31, 2017 and 2016. This percentage interest is equivalent to the ratio of the gross billed revenue generated by the District from its outreach laboratory testing business to other members' volumes. For the years ended December 31, 2017 and 2016, the District recognized a loss of \$0.02 million and \$0.11 million, respectively, for its share of the net loss realized by PacLab, LLC, which is recorded within other operating revenue. Due to the nature of the investment, the District recorded distributions of excess cash from PacLab, LLC in other operating revenue of \$3.4 million and \$3.2 million for the years ended December 31, 2017 and 2016, respectively. The District records its investment in PacLab, LLC using the equity method of accounting. The investment balance was \$0.71 million and \$0.73 million as of December 31, 2017 and 2016, respectively, and is included in other assets in the District's statements of net position. In May 2017, PacLab, LLC was purchased by Laboratory Corporation of America (LabCorp). The District was paid approximately \$19 million for its interest in PacLab, which is classified as a deferred inflow of resources as of December 31, 2017. The closing and the associated sale were effective February 5, 2018, at which time the deferred inflow of resources was recognized as nonoperating income.

The following represents the summary financial information of Evergreen Radia, LLC and PacLab, LLC as of December 31, 2017 and 2016 (in thousands):

	2017	
	Evergreen Radia, LLC (Audited)	PacLab, LLC (Unaudited)
Current assets	\$ 4,693	4,254
Noncurrent assets, net	774	2,676
	\$ 5,467	6,930
Current liabilities	\$ 1,574	574
Long-term liabilities	207	—
Equity	3,687	6,355
	\$ 5,468	6,929
Revenue	\$ 12,757	190
Expenses	9,170	1,059
Net income (loss)	\$ 3,587	(869)

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	<u>2016</u>	
	<u>Evergreen Radia, LLC (Audited)</u>	<u>PacLab, LLC (Unaudited)</u>
Current assets	\$ 4,124	4,043
Noncurrent assets, net	1,046	3,209
	<u>\$ 5,170</u>	<u>7,252</u>
Current liabilities	\$ 1,332	27
Long-term liabilities	339	—
Equity	3,499	7,225
	<u>\$ 5,170</u>	<u>7,252</u>
Revenue	\$ 10,826	173
Expenses	8,358	1,087
Net income (loss)	<u>\$ 2,468</u>	<u>(914)</u>

(6) Long-Term Debt and Capital Lease Obligations

Long-term debt and capital lease obligations of the District consist of the following:

	<u>December 31</u>	
	<u>2017</u>	<u>2016</u>
	(In thousands)	
Limited Tax General Obligation Bonds (LTGO)		
Series 2010 (fixed rate), payable annually through 2028, interest at 2.00% to 5.25%	\$ 24,350	25,980
LTGO Series 2011 (fixed rate), payable annually through 2030, interest at 2.00% to 5.00%	21,565	22,800
LTGO Series 2015 (fixed rate), payable annually through 2031, interest at 3.63 to 5.00%	55,065	57,740
LTGO Series 2015 B (fixed rate), payable annually through 2037, interest at 4.00% to 5.00%	54,000	54,000
Unlimited Tax General Obligation Refunding Bonds (UTGO), Series 2013 (fixed rate), payable semiannually through 2023, interest at 3.00% to 5.00%	42,300	48,266

KING COUNTY PUBLIC HOSPITAL DISTRICT NO. 2

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	<u>December 31</u>	
	<u>2017</u>	<u>2016</u>
	(In thousands)	
Capital lease obligations, \$8,919 (fixed rate), payable monthly including interest at 0.18% to 10.0%, collateralized by equipment	\$ 8,918	9,854
	206,198	218,640
Plus bond discounts and premiums	14,999	17,447
	221,197	236,087
Less current portion	(13,101)	(12,440)
	<u>\$ 208,096</u>	<u>223,647</u>

Long-term debt and capital lease obligations 2017 and 2016 activity summary for the District is as follows (in thousands):

	<u>January 1, 2017</u>	<u>Additions</u>	<u>Reductions</u>	<u>December 31, 2017</u>	<u>Amounts due within one year</u>
Limited general obligation bonds:					
2010 series	\$ 25,980	—	1,630	24,350	1,715
2011 series	22,800	—	1,235	21,565	1,295
2015 series	57,740	—	2,675	55,065	2,815
2015 series B	54,000	—	—	54,000	—
Unlimited general obligation bonds:					
2013 series	48,265	—	5,965	42,300	6,265
Total long-term debt	208,785	—	11,505	197,280	12,090
Capital lease obligations	9,855	—	937	8,918	1,011
Total long-term debt and capital lease obligations	218,640	—	12,442	206,198	13,101
Bond discounts and premiums	17,447	—	2,448	14,999	—
Total long-term debt and capital lease obligations	<u>\$ 236,087</u>	<u>—</u>	<u>14,890</u>	<u>221,197</u>	<u>13,101</u>

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	<u>January 1, 2016</u>	<u>Additions</u>	<u>Reductions</u>	<u>December 31, 2016</u>	<u>Amounts due within one year</u>
Limited general obligation bonds:					
2010 series	\$ 27,535	—	1,555	25,980	1,630
2011 series	24,010	—	1,210	22,800	1,235
2015 series	60,295	—	2,555	57,740	2,675
2015 series B	54,000	—	—	54,000	—
Unlimited general obligation bonds:					
2013 series	<u>53,950</u>	<u>—</u>	<u>5,685</u>	<u>48,265</u>	<u>5,965</u>
Total long-term debt	219,790	—	11,005	208,785	11,505
Capital lease obligations	<u>10,719</u>	<u>—</u>	<u>864</u>	<u>9,855</u>	<u>935</u>
Total long-term debt and capital lease obligations	230,509	—	11,869	218,640	12,440
Bond discounts and premiums	<u>20,242</u>	<u>—</u>	<u>2,795</u>	<u>17,447</u>	<u>—</u>
Total long-term debt and capital lease obligations	\$ <u>250,751</u>	<u>—</u>	<u>14,664</u>	<u>236,087</u>	<u>12,440</u>

A summary of the District future maturities on long-term debt for the next five years and thereafter as of December 31, 2017 for both principal and interest is presented below (in thousands):

	<u>Principal</u>	<u>Interest</u>
2018	\$ 12,090	9,354
2019	12,695	8,750
2020	13,280	8,156
2021	13,870	7,564
2022	54,010	28,298
Amounts due 2023–2027	38,810	17,337
Amounts due 2028–2032	42,235	8,212
Amounts due 2033–2037	10,290	412
Amounts due 2038–2042	<u>—</u>	<u>—</u>
	197,280	\$ <u>88,083</u>
Plus amount representing net unamortized bond discounts and premiums	<u>—</u>	
	\$ <u>197,280</u>	

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LTGO bonds are secured by the irrevocable pledge of the District to levy taxes annually, without limitation as to rate or amount based on a vote of the electors, on all taxable property within the District. LTGO are secured by the irrevocable pledge of the District to levy taxes annually, within the constitutional and statutory limitations provided by law without a vote of the electors, upon property in the District, as well as the net revenue of the District for amounts that exceed that available through the levy.

In January 2015, the District refinanced \$62.7 million of the 2006 LTGO bonds from an original bond amount of more than \$76.9 million. The new bonds, to which Moody's Investor Service gave an Aa3 rating, will mature in December 2031. The bond closing date was January 7, 2015. The difference between the reacquisition price of the new debt and the net carrying amount of the old debt resulted in a loss on refunding of approximately \$3.7 million, which is accounted for as a deferred outflow of resources.

In October 2015, the District issued \$54.0 million in LTGO bonds to be used to provide funds necessary to carry out capital improvements in accordance with the District's Board approved long-term master facility plan. The new bonds, to which Moody's Investor Service gave an Aa3 rating, will mature in December 2037. The bond closing date was October 15, 2015.

Component Unit – EHM

Long-term debt and capital lease obligations of EHM consist of the following (in thousands):

	December 31	
	2017	2016
LTGO Improvement and Refunding Bonds, 2009, payable annually through 2034, interest at 5.00% to 5.38%	\$ 17,510	17,510
LTGO Bonds, 2004, payable annually through 2018, interest at 4.10% to 4.50%	535	1,025
Capital lease obligations, payable monthly including interest at 6.70% to 10.51%, collateralized by equipment	518	532
	<u>18,563</u>	<u>19,067</u>
Plus bond discounts and premiums	<u>(204)</u>	<u>(218)</u>
	18,359	18,849
Less current portion	<u>(761)</u>	<u>(795)</u>
	<u>\$ 17,598</u>	<u>18,054</u>

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Long-term debt and capital lease obligations 2017 and 2016 activity summary of EHM is as follows (in thousands):

	<u>January 1, 2017</u>	<u>Additions</u>	<u>Reductions</u>	<u>December 31, 2017</u>	<u>Amounts due within one year</u>
Limited general obligation bonds:					
2009 series	\$ 17,510	—	—	17,510	—
2004 series	1,025	—	490	535	535
Total long-term debt	18,535	—	490	18,045	535
Capital lease obligations	532	387	401	518	226
Total long-term debt and capital lease obligations	19,067	387	891	18,563	761
Bond discounts and premiums	(218)	14	—	(204)	—
Total long-term debt and capital lease obligations	\$ 18,849	401	891	18,359	761
	<u>January 1, 2016</u>	<u>Additions</u>	<u>Reductions</u>	<u>December 31, 2016</u>	<u>Amounts due within one year</u>
Limited general obligation bonds:					
2009 series	\$ 17,510	—	—	17,510	—
2004 series	1,475	—	450	1,025	490
Total long-term debt	18,985	—	450	18,535	490
Capital lease obligations	885	—	353	532	305
Total long-term debt and capital lease obligations	19,870	—	803	19,067	795
Bond discounts and premiums	(232)	14	—	(218)	—
Total long-term debt and capital lease obligations	\$ 19,638	14	803	18,849	795

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A summary of EHM's future maturities on long-term debt for the next five years and thereafter as of December 31, 2017 for both principal and interest is presented below (in thousands):

	<u>Principal</u>	<u>Interest</u>
2018	\$ 535	930
2019	585	906
2020	635	876
2021	690	845
2022	745	810
Amounts due 2023–2027	4,710	3,428
Amounts due 2028–2032	6,730	2,035
Amounts due 2033–2035	<u>3,415</u>	<u>278</u>
	18,045	\$ <u><u>10,108</u></u>
Plus amount representing net unamortized bond discounts	<u>(204)</u>	
	\$ <u><u>17,841</u></u>	

Capital Leases

The District acquired certain equipment under capital lease obligations. The leases are collateralized by the related equipment. Future minimum lease payments are as follows (in thousands):

	<u>Amount</u>
Year(s) ending December 31:	
2018	\$ 1,394
2019	1,382
2020	1,217
2021	1,227
2022	1,267
2023–2027	4,170
2028–2032	<u>—</u>
Total minimum lease payments	10,657
Less amount representing interest	<u>(1,738)</u>
Total capital lease payments	\$ <u><u>8,919</u></u>

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EHM acquired certain equipment under capital lease obligations. The leases are collateralized by the related equipment. Future minimum lease payments are as follows (in thousands):

	<u>Amount</u>	
Year(s) ending December 31:		
2018	\$	226
2019		90
2020		89
2021		84
2022		<u>84</u>
Total minimum lease payments		573
Less amount representing interest		<u>(55)</u>
Total capital lease payments	\$	<u><u>518</u></u>

(7) Tenant Lease Receipts

The District owns and operates the Evergreen Professional Center (EPC), the Evergreen Surgical and Physicians Center (ES&PC), and the DeYoung Pavilion, which contain approximately 56,860 total square feet of space for physician offices available for lease. As of December 31, 2017 and 2016, the District had space under operating lease terms from 5 to 15 years.

Future minimum rent receipts and sublease receipts on noncancelable operating leases are as follows:

	<u>Owned property receipts</u>	<u>Leased property receipts</u>	<u>Total amount</u>
		(In thousands)	
Year ending December 31:			
2018	\$ 1,763	4,144	5,907
2019	1,661	3,535	5,196
2020	1,178	3,309	4,487
2021	1,182	2,605	3,787
2022	1,148	2,098	3,246
Thereafter	<u>1,554</u>	<u>8,068</u>	<u>9,622</u>
	\$ <u><u>8,486</u></u>	<u><u>23,759</u></u>	<u><u>32,245</u></u>

Rental income related to the EPC, ES&PC, and the DeYoung Pavilion leases was approximately \$1.8 million and \$1.7 million in 2017 and 2016, respectively, and is included in other operating revenue.

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(8) Commitment and Contingencies

(a) Leases

The District leases various equipment and facilities under operating leases. Total rental expense in 2017 and 2016 for all operating leases and various rental agreements was approximately \$13.8 million and \$11.7 million, respectively.

The future minimum lease payments under noncancelable operating leases that have initial lease terms in excess of one year are as follows:

	Payments
	(In thousands)
Year ending December 31:	
2018	\$ 9,335
2019	9,305
2020	9,183
2021	9,192
2022	9,300
Thereafter	70,434
	\$ 116,749

(b) Insurance Coverage

The District holds professional liability insurance coverage through an independent insurance company. The insurance coverage is based on a claims-made policy. The District is self-insured for professional liability tail and expected claims payout on this coverage. The policy's self-insured retention limit is \$1.0 million per claim and \$3.5 million per aggregate.

The District records its actuarial estimate for professional claims liability at its best estimate of the ultimate losses and costs associated with settling claims. The professional liability expense was \$2.4 million and \$3.2 million for the years ended December 31, 2017 and 2016, respectively. At December 31, 2017 and 2016, the estimated professional claims liability was \$6.9 million and \$6.3 million, respectively.

The District is self-insured for various programs, including employee medical benefits and workers' compensation. The estimated ultimate costs of claims under these programs are accrued when the incidents occur that give rise to the claims. Accrued amounts for these programs of approximately \$5.7 million and \$6.2 million at December 31, 2017 and 2016, respectively, are reported as part of accrued compensation and related liabilities in the accompanying statements of net position. The accrued amounts include known liabilities of the programs and estimated incurred but not reported claims.

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Notes to Financial Statements

December 31, 2017 and 2016

(c) *Litigation*

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

(d) *Compliance with Laws and Regulations*

The healthcare industry is subject to numerous laws and regulations of 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 by healthcare providers, together with the imposition of significant fines and penalties, as well as significant repayments for patient services previously billed. Management believes that the District 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 known or unasserted at this time.

(e) *Risk Management*

The District 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. The District maintains commercial insurance coverage designed to provide for claims arising from such matters.

(9) *Retirement Plans*

The District has a defined-contribution retirement plan covering substantially all eligible employees. The District makes a matching contribution of up to a maximum of 8% of the employee's eligible compensation. All contributions vest over a five-year schedule.

In addition to the retirement plan, the District maintains a voluntary employee deferred compensation program under the provision of Section 457 of the Internal Revenue Service Code. Under this program, the District employees can defer a portion of their income until withdrawn in future years. All assets are required to be held in trust for the exclusive benefit of participants and their beneficiaries. The District also contributes up to 4% of compensation as base pension depending on years of service.

Retirement plan expense, incurred and reflected in employee benefits, was approximately \$18.1 million and \$17.1 million in 2017 and 2016, respectively. Contributions made by employees to the benefit plans totaled approximately \$26.2 million and \$25.7 million in 2017 and 2016, respectively. Both plans are administered by the District under record-keeping and trust agreements with third parties.

The District has a postemployment benefit plan covering the executive management team. The District makes annual contributions to the SERP. The SERP is recorded under assets limited as to use and under noncurrent liabilities on the statements of net position. At December 31, 2017 and 2016, the SERP balance was \$2.7 million and \$2.2 million, respectively.

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December 31, 2017 and 2016

(10) Concentration of Credit Risk

The District grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payor agreements. The mix of hospital receivables at December 31 was as follows:

	Receivables	
	2017	2016
Medicare	31.8%	30.2%
Other third-party payors	16.8	18.6
Medicaid	12.1	14.1
Patients self-pay	11.5	13.0
Premera	14.4	12.0
Regence	9.7	9.0
First choice	3.7	3.1
	100.0%	100.0%

(11) Property Taxes

The King County treasurer acts as an agent to collect property taxes levied in the county for all taxing authorities. Taxes are levied annually on January 1, on property values listed as of the prior May 31. Assessed values are established by the King 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. Collections are distributed monthly by the county treasurer.

The District is permitted by law to levy up to \$0.75 per \$1,000 of assessed valuation for general district purposes. The Washington State Constitution and Washington State Law, RCW 84.55.100, limit the rate. The District may also levy taxes at a lower rate. Additional amounts of tax need to be authorized by a vote of the residents of the District.

For 2017 and 2016, the District's regular levy request was \$0.24 and \$0.25 per \$1,000 on a total assessed valuation of the property within the District of \$72.0 billion and \$66.9 billion for a total regular levy of \$17.5 million and \$17.0 million, respectively. Excess levies totaled \$8.2 million in both 2017 and 2016, related to debt service, mainly due to the hospital-based emergency department and patient facility, which opened in 2007.

Property taxes are recorded as receivables when levied. Since state law allows for sale of property for failure to pay taxes, no estimate of uncollectible taxes is made.

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December 31, 2017 and 2016

(12) Blended Component Unit

Condensed combining statements for the District and its blended component unit, the Foundation, are shown below:

Statement of net position – December 31, 2017				
	<u>Combined entities</u>	<u>Eliminations/ reclassifications</u>	<u>District</u>	<u>Foundation</u>
	(In thousands)			
Assets:				
Current assets:				
Total current assets	\$ 154,678	(682)	149,740	5,620
Noncurrent assets:				
Total other assets	183,195	310	178,967	3,918
Capital assets, net	<u>327,097</u>	<u>—</u>	<u>327,097</u>	<u>—</u>
Total assets	<u>\$ 664,970</u>	<u>(372)</u>	<u>655,804</u>	<u>9,538</u>
Liabilities:				
Total current liabilities	\$ 86,449	(372)	86,449	372
Total noncurrent liabilities	<u>215,997</u>	<u>—</u>	<u>215,997</u>	<u>—</u>
Total liabilities	<u>302,446</u>	<u>(372)</u>	<u>302,446</u>	<u>372</u>
Deferred inflows of resources:				
Deferred proceeds (current)	19,139	—	19,139	—
Net position:				
Invested in capital assets, net of related debt	105,899	—	105,899	—
Restricted:				
Expendable	1,716	—	(108)	1,824
Nonexpendable	6,031	—	717	5,314
Unrestricted	<u>229,739</u>	<u>—</u>	<u>227,711</u>	<u>2,028</u>
Total net position	<u>343,385</u>	<u>—</u>	<u>334,219</u>	<u>9,166</u>
Total liabilities and net position	<u>\$ 664,970</u>	<u>(372)</u>	<u>655,804</u>	<u>9,538</u>

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Notes to Financial Statements

December 31, 2017 and 2016

Statement of net position – December 31, 2016

	Combined entities	Eliminations/ reclassifications	District	Foundation
	(In thousands)			
Assets:				
Current assets:				
Total current assets	\$ 123,892	(1,189)	118,523	6,558
Noncurrent assets:				
Total other assets	217,153	299	213,460	3,394
Capital assets, net	<u>310,926</u>	<u>—</u>	<u>310,926</u>	<u>—</u>
Total assets	\$ <u>651,971</u>	<u>(890)</u>	<u>642,909</u>	<u>9,952</u>
Liabilities:				
Total current liabilities	\$ 92,535	(890)	92,535	890
Total noncurrent liabilities	<u>230,887</u>	<u>—</u>	<u>230,887</u>	<u>—</u>
Total liabilities	<u>323,422</u>	<u>(890)</u>	<u>323,422</u>	<u>890</u>
Net position:				
Invested in capital assets, net of related debt	74,838	—	74,838	—
Restricted:				
Expendable	1,707	—	25	1,682
Nonexpendable	6,465	—	846	5,619
Unrestricted	<u>245,539</u>	<u>—</u>	<u>243,778</u>	<u>1,761</u>
Total net position	<u>328,549</u>	<u>—</u>	<u>319,487</u>	<u>9,062</u>
Total liabilities and net position	\$ <u>651,971</u>	<u>(890)</u>	<u>642,909</u>	<u>9,952</u>

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	Statement of revenue, expenses, and changes in net position – year ended December 31, 2017		
	Combined entities	District	Foundation
		(In thousands)	
Revenue:			
Operating revenue:			
Net patient service revenue	\$ 627,360	627,360	—
Other operating revenue	41,906	39,744	2,162
Total operating revenue	<u>669,266</u>	<u>667,104</u>	<u>2,162</u>
Expenses:			
Operating expenses:			
Other operating expenses	639,387	636,917	2,470
Depreciation and amortization	34,229	34,229	—
Total operating expenses	<u>673,616</u>	<u>671,146</u>	<u>2,470</u>
Deficit of revenue over expenses from operations	<u>(4,350)</u>	<u>(4,042)</u>	<u>(308)</u>
Nonoperating income, net of expenses:			
Property taxes	25,731	25,731	—
Interest and amortization expense	(8,490)	(8,490)	—
Other nonoperating revenue	1,723	1,310	413
Net nonoperating income	<u>18,964</u>	<u>18,551</u>	<u>413</u>
Excess of revenue over expenses	14,614	14,509	105
Capital grants and contributions	<u>222</u>	<u>(855)</u>	<u>1,077</u>
Total change in net position	14,836	13,654	1,182
Net position, beginning of year	<u>328,549</u>	<u>317,184</u>	<u>11,365</u>
Net position, end of year	<u>\$ 343,385</u>	<u>330,838</u>	<u>12,547</u>

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December 31, 2017 and 2016

	Statement of revenue, expenses, and changes in net position – year ended December 31, 2016		
	Combined entities	District	Foundation
		(In thousands)	
Revenue:			
Operating revenue:			
Net patient service revenue	\$ 597,304	597,304	—
Other operating revenue	42,817	39,510	3,307
Total operating revenue	<u>640,121</u>	<u>636,814</u>	<u>3,307</u>
Expenses:			
Operating expenses:			
Other operating expenses	612,055	608,630	3,425
Depreciation and amortization	32,019	32,019	—
Total operating expenses	<u>644,074</u>	<u>640,649</u>	<u>3,425</u>
Deficit of revenue over expenses from operations	<u>(3,953)</u>	<u>(3,835)</u>	<u>(118)</u>
Nonoperating income, net of expenses:			
Property taxes	25,201	25,201	—
Interest and amortization expense	(8,914)	(8,914)	—
Other nonoperating revenue	1,719	1,460	259
Net nonoperating income	<u>18,006</u>	<u>17,747</u>	<u>259</u>
Excess of revenue over expenses	14,053	13,912	141
Capital grants and contributions	1,227	(2)	1,229
Total change in net position	15,280	13,910	1,370
Net position, beginning of year	313,269	303,274	9,995
Net position, end of year	<u>\$ 328,549</u>	<u>317,184</u>	<u>11,365</u>

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Notes to Financial Statements

December 31, 2017 and 2016

**Statement of cash flows – year ended
December 31, 2017**

	Combined entities	District	Foundation
		(In thousands)	
Net cash provided by (used in):			
Operating activities	\$ 5,787	6,330	(543)
Noncapital financing activities	4,343	4,206	137
Capital and related financing activities	(45,720)	(45,720)	—
Investing activities	56,803	57,005	(202)
Net increase (decrease) in cash and cash equivalents	21,213	21,821	(608)
Cash and cash equivalents, beginning of year	22,290	16,331	5,959
Cash and cash equivalents, end of year	\$ 43,503	38,152	5,351

**Statement of cash flows – year ended
December 31, 2016**

	Combined entities	District	Foundation
		(In thousands)	
Net cash provided by (used in):			
Operating activities	\$ 32,458	32,316	142
Noncapital financing activities	3,860	3,715	145
Capital and related financing activities	(43,746)	(43,746)	—
Investing activities	11,041	11,098	(57)
Net increase in cash and cash equivalents	3,613	3,383	230
Cash and cash equivalents, beginning of year	18,677	12,948	5,729
Cash and cash equivalents, end of year	\$ 22,290	16,331	5,959

(13) Subsequent Events

The District has performed an evaluation of subsequent events through July 25, 2018, which is the date these financial statements were available to be issued.