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

(A Component Unit of the University of Washington)

Financial Statements

June 30, 2013 and 2012

(With Independent Auditors' Report Thereon)

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

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The following discussion and analysis provides an overview of the financial position and activities of Public Hospital District No. 1 of King County, Washington, dba Valley Medical Center (VMC), for the years ended June 30, 2013 and 2012. This discussion has been prepared by management and is designed to focus on current activities, resulting changes, and current known facts and should be read in conjunction with the financial statements and accompanying notes that follow this section.

Using the Financial Statements

VMC's financial statements consist of three statements: statements of net position; statements of revenues, expenses, and changes in net position; and statements of cash flows. These financial statements and related notes provide information about the activities of VMC, including resources held by VMC but restricted for specific purposes by contributors, grantors, or enabling legislation.

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

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

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

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

Financial Health

Statement of Net Position

The table to the left is a presentation of certain condensed financial information derived from VMC's statement of net position for the fiscal years ended June 30, 2013, 2012 and 2011. As part of the affiliation with the University of Washington Medicine (UWM), VMC changed its fiscal year to June 30, effective as of June 30, 2012.

Total assets were $615.1 million at June 30, 2013 compared to $642.1 million at June 30, 2012, a decrease of $27 million. Significant events within total assets during fiscal year 2013 included implementation of the electronic health record system and the build-out of the 6th and 7th floors of the Emergency Services Tower. The overall cause of decreased net position during the same fiscal year relates to operating loss during the period (in thousands).

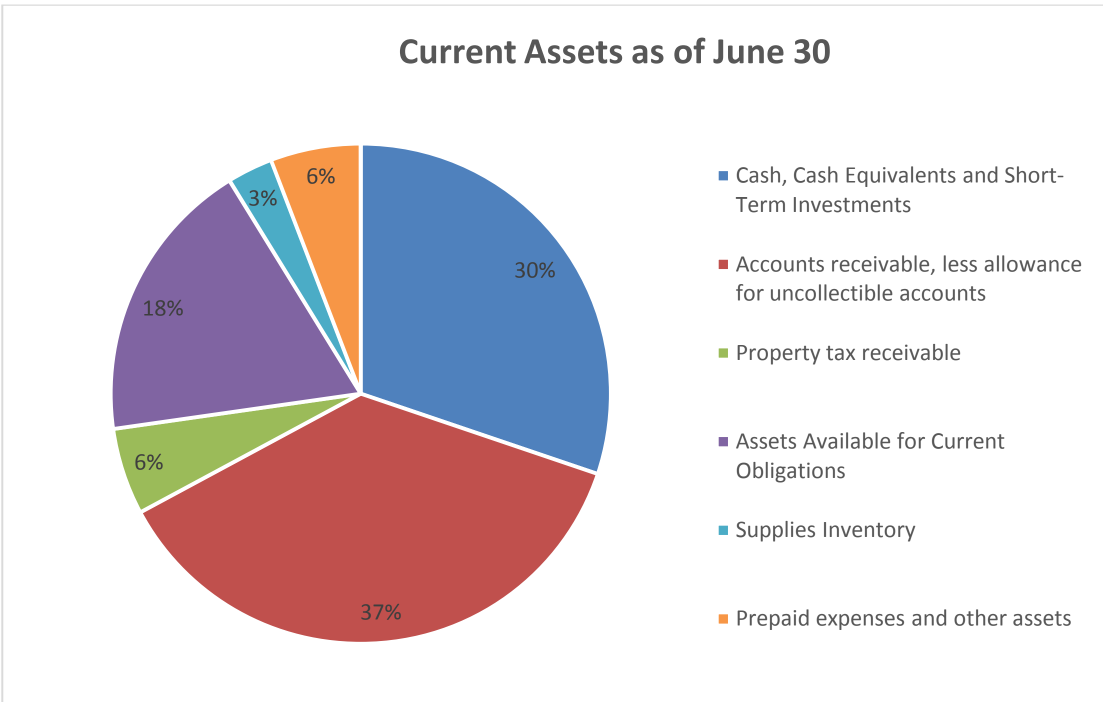
		2013	2012	2011
Current assets	$	143,293	160,830	169,503
Noncurrent assets:				
Capital assets, net		386,179	385,610	344,259
Noncurrent assets		46,501	62,795	107,492
Long-term investments		31,264	24,178	15,300
Other		7,858	8,673	9,932
Total assets		615,095	642,086	646,486
Current liabilities		78,987	81,391	71,357
Noncurrent liabilities		326,807	334,444	343,671
Total liabilities		405,794	415,835	415,028
Net position	$	209,301	226,251	231,458

Total assets decreased $27.3 million in fiscal year 2013 from fiscal year 2012 and decreased $4.4 million in fiscal year 2012 from fiscal year 2011.

Current Assets

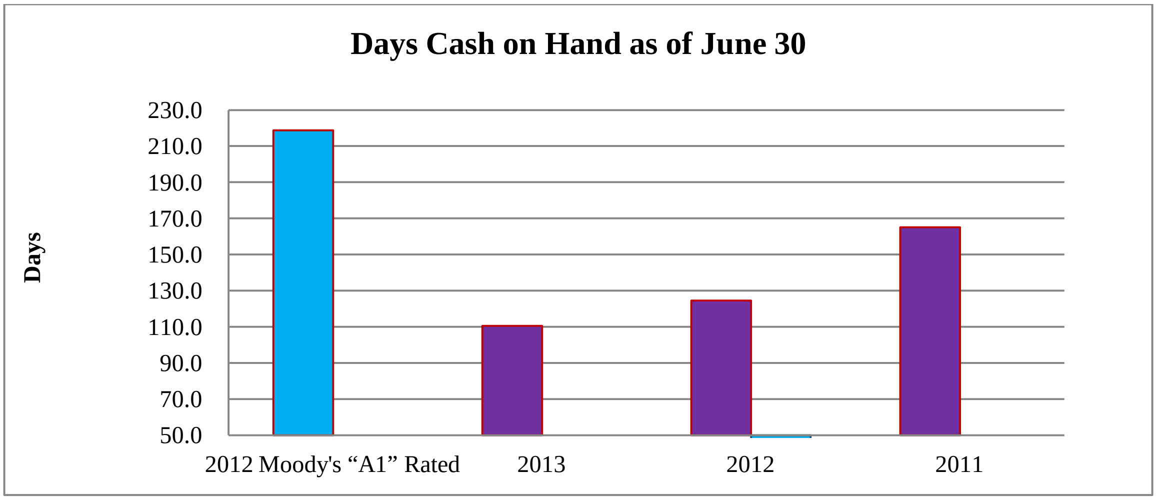
Current Assets consist of cash and cash equivalents, and other assets that are expected to be converted to cash within a year. Current assets also include net patient accounts receivable valued at the estimated net realizable amount due from patients and insurers.

Total current assets were $143.3 million at fiscal year-end 2013, compared to $160.8 million at year-end 2012. Fiscal year 2013 composition of current assets is illustrated in the pie chart below.



Cash and short-term investments were essentially comparable between years as cash and short-term investments decreased $0.1 million in 2013 from $43.4 million at June 30, 2012 to $43.3 million at June 30, 2013.

Days cash on hand is utilized to evaluate an organization's continuing ability to meet its short-term operating needs. Days cash on hand, including short and long-term investments and board designated assets for general capital improvements and operations, as of June 30 for fiscal years 2013, 2012 and 2011 are illustrated in the graph to the right.



VMC's total days cash on hand, including short and long-term investments and board designated assets for general capital improvements and operations, decreased 14 days from 125 days at June 30, 2012 to 111 days at June 30, 2013 and decreased 40 days from 165 days at June 30, 2011 to 125 days at June 30, 2012. Decreases in both years were primarily due to planned funding of major capital projects including an electronic health record system and the 6th and 7th floors Emergency Services Tower expansion. Days cash on hand at June 30, 2013 was also impacted by declining operating performance in fiscal year 2013.

Net patient accounts receivable was comparable between years, and was \$52.9 million as of June 30, 2013, compared to \$53.1 million at June 30, 2012.

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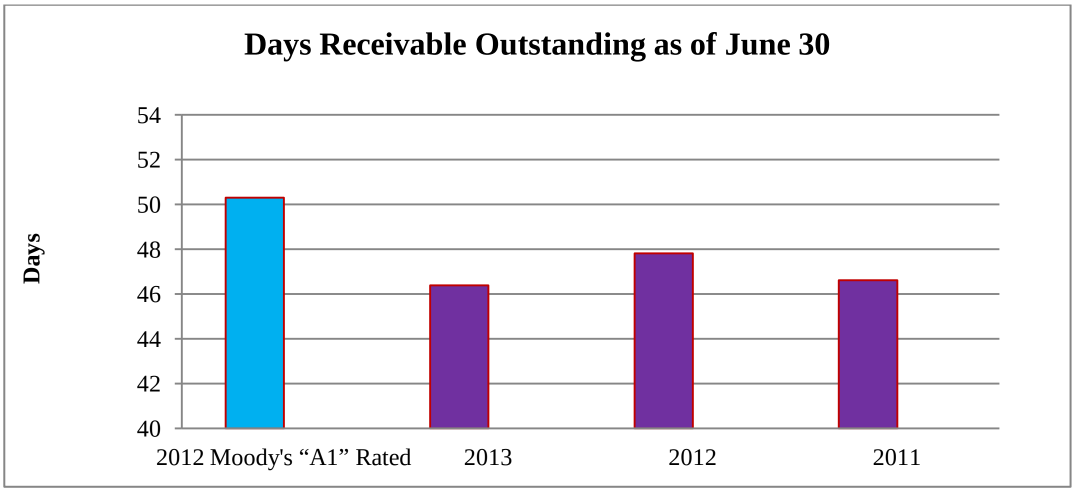
Net patient accounts receivable increased $4.0 million during fiscal years 2012 and 2011, respectively, which was reflective of higher revenues between years and an increase in days receivable outstanding.



Days receivable outstanding illustrates an organization's ability to convert service revenue to cash. Days receivable outstanding as of June 30 for fiscal years 2013, 2012 and 2011 are illustrated in the graph above.

VMC's total days receivable outstanding decreased 1.4 days from 47.8 days at June 30, 2012 to 46.4 days at June 30, 2013, and increased 1.2 days from 46.6 days at June 30, 2011 to 47.8 days at June 30, 2012.

As of June 30, 2013 and 2012, 45% and 48% of the net patient accounts receivable balance is due from commercial payers, 39% and 39% is due from governmental payers Medicare and Medicaid, 16% and 13% from patients. Due to a variety of factors, including overall economic conditions, employers and insurers have continued to shift responsibility of payment to patients in the form of increased coinsurance and deductibles. Therefore, the patient responsibility component of accounts receivable has increased. Generally speaking, the collection of patient responsibility amounts requires more effort than collection of insurance amounts because patient responsibility balances are typically composed of a high number of smaller dollar accounts.

Property tax receivable decreased $0.5 million from $8.5 million at June 30, 2012 to $8.0 million at June 30, 2013 and is reflective of the lower property tax levy for calendar year 2013.

Restricted unspent bond proceeds represents proceeds from bond issuances that have not been expended. Bond issuances are restricted to a specific purpose as outlined in the associated public offering statement. Until expenditures have been incurred related to the defined purpose funds are required to be held by a trustee in limited risk investments. Restricted unspent bond proceeds decreased $8.0 million from $8.0 million at June 30, 2012 to $0.0 million at June 30, 2013 as all bond proceeds were completely expended on the completion of the 6th and 7th floors of the Emergency Services tower, the electronic health record system, and other infrastructure projects.

Noncurrent assets available for current obligations represents board designated and externally restricted funds expected to be used within one year. Assets available for current obligations decreased $6.5 million from $33.0 million at June 30, 2012 to $26.5 million at June 30, 2013.

Supplies inventory was comparable between years, as the balance was $4.2 million as of June 30, 2013, compared to $4.2 million at June 30, 2012.

Other current assets include prepaid expenses and other assets.

Noncurrent Assets

Capital assets increased $0.6 million during fiscal year 2013 from $385.6 million at June 30, 2012 to $386.2 million at June 30, 2013 and $41.4 million during fiscal year 2012 from $344.3 million at June 30, 2011 to $385.6 million at June 30, 2012. In fiscal year 2013, the information system electronic health record was placed into service resulting in a shift from construction in progress to depreciable capital assets. The increase in fiscal year 2012 was due to continued work on the construction of the 6th and 7th patient floors of the Emergency Services Tower and investment in information system electronic health record. The table below illustrates capital spend and commitment activity by major project category for the fiscal year-ended June 30, 2013.

		FY13 capital spend	Outstanding commitments at June 30, 2013
		(in millions)	
Major renovation and remodel projects	$	16.2	1.1
Purchase and replacement of major movable equipment		1.2	0.0
Information system infrastructure, business systems and equipment		16.3	4.0
	$	33.7	5.1

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

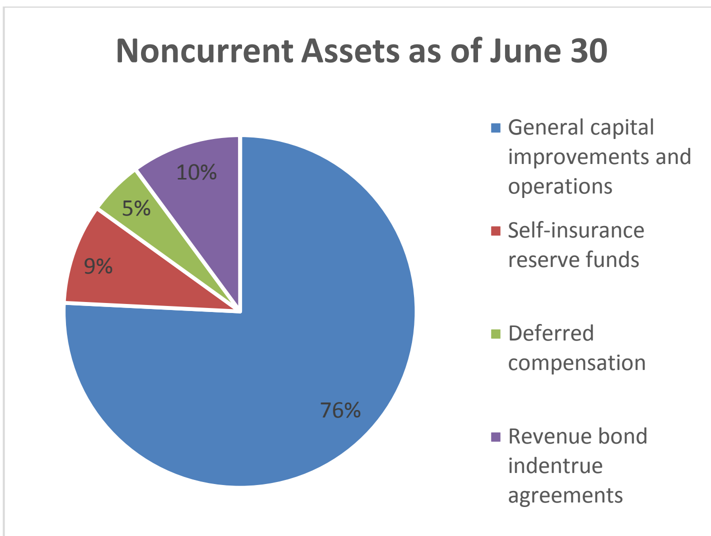
Noncurrent assets consist of board-designated and externally restricted assets held by VMC for general capital improvements and other operations, self-insurance reserves, and deferred compensation arrangements, and various revenue obligation bond agreements.

Total noncurrent assets decreased $16.3 million between June 30, 2012 and 2013. The majority of the decrease is related to the $15.2 million decrease in unrestricted assets for general capital improvements, as well as $8.0 million in restricted bond proceeds, both of which illustrated the continued spend specific construction and Information Technology (IT) projects (including the completion of the electronic health record) the 6th and 7th floors, and the ongoing construction of the Covington Ambulatory/Urgent Care building.

Total noncurrent assets decreased $44.7 million during fiscal years 2012 for the same reasons mentioned for fiscal year 2013.

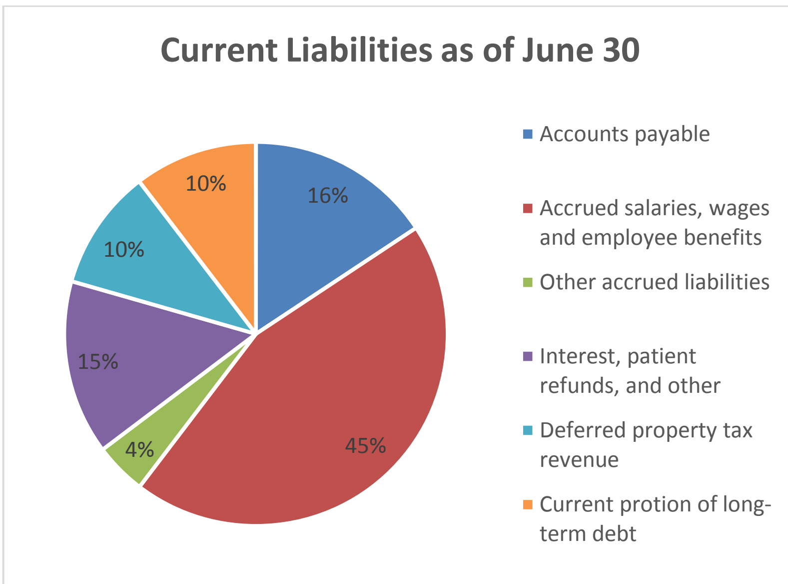
Long-term investments represent unrestricted and undesignated investments with greater than one year to maturity. Long-term investments increased $7.1 million from $24.2 million at June 30, 2012 to $31.3 million at June 30, 2013 and increased $8.9 million from $15.3 million at June 30, 2011 to $24.2 million at June 30, 2012.

Other noncurrent assets consist primarily of VMC's net deferred financing costs, as well as goodwill and intangible assets related to the acquisition of two physician practices and VMC's membership interest in First Choice Health Network. Other noncurrent assets decreased $0.8 million from $8.7 million at June 30, 2012 to $7.9 million at June 30, 2013.



Current Liabilities

Current liabilities consist of accounts payable and other accrued liabilities that are expected to be paid within a year. Total current liabilities were $79.0 million at June 30, 2013, compared to $81.4 million at June 30, 2012. Fiscal year 2013 composition of current liabilities is illustrated in the pie chart below.



Accounts payable at June 30, 2013 was $12.4 million, compared to $19.3 million at June 30, 2012. **Accrued salaries, wages and employee benefits** increased $2.2 million from $33.1 million at June 30, 2012 to $35.3 million at June 30, 2013 and $0.2 million from $32.9 million at June 30, 2011 to $33.1 million at June 30, 2012. Changes in accounts payable and accrued liabilities are primarily driven by timing of payments to vendors. Accounts payable includes amounts accrued for capital related expenditures. Included in accounts payable as of June 30, 2013 and 2012 were amounts accrued for capital related expenditures of $0.9 million and $9.0 million, respectively.

Other accrued liabilities, including estimated third-party payor settlements decreased $0.2 million from $3.6 million at June 30, 2012 to $3.4 million at June 30, 2013.

Deferred property tax revenue decreased $0.4 million at June 30, 2013 to $8.0 million compared to $8.4 million at June 30, 2012. The decrease was due to a statutorily required reduction in the District's authorized 2013 and 2012 calendar year tax levy.

The current portion of long-term debt was $8.2 million as of June 30, 2013 and represents upcoming debt payments on various bond issues within the next year. The current portion of long-term debt as of June 30, 2012 was $8.0 million.

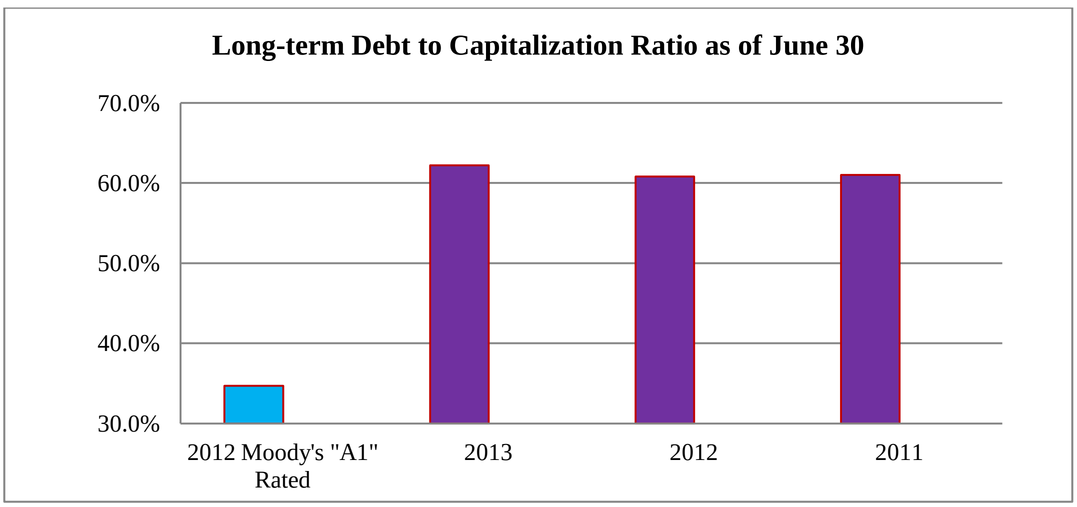
Other current liabilities consist of accrued interest relating to long-term debt, accrued taxes and retainage and accrued professional liability expense.

Noncurrent Liabilities

Noncurrent liabilities consists of long-term debt and other noncurrent liabilities. In total noncurrent liabilities were $326.8 million at June 30, 2013, compared to $334.4 million at June 30, 2012.

Long-term debt decreased $7.9 million from $331.2 million at June 30, 2012 to $323.3 million at June 30, 2013 and decreased $9.4 million from $340.6 million at June 30, 2011 to $331.2 million at June 30, 2012. Decreases in both years were a result of payments made in accordance with debt repayment schedules.

Long-term debt to capitalization is a ratio used to evaluate the capital structure of healthcare organizations. The graph above shows the long-term debt to capitalization ratio as of June 30 for 2013, 2012 and 2011 and comparison to the stand-alone hospital for Moody's A1 rated hospitals has been included in the bar chart to the right.



VMC's long-term debt to capitalization ratio is higher than the stand-alone hospital median due to planned debt issues to fund several significant construction and information technology initiatives, including the 6th and 7th floor Emergency Services Tower expansion, the Covington Ambulatory Clinic, and the information technology electronic medical record. Additional discussion regarding long-term debt activity during the fiscal years can be found in the notes to the financial statements.

Other noncurrent liabilities include deferred compensation arrangements with employees.

Net Position

VMC reports its net position in three categories (VMC does not have assets meeting the criteria of the fourth category, donor-restricted nonexpendable net position):

Invested in capital assets net of related debt – Total investment in VMC property, plant, and equipment net of accumulated depreciation and outstanding debt obligations related to those capital assets

Restricted for debt service and expendable net position – Resources VMC is legally or contractually obligated to spend in accordance with restrictions placed by donors and/or external parties that have placed time or purpose restrictions on the use of the asset

Unrestricted net position – All other funds available to VMC for the general obligations to meet current expenses for any purpose

As of June 30, 2013, total net position was $209.3 million compared to $226.3 million at June 30, 2012.

Statements of Revenues, Expenses, and Changes in Net Position

VMC reported an operating loss of $17.8 million and $8.7 million and a total decrease in net position of $16.9 million and $5.2 million for the years ended June 30, 2013 and 2012, respectively. Contributing factors for the declining performance in fiscal year 2013 included the following (in thousands):

		2013	2012	2011
Total operating revenues	$	443,609	428,574	399,840
Total operating expenses		461,435	437,252	388,150
Operating income (loss)		(17,826)	(8,678)	11,690
Revenue from taxation		16,253	17,818	19,388
Interest income		4,009	3,900	6,551
Interest and amortization expense		(17,905)	(17,782)	(17,653)
Investment income, net		(1,059)	905	(1,603)
Other, net		(421)	(1,370)	384
Increase (decrease) in net position		(16,949)	(5,207)	18,757
Net position, beginning of year		226,251	231,458	212,701
Net position, end of year	$	209,302	226,251	231,458

Significant operational expense in the implementation of the electronic health record information technology, higher than anticipated healthcare benefit expense, and lower surgery volumes were all factors that impacted operations during fiscal year 2013.

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Patient days and discharges increased in fiscal year 2013 compared to fiscal year 2012. Surgery cases declined, as did primary care clinic visits, due to physician vacancies for a portion of the year. Specialty and urgent care clinic visits increased with the introduction of additional providers.

	2013	**2012**	**2011**
Available beds	270	270	260
Discharges	17,477	16,842	16,724
Patient days	65,769	63,001	62,218
Average length of stay	3.8	3.7	3.4
Occupancy	67%	66%	65%
Case mix index (CMI)	1.33	1.30	1.30
Surgery cases	11,171	11,444	11,038
Emergency room visits	74,202	75,586	75,282
Primary care clinic visits	152,594	154,350	154,147
Specialty/Urgent care clinic visits	209,680	190,597	190,876
Full time equivalents (FTEs)	2,456	2,445	2,253
Births	4,356	3,964	3,904

Total Operating Revenues

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

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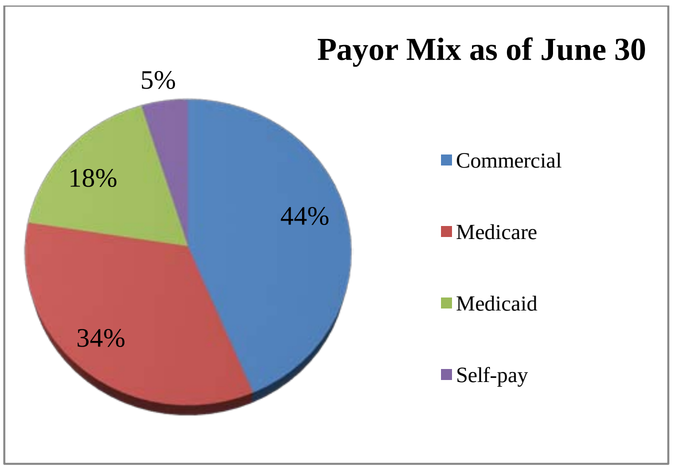
Net patient revenue comprises inpatient and outpatient revenue. Outpatient revenue consists of both hospital-based and clinic network revenue. Other operating revenue comprises hospital-related revenues such as the pharmacies and the cafeteria. The composition of services provided to patients (whether governmental or commercial insured or self-pay) is a key factor in VMC's overall financial operating results. Reimbursement from governmental payers is generally below commercial rates, and reimbursement rules are complex and subject to both interpretation and modification. The pie chart below illustrates payor mix for 2013.



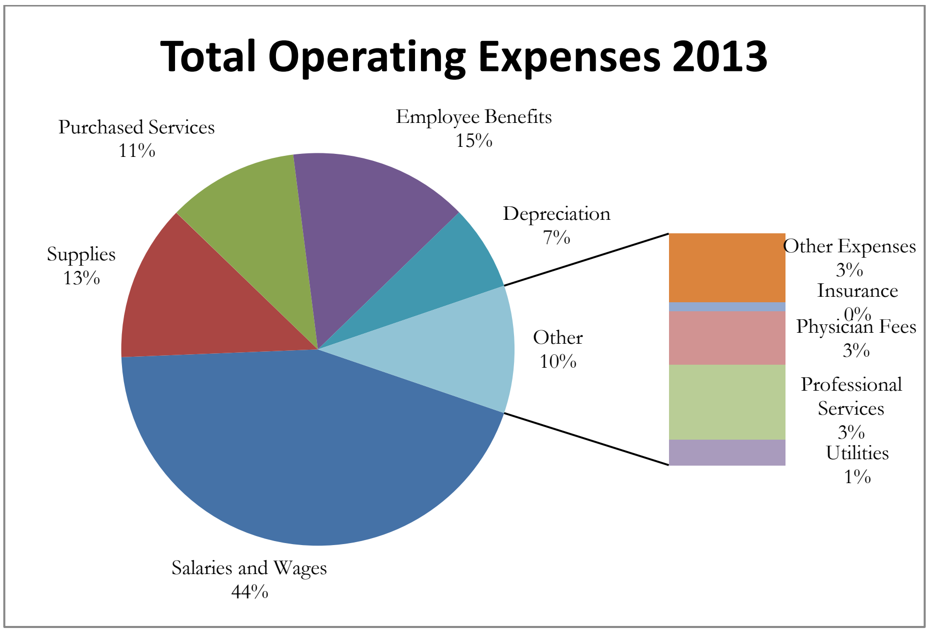
For the years ended June 30, 2013 and 2012, VMC's total operating revenues were $443.6 million and $428.6 million, composed of $416.3 million and $405.6 million in net patient service revenues and $27.3 million and $23.0 million in other operating revenue, respectively. The increase is due to increases in inpatient volumes, year over year. The increases within other operating revenue are primarily related to the opening of several new pharmacy locations, as well as a Medicaid electronic health record incentive payment.

Total Operating Expenses

Total operating expenses were just over $461.4 million for the years ending June 30, 2013 compared to $437.3 million for the years ending June 30, 2012. The composition of fiscal year 2013 operating expenses is illustrated in the pie chart below.

Salaries and wages increased $9.3 million from $194.3 million in fiscal year 2012 to $203.6 million in fiscal year 2013. The increases were primarily related to contract labor in information technology due to the EPIC electronic health record implementation; the clinic network's expansion of services in urgent care, oncology, women's healthcare/obstetrics and gynecology; the opening of several outpatient pharmacies, and in general medical/surgical units due to volume increases.

Employee benefits increased $7.4 million from $60.6 million in fiscal year 2012 to $68.0 million in fiscal year 2013 and increased $6.6 million from $54.0 million in fiscal year 2011 to $60.6 million in fiscal year 2012. Employee benefit costs are a function of employment. In fiscal year 2013, much of the increase in employee benefits was related to healthcare benefit expense. Other increases in expense between fiscal years 2013, 2012 and 2011 were consistent with increased salaries and wages expense.

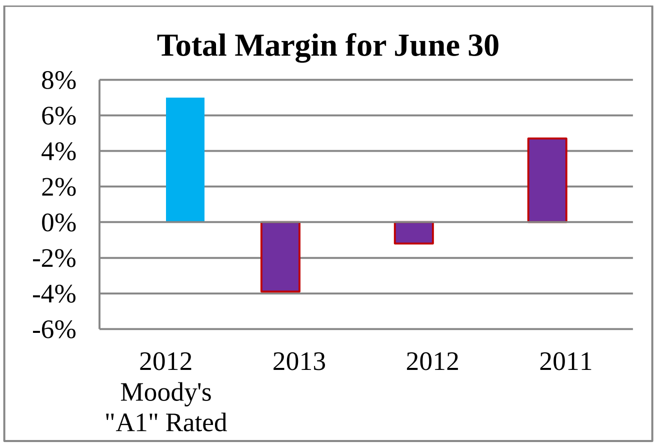


Supplies and other expense includes medical and surgical supplies, pharmaceutical supplies, professional fees, purchased services, consulting fees, insurance, taxes, and other expenses. In total, these expenses increased $7.6 million from $149.8 million in fiscal year 2012 to $157.4 million in fiscal year 2013. The increase was driven by increased consulting fees for IT work related to the electronic health record implementation. Medical supplies expense increased as a result of price inflation. Pharmaceutical expense increased with the additional of several new outpatient pharmacies.

Depreciation expense was comparable between years, and was $32.5 million in fiscal year 2012 and $32.4 million in fiscal year 2013.

Net Nonoperating Income

Net nonoperating income consists of revenue from property taxes and interest and investment income offset by interest and amortization expense and other activities not directly related to patient care. Net nonoperating income decreased $2.6 million between fiscal years 2013 and 2012. This decrease is related to a statutorily required $1.5 million reduction in property tax revenue and changes in investment income which includes unrealized changes in the fair market value of investments.



Total Margin

Total margin or excess margin is a ratio that defines the percentage of total revenue that has been realized in the form of net income and is a common measure of total hospital profitability. Total margin for the fiscal years 2013, 2012 and 2011 compared to the industry median for Moody's A1 rated stand-alone hospitals is illustrated in the bar chart above.

UW Medicine Strategic Planning

- ***Accountable Care Organization (ACO)***

  UW Medicine continues to work toward developing a connected network of healthcare providers in the spirit of developing an accountable care organization (ACO) that ensures efficient healthcare at the lowest possible cost for the population. The UW Medicine ACO will include all UW Medicine member entities, UW Medicine affiliated entities through inter-affiliate agreements and UW Medicine ACO network organizations established with contracts. The ACO infrastructure will focus on the following key areas:

  – Coordinated care management – The ACO will offer an information technology platform that supports coordination of evidence – based healthcare and sophisticated clinical and operational decision-making. Patients will be experience this coordinated care model through a medical home option that will coordinate with UW Medicine specialty clinics to provide a seamless continuity of care to patients.

– Performance management – The ACO will utilize a standardized report set for quality metrics including patient experience, continuity of care, chronic care management preventative care and screening and appropriate use of care.

– Cost management – The ACO will focus on cost control through reduction of ED visits and admissions through:

  - Increased access to after-care clinics
  - Provide same-day and walk-in clinic access for primary care
  - 24/7 nurse advise line for patients
  - Proactive outreach to high utilizers
  - After discharge follow up calls
  - Established designated outpatient observation protocols

UW Medicine does not currently have plans to register with the Centers for Medicare and Medicaid Services as an ACO; however, it does anticipate completing its implementation of the ACO structure by the end of calendar year 2014.

- ***PeaceHealth Strategic Alliance***

  In May 2013 UW Medicine signed a letter of intent with PeaceHealth to create a strategic affiliation that will provide patients throughout much of Washington and Alaska with access to the most comprehensive care available in the Pacific Northwest. The letter of intent outlines opportunities the organizations could pursue together, including ongoing performance improvement initiatives to reduce costs and clinical programming to increase access to specialized services such as cardiovascular care, high risk obstetrics and neonatology, cancer care, behavioral health and neurosciences. The two organizations will remain legally independent and governance will not be affected. The affiliation is expected to be further defined in additional agreements in late 2013.

- ***UW Medicine IT Services***

  In July 2013 UW Medicine created a shared service function for enterprise-wide IT services and solutions. This function operates as a division of UW Medicine within the University of Washington. As a result of the organizational change, VMC expects to see declining capital spend for IT related assets.

UW Medicine Patients Are First

UW Medicine is committed to its mission of improving health. The Patients Are First initiative, implemented throughout UW Medicine in 2011, is the organizational framework for delivering consistent service excellence to every patient, every time. Through Patients Are First, UW Medicine creates better leaders, refines metrics to support systems of accountability, and provides staff, managers, physicians, and leaders with the tools, tactics, and reports to achieve our strategic outcomes. UW Medicine relies on the following four "pillars" as the foundation for building its Patients Are First culture:

- Focus on Serving the Patient & Family: serve all patients and family members with compassion, respect, and excellence
- Provide the Highest Quality Care: provide the highest quality, safest and most effective care to every patient, every time
- Become the Employer of Choice: recruit and retain a competent, professional workforce focused on serving our patients and their families
- Practice Fiscal Responsibility: ensure effective financial planning and the economic performance necessary to invest in strategies that improve the health of our patients

Each pillar has several measurable core goals that, when cascaded throughout the entire health system and teamed with other evidence-based leadership tactics, hardwire commitment to Patients Are First.

In support of the initiative, UW Medicine has engaged the Studer Group, LLC, a national expert consultant group on implementing evidence-based practices that improve service, satisfaction, quality, and safety while reducing costs. The current contract with the Studer Group runs through fiscal year 2016.

Regulatory and Legislative Changes

The following regulatory and legislative activity will impact UW Medicine in FY14 and beyond:

- ***International Classification of Diseases (ICD) v10*** – Code of Federal Regulations (45 CFR Part 162) requires healthcare providers to implement ICD-10 no later than October 1, 2014.

  ICD-10 represents a significant change in the standard healthcare coding system and will impact every system, process and transaction that contains or uses a diagnosis code or inpatient procedure code including, but not limited to, the areas of patient access, supply chain, care delivery, health information management, patient financial services and finance.

  UW Medicine has been undertaking activities related to the implementation of ICD-10 since the beginning of fiscal year 2013. Transition activities include changes to electronic health record systems and training related to new clinical documentation standards and changes in coding. These activities will continue through to the required implementation date of October 1, 2014.

- ***Medicare Sequestration –*** On April 1, 2013 a provision of the *Budget Control Act of 2011* requiring mandatory across-the-board reductions in Federal spending commenced (commonly referred to as sequestration). The provision included a 2% reduction to Medicare payments made to healthcare providers, including payments made under the meaningful use incentive program. The payment reduction is effective for nine years; however, Congress does have the ability repeal or amend provisions of the *Budget Control Act*.
- ***WA Medicaid Inpatient & Outpatient Payment System Rebasing –*** The Washington Healthcare Authority (HCA) uses the Outpatient Prospective Payment System (OPPS) and All Patient Diagnosis Related Group (AP-DRG) methodologies for reimbursing outpatient and inpatient Medicaid claims, respectively. In 2013 HCA began a project to implement new payment systems for outpatient and inpatient claims with anticipated go-live in 2014. Under the project, outpatient reimbursement will transition to Enhanced Ambulatory Payment Groups (EAPG) methodology and inpatient reimbursement will transition to All Patient Refined Diagnosis Related Group (APR-DRG) methodology. The EAPG method is a visit-based patient classification system that directs payment to the main significant procedure or treatment provided during a visit, instead of "a la carte" volume-based purchasing and uses packaging and bundling of payment for related services to create incentives to provide services in the most efficient way. The APR-DRG will ensure the state is compliant with ICD-10 requirements, is more granular than AP-DRG and will increase the number of acuity-driven groupings for payment purposes.
- ***Health Insurance Exchange Enrollment –*** In October 2013 the Washington Health Benefit Exchange will begin open enrollment for Washington State residents through Washington Healthplanfinder. It is anticipated that the insurance exchange, coupled with penalties for individuals electing to not obtain health insurance and subsidies for individuals meeting certain income thresholds, will result in reductions in uninsured and underinsured patients and significantly change hospital payor mix. The reduction of uninsured and underinsured patients will also have an impact on Medicare and Medicaid Disproportionate Share (DSH) reimbursement methodologies.

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Independent Auditors' Report

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

We have audited the accompanying financial statements of the business-type activities of Public Hospital District No. 1 of King County, Washington, dba Valley Medical Center (VMC), a component unit of the University of Washington, and VMC's discretely presented component unit, The Imaging Partners at Valley, which comprise the balance sheets as of June 30, 2013 and 2012, and the related statement of revenues, expenses and changes in net position, and cash flows for the years then ended, and the related notes to the financial statements. We did not audit the financial statements of The Imaging Partners at Valley as of and for the year ended June 30, 2012, which represents 100% of the asssets and revenues of the discretely presented component unit. Those financial statements were audited by other auditors whose report thereon has been furnished to us, and our opinion, insofar as it relates to the amounts included for The Imaging Partners at Valley as of and for the year ended June 30, 2012, is based on the report of the other auditors.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

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

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

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

KPMG

Opinion

In our opinion, based on our audits and the report of other auditors, the financial statements referred to above present fairly, in all material respects, the financial position of the business-type activities and the aggregate discretely presented component unit of VMC, The Imaging Partners at Valley as of June 30, 2013 and 2012, and the results of its changes in net position and its cash flows for the years then ended in accordance with U.S. generally accepted accounting principles.

Other Matter

U.S. generally accepted accounting principles require that the management's discussion and analysis on pages 1 through 17 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by U.S. generally accepted accounting principles who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Our audits were conducted for the purpose of forming an opinion on the basic financial statements as a whole. The supplementary information included in the Aggregating Schedules on pages 62 through 64 is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has not been subjected to the auditing procedures applied in the audit of the basic financial statements, and accordingly, we do not express an opinion or provide any assurance on it.

KPMG LLP

Seattle, WA
October 29, 2013

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

Statements of Net Position

June 30, 2013 and 2012

	VMC		Component unit – IPV	
	June 30		June 30	
Assets	**2013**	**2012**	**2013**	**2012**
Current assets:				
Cash and cash equivalents	$ 22,557,276	24,584,212	1,108,028	1,363,546
Short-term investments	20,724,208	18,835,857	—	—
Restricted unspent bond proceeds	—	7,951,660	—	—
Accounts receivable, less allowance for uncollectible accounts	52,914,600	53,133,042	302,219	1,297,888
Property tax receivable	8,028,709	8,481,694	—	—
Due from:				
Primary government	—	—	1,836,989	153,601
Component unit	1,420,241	1,287,899	—	—
Noncurrent assets, required for current obligations	26,476,410	32,976,897	—	—
Supplies inventory	4,224,793	4,246,711	—	38,582
Prepaid expenses and other assets	6,946,482	9,332,265	55,647	67,870
Total current assets	143,292,719	160,830,237	3,302,883	2,921,487
Long-term investments	31,264,465	24,178,275	—	—
Noncurrent assets:				
Unrestricted for general capital improvements and operations	55,298,974	70,469,244	—	—
Restricted for self-insurance reserve funds	6,686,547	6,320,907	—	—
Restricted unspent bond proceeds	—	7,997,039	—	—
Restricted under deferred compensation arrangements	3,613,518	3,635,818	—	—
Restricted under revenue bond indenture agreements	7,378,745	7,348,790	—	—
	72,977,784	95,771,798	—	—
Less amounts required for current obligations	(26,476,410)	(32,976,897)	—	—
Total noncurrent assets	46,501,374	62,794,901	—	—
Capital assets:				
Land	13,299,497	13,299,497	—	—
Construction in progress	33,062,351	71,151,194	—	—
Depreciable capital assets, net of accumulated depreciation	339,817,116	301,159,689	1,524,892	1,381,771
Total capital assets	386,178,964	385,610,380	1,524,892	1,381,771
Deferred financing costs	3,443,495	3,777,937	—	—
Goodwill, intangible assets & other	4,414,454	4,894,671	—	—
Total assets	$ 615,095,471	642,086,401	4,827,775	4,303,258

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

Statements of Net Position

June 30, 2013 and 2012

	VMC		Component unit – IPV	
	June 30		June 30	
Liabilities and Net Position	**2013**	**2012**	**2013**	**2012**
Current liabilities:				
Accounts payable	$ 10,570,098	19,152,813	512,790	202,270
Accrued salaries, wages and benefits	35,275,544	33,072,565	22,802	215,912
Due to:				
Primary government	—	—	1,420,241	1,287,899
Component unit	1,836,989	153,601	—	—
Other accrued liabilities, including estimated third-party payor settlements	3,448,968	3,637,560	—	—
Interest, patient refunds and other	11,606,792	8,975,841	9,285	99,912
Deferred property tax revenue	8,023,310	8,393,046	—	—
Current portion of long-term debt and capital lease obligations	8,225,472	8,005,578	211,806	199,112
Total current liabilities	78,987,173	81,391,004	2,176,924	2,005,105
Deferred compensation	3,525,258	3,255,699	—	—
Long-term debt and capital lease obligations, net of current portion	323,281,483	331,188,702	264,233	476,039
Total liabilities	405,793,914	415,835,405	2,441,157	2,481,144
Net position:				
Invested in capital assets net of related debt	53,946,246	62,413,772	1,048,853	706,620
Restricted:				
For debt service	7,378,745	7,348,790	—	—
Expendable for specific operating activities	348,374	358,525	—	—
Unrestricted	147,628,192	156,129,909	1,337,765	1,115,494
Total net position	209,301,557	226,250,996	2,386,618	1,822,114
Total liabilities and net position	$ 615,095,471	642,086,401	4,827,775	4,303,258

See accompanying notes to financial statements.

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

Statements of Revenues, Expenses and Changes in Net Position

June 30, 2013 and 2012

	VMC		Component unit – IPV	
	June 30		June 30	
	2013	2012	2013	2012
Operating revenues:				
Net patient service revenue (net of allowance for uncollectible accounts of $35,924,268 in 2013 and $33,915,355 in 2012)	$ 416,324,353	405,616,069	9,564,159	13,496,961
Other operating revenue	27,284,521	22,958,470	1,846,042	11,937
Total operating revenues	443,608,874	428,574,539	11,410,201	13,508,898
Operating expenses:				
Salaries and wages	203,576,730	194,315,940	1,940,753	2,772,053
Employee benefits	68,019,926	60,582,211	830,361	946,224
Supplies and other expenses	157,399,230	149,825,045	3,843,611	4,313,105
Depreciation	32,439,867	32,528,941	469,621	425,558
Total operating expenses	461,435,753	437,252,137	7,084,346	8,456,940
Operating income (loss)	(17,826,879)	(8,677,598)	4,325,855	5,051,958
Nonoperating income (expense):				
Revenue from taxation	16,253,562	17,818,068	—	—
Interest income	4,009,173	3,900,299	—	—
Interest and amortization expense	(17,904,892)	(17,781,734)	(36,242)	(48,175)
Investment income (loss)	(1,059,459)	904,426	—	—
Other, net	(420,944)	(1,370,651)	—	3,342
Members' cash distributions	—	—	(3,725,109)	(5,698,519)
Net nonoperating income (expense)	877,440	3,470,408	(3,761,351)	(5,743,352)
(Decrease) increase in net position	(16,949,439)	(5,207,190)	564,504	(691,394)
Net position, beginning of year	226,250,996	231,458,186	1,822,114	2,513,508
Net position, end of year	$ 209,301,557	226,250,996	2,386,618	1,822,114

See accompanying notes to financial statements.

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

Statements of Cash Flows

June 30, 2013 and 2012

	Valley Medical Center		Component unit – IPV	
	June 30		June 30	
	2013	2012	2013	2012
Cash flows from operating activities:				
Receipts from and on behalf of patients	$ 416,354,203	401,653,878	10,559,828	13,575,788
Payments to suppliers and contractors	(150,752,108)	(149,832,926)	(3,909,577)	(4,347,936)
Payments to employees	(269,124,118)	(254,536,668)	(2,964,224)	(3,358,053)
Other cash receipts	24,303,892	18,298,958	162,654	11,937
Net cash from operating activities	20,781,869	15,583,242	3,848,681	5,881,736
Cash flows from noncapital financing activities:				
Cash received from tax levy	16,336,811	17,831,506	—	—
Other	(10,151)	27,294	—	—
Net cash from noncapital financing activities	16,326,660	17,858,800	—	—
Cash flows from capital and related financing activities:				
Proceeds from issuance of refunding bonds	—	35,636,412	—	—
Payment to refunding bond escrow agent	—	(34,630,000)	—	—
Cash paid for bond issuance	—	(115,637)	—	—
Principal payments on long-term debt and capital lease obligations	(7,525,478)	(7,575,868)	(199,112)	(187,179)
Interest paid, net of amounts capitalized	(16,792,410)	(17,424,855)	(36,242)	(48,175)
Purchases of capital assets	(41,376,137)	(66,436,800)	(612,741)	(154,403)
Purchase of VM Oncology	(480,100)	(1,370,000)	—	—
Purchase of Valley Women's Healthcare Clinic	—	(865,000)	—	—
Other	33,624	(919,410)	—	—
Net cash from capital and related financing activities	(66,140,501)	(93,701,158)	(848,095)	(389,757)
Cash flows from investing activities:				
Distributions from joint venture	2,284,187	4,227,979	—	—
Distribution to Valley Medical Center	—	—	(2,848,287)	(4,227,979)
Distribution to noncontrolling member of Imaging Partners at Valley, LLC	—	—	(407,817)	(1,155,669)
Sale of investments and noncurrent assets	71,706,832	88,049,092	—	—
Purchases of investments and noncurrent assets	(50,995,156)	(48,473,001)	—	—
Investment and interest income, net of amounts capitalized	4,009,173	3,900,299	—	3,342
Net cash from investing activities	27,005,036	47,704,369	(3,256,104)	(5,380,306)
Net decrease in cash and cash equivalents	(2,026,936)	(12,554,747)	(255,518)	111,673
Cash and cash equivalents, beginning of year	24,584,212	37,138,959	1,363,546	1,251,873
Cash and cash equivalents, end of year	$ 22,557,276	24,584,212	1,108,028	1,363,546

(Continued)

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

Statements of Cash Flows

June 30, 2013 and 2012

	Valley Medical Center June 30		Component unit – IPV June 30	
	2013	**2012**	**2013**	**2012**
Reconciliation of operating income to net cash from operating activities:				
Operating income (loss)	$ (17,826,879)	(8,677,598)	4,325,856	5,051,958
Adjustments to reconcile operating income to net cash from operating activities:				
Depreciation	32,439,867	32,528,941	469,621	425,558
Provision for bad debts	35,924,268	33,915,355	181,410	182,306
Income recognized from joint venture	(2,980,629)	(4,635,286)	—	—
Amount expensed from purchase of VM Healthcare Clinic	—	184,000	—	—
Changes in assets and liabilities:				
Accounts receivable	(35,705,826)	(37,987,367)	814,259	(84,705)
Due from:				
Primary government	—	—	(1,683,388)	(18,774)
Component unit	(132,342)	(797,166)	—	—
Supplies inventory	21,918	314,528	38,582	(19,368)
Prepaid expenses and other assets	3,082,225	(2,865,320)	12,223	(26,499)
Accounts payable	(659,447)	672,138	(26,145)	(786,130)
Due to:				
Primary government	—	—	—	797,166
Component unit	1,683,388	18,774	—	—
Accrued salaries, wages, and benefits	2,202,979	141,874	(283,737)	360,224
Other accrued liabilities and estimated third-party payor settlements	(188,592)	109,820	—	—
Other liabilities	2,651,380	2,440,940	—	—
Deferred compensation	269,559	219,609	—	—
Net cash from operating activities	$ 20,781,869	15,583,242	3,848,681	5,881,736
Supplemental disclosure of noncash investing, capital, and financing activities:				
Increase (decrease) in capital assets included in accounts payable	$ (7,923,268)	7,922,116	—	—

See accompanying notes to financial statements.

(1) Organization

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

On July 1, 2011, Public Hospital District No. 1 of King County, dba Valley Medical Center (VMC), and the University of Washington (the University) entered into a Strategic Alliance Agreement, whereby the governance of VMC was modified. VMC is managed as a discretely presented component unit of the University, subject to the oversight of a Board of Trustees.

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

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

The Board of Trustees is designed to include all of the then-current Public Hospital District Commissioners, as well as five trustees who reside within the District Service Area, at least three of whom also reside within the boundaries of the District. In addition, two current or former trustees of the UW Medicine board or a Board of another component unit within UW Medicine and the CEO of UW Medicine and dean of the School of Medicine, University of Washington or his designee also serve on the Board of Trustees. The Board of Trustees members, which included the five elected Board of Commissioners, during fiscal year 2013 were:

Lisa Jensen, Chair
Peter Evans, Vice Chair
Sue Bowman (Commissioner)
Bernie Dochnahl
Beverly Fletcher
Paul Joos, M.D. (President of Board of Commissioners)
Gary Kohlwes, Ed. D.
Aaron Heide, M.D. (Commissioner – resigned from Board of Trustees)
Anthony Hemstad (Vice President of Board of Commissioner – resigned from Board of Trustees)
Don Jacobson
Carolyn Parnell (Commissioner)
Julia Patterson
Johnese Spisso, R.N., M.P.A.

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

The District owns and operates a district health system, VMC, which comprises a 303 licensed bed hospital and a network of primary care, specialty care and behavioral health clinics. The district health system mission statement states that it "is committed to providing access to safe, quality healthcare for the public. The District healthcare system is integrated with UW Medicine and collaborates to ensure comprehensive, high quality, safe, compassionate, cost-effective healthcare is provided."

Financial Reporting Entity

As defined by generally accepted accounting principles (GAAP), the financial reporting entity consists of VMC as the primary government, and its component unit, which is a legally separate organization for which the primary government is financially accountable. Financial accountability is defined as an appointment of the voting majority of the component unit's board, and either (a) the ability to impose will by the primary government, or (b) the possibility that the component unit will provide a financial benefit to or impose a financial burden on the primary government, or (c) the component unit is financially dependent on the primary government.

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

The discrete method presents the financial statements of the component unit outside of the basis of the financial statement totals of the primary government. The following is a description of the discrete component unit of VMC.

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

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

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

(Continued)

(2) Summary of Significant Accounting Policies

(a) Accounting Standards

The accompanying financial statements are prepared in accordance with accounting principles generally accepted in the United States of America using the accrual basis of accounting. VMC's financial statements and note disclosures are based on all applicable Government Accounting Standards Board (GASB) pronouncements and interpretations. VMC uses proprietary fund accounting.

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

(b) Basis of Accounting

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

(c) Use of Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles, requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Significant estimates in VMC's financial statements include patient accounts receivable allowances, third-party payor settlements, liabilities related to self-insurance programs and the fair value of investments.

(d) General Accounts

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

Operating Account

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

(Continued)

Plant and Construction Accounts

These account for land, buildings, and equipment; and the proceeds of the 2001, 2004, 2008, and 2011 limited tax general obligation bonds. The District transfers sufficient taxation revenues to the bond redemption fund to make principal payments on the Series 2004, 2008, and 2011 bonds. Interest payments are also made from the bond redemption fund.

Bond Account

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

Revenue Bond Account

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

2010 Refundable Credits Account

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

Restricted Accounts

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

(e) Cash and Cash Equivalents

Cash and cash equivalents include investments in highly liquid debt instruments with an original maturity of three months or less at the date of purchase, excluding amounts whose use is limited by board designation or by other arrangements under trust agreements. Cash and cash equivalents for the primary government were $22.2 million and $24.2 million at June 30, 2013 and 2012, respectively.

Custodial credit risk for deposits is the risk that in the event of a financial institution failure, the deposits may not be returned to the depositor. The Federal Deposit Insurance Corporation (FDIC) provides insurance to depositors to guard against custodial credit risk. Under FDIC insurance coverage is provided for account balances up to $250,000 per depositor, per insured bank. As of June 30, 2013, VMC had bank balances of approximately $768,000 that were subject to custodial credit risk as they were neither insured nor collateralized

(f) Investments

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

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

(g) Inventories

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

(h) Capital Assets

Capital assets, defined as purchases with a per item cost of $2,500 or greater and a useful life of at least three years, are stated at cost at acquisition or if acquired by gift, at fair market value at the date of the gift. Additions, replacements, major repairs, and renovations are capitalized. Maintenance and repairs are expensed. The cost of the capital assets sold or retired and the related accumulated depreciation are removed from the accounts, and any resulting gain or loss is recorded.

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

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

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

Interest is capitalized on construction projects as a cost of the related project beginning with commencement of construction and ceases when the construction period ends and the related asset is placed in service. Interest capitalized during 2013 and 2012 was $1,014,319 and $1,464,299, respectively.

(i) Goodwill, Intangible Assets, and Other

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

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

(j) Compensated Absences

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

Annual leave accrued at June 30, 2013 and 2012 was $11.4 million and $10.4 million, respectively. Sick leave accrued as of June 30, 2013 and 2012 was $3.9 million and $3.8 million, respectively.

(k) Payable to Contractual Agencies, Net

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

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

(l) Classification of Revenues and Expenses

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

Operating expenses are all expenses, other than financing costs, incurred by the primary government and component units to provide healthcare services to patients.

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

(m) Net Patient Service Revenue

VMC has agreements with third-party payors that provide for payments to VMC at amounts different from its established rates. Payment arrangements include prospectively determined rates per discharge, reimbursed costs, discounted charges, and per diem payments. Net patient service revenues are reported at the estimated net realizable amounts from patients, third-party 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. A summary of the payment arrangements with major third-party payors is as follows:

Medicare

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

Medicaid

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

Commercial

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

(n) Charity Care

VMC provides care at no charge or reduced charges to indigent patients who meet certain criteria under VMC's approved charity care policies. Because VMC does not pursue collection of amounts determined to qualify as charity care, they are not reported as net patient service revenue.

VMC maintains records to identify and monitor the level of charity care it provides. These records include charges foregone for services and supplies furnished under its charity care policy to the uninsured and the underinsured. Because VMC does not pursue collection of amounts determined to qualify as charity care, these are not reported as net revenue. The charges associated with charity care provided by VMC were approximately $24,639,644 and $24,828,561, respectively, for the years ended June 30, 2013 and 2012.

VMC estimates the cost of charity care using its cost to charge ratio of 29.9% and 29.9% for the fiscal years ended June 30, 2013 and 2012, respectively. Applying VMC's cost to charge ratio of 29.9% to total charity of $24,639,644 results in a cost of charity care of $7,367,253 for the fiscal year ended June 30, 2013. Applying VMC's cost to charge ratio of 29.9% to total charity of approximately $24,828,561 results in a cost of charity care of $7,423,740 for the fiscal year ended June 30, 2012.

(o) Federal Income Taxes

The District, as a political subdivision of the state of Washington, is not subject to federal income taxes under Section 115 of the Internal Revenue Code unless unrelated business income is generated during the year.

Since 1983, the District has been deemed a 501(c)(3) entity by the IRS. Because of what the District believes to be a clerical error, that status has been administratively revoked, but the District has taken action to reinstate that status and correct the administrative error.

VMC's discretely presented component unit is a limited liability company and, therefore, is not a tax-paying entity for federal income tax purposes. Accordingly, no current or deferred income tax expense has been recorded in the component unit's financial statements. Income of the component

(Continued)

unit is taxed to the members on their individual tax returns, if applicable. The discretely presented component unit had no uncertain tax positions at June 30, 2013 and 2012.

(p) New Accounting Pronouncements

In December 2010, GASB issued Statement No. 61 (GASB 61), *The Financial Reporting Entity: Omnibus*, which amended the reporting standards for reporting component units in a government's financial statements. This standard was effective for fiscal year 2013. The adoption of GASB 61 did not have a material on VMC's financial statements.

In December 2010, GASB issued Statement No. 62 (GASB 62), *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*. That statement supersedes Statement No. 20, Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting. This standard was effective for fiscal year 2013. The adoption of GASB 62 did not have a material impact on VMC's financial statements.

In June 2011, GASB issued Statement No. 63 (GASB 63), *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*, which changes how governments organize their statements of financial position. This standard was effective for fiscal year 2013. The adoption of GASB 63 resulted in the establishment of net position and elimination of the term "net assets.". Additionally, VMC transactions were evaluated against the criteria for deferred outflows of resources and deferred inflows of resources; however, no transactions were considered to meet the criteria for reporting under these categories.

In June 2011, GASB issued Statement No. 64 (GASB 64), *Derivative Instruments: Application of Hedge Accounting Termination Provisions – an amendment of GASB Statement No. 53*, which clarifies whether an effective hedging relationship continues after the replacement of a swap counterparty or a swap counterparty's credit support provider. The standard is effective for fiscal year 2014. The adoption of GASB 64 will not have a material impact on VMC's financial statements.

In June 2011, GASB issued Statement No. 65 (GASB 65), *Items Previously Reported as Assets and Liabilities*, which specifically identifies transactions qualifying for Deferred Outflows of Resources and Deferred Inflows of Resources reporting, as required in GASB 63. This standard is effective for fiscal year 2014. VMC is currently analyzing the financial statement impact of this statement.

In June 2011, GASB issued Statement No. 66 (GASB 66), *Technical Corrections – 2012 – an amendment of GASB Statements No. 10 and No. 62*, which eliminates provisions limiting fund-based reporting of an entity's risk financing activities to the general fund and internal service fund type and modifies guidance for accounting for operating leases and service fees related to mortgage loans. This standard is effective for fiscal year 2014. The adoption of GASB 66 will not have a material impact on VMC's financial statements.

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(3) Net Patient Service Revenue

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. In 2013 and 2012, net patient service revenue includes approximately $1,921,293 and $2,732,086, respectively, relating to prior years' net Medicare and Medicaid cost report settlements and revised estimates, including disproportionate share reimbursement.

The following are the components of net patient service revenue for the years ended June 30, 2013 for VMC and the component unit:

	VMC	Component unit
Patient service revenue	$ 1,255,937,306	21,237,399
Less adjustments to patient service revenue:		
Charity	(24,639,644)	—
Contractual discounts	(779,049,041)	(11,491,830)
Provision for uncollectible accounts	(35,924,268)	(181,410)
Total adjustments to patient service revenue	(839,612,953)	(11,673,240)
Net patient service revenue	$ 416,324,353	9,564,159

The following are the components of net patient service revenue for the years ended June 30, 2012 for VMC and the component unit:

	VMC	Component unit
Patient service revenue	$ 1,192,078,267	29,939,796
Less adjustments to patient service revenue:		
Charity	(24,828,561)	—
Contractual discounts	(727,718,282)	(16,260,529)
Provision for uncollectible accounts	(33,915,355)	(182,306)
Total adjustments to patient service revenue	(786,462,198)	(16,442,835)
Net patient service revenue	$ 405,616,069	13,496,961

(Continued)

VMC grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payer agreements. The mix of gross patient charges from significant third-party payers at June 30, 2013 and 2012 was as follows:

	2013	
	VMC	
	Patient service charges	Accounts receivable
Medicare	34%	25%
Medicaid	17	14
Commercial and other	44	45
Self pay	5	16
Total	100%	100%

	2012	
	VMC	
	Patient service charges	Accounts receivable
Medicare	34%	25%
Medicaid	16	14
Commercial and other	45	48
Self pay	5	13
Total	100%	100%

(a) Medicaid Certified Public Expenditure Reimbursement

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

“Full cost” payments are determined using the respective hospital’s Medicaid ratio of cost to charges to determine the cost for covered medically necessary services. The costs will be certified as actual expenditures by the hospital and the State claim will be allowed federal match on the amount of the related certified public expenditures. The payment method pays only the federal match portion of the allowable claims. VMC received $8,434,554 and $8,759,922 in claims payments under this program for the years ended June 30, 2013 and 2012, respectively.

In addition, VMC receives the federal match portion of Disproportionate Share Payments (DSH), which are the lesser of qualifying uncompensated care cost or the hospital’s specific limit. VMC received $13,338,493 and $12,275,815 in DSH funding under this program for the years ended June 30, 2013 and 2012, respectively.

To meet legislative requirements, the Washington State Legislature (the State) includes a "hold harmless" provision for eligible hospital providers under the CPE program. Hospitals eligible for CPE payments will receive no less in combined state and federal payments than they would have received under the previous payment methodology. In addition, the hold harmless provision ensures that participating hospitals receive DSH payments as specified in the legislation.

In the event of a shortfall between CPE program payments and the amount determined under the hold harmless provision, the difference is paid to the hospitals as a grant from state-only funds. VMC did not receive any state grants for the years ended June 30, 2013 or 2012. Claims payments, DSH payments, and state grant funds are included in net patient service revenues in the statements of revenues, expenses, and changes in net position.

CPE payments are subject to retrospective determination of actual costs once VMC's Medicare Cost Report is audited. CPE program payments are not considered final until retrospective cost reconciliation is complete, after VMC receives its Medicare Notice of Program Reimbursements (NPR) for the corresponding cost reporting year. To date, no CPE program year has had a final settlement.

Interim state grant payments are retrospectively reconciled to "hold harmless" after actual claims are repriced using the applicable DRG payment methodology. This process takes place approximately 12 months after the end of the fiscal year and results in either a payable to, or receivable from, the state Medicaid Program. VMC has estimated the expected final settlement amounts based on the difference between CPE payments received and the estimated hold harmless amount.

As of June 30, 2013 and 2012, for fiscal years 2006 through 2012, VMC had an estimated payable of \$3.8 million and \$3.6 million, respectively, which is included as a liability in other accrued liabilities, including estimated third-party payor settlements in the accompanying statements of net position.

(b) Professional Services Supplemental Payment (PSSP) Program

The professional services supplemental payment (PSSP) program is a program managed by the Washington State Health Care Authority benefiting certain public hospitals. Under the program, VMC receives supplemental Medicaid payments for the physician and other professional services for which they bill. These supplemental payments equal the difference between the standard Medicaid reimbursement and the upper payment limit allowable by federal law. VMC provides the nonfederal share of the supplemental payments that will be used to obtain the matching federal funds.

VMC recorded \$561,933 and \$381,218 for the years ended June 30, 2013 and 2012, respectively, in supplemental payments, via Intergovernmental Transfers (IGTs) to DSHS related to professional claims paid in those fiscal years, which is included in net patient service revenue in the statements of revenues, expenses, and changes in net position.

DSHS used the hospital supplemental payments and federal match funds to make professional services payments to VMC. VMC received \$1,078,431 and \$733,078 of supplemental professional service payments for the years ended June 30, 2013 and 2012, respectively. These payments are included in net patient service revenues in the statements of revenue, expenses, and changes in net position.

(c) Hospital Safety Net Program

In April 2010, the Hospital Safety Net Assessment Act was passed by the Washington State legislature. This legislation uses federal matching funds to increase hospital payments across the State by almost $200 million between 2009 and 2011 in order to mitigate significant budget cuts made to hospitals during the 2009 session of the state legislature. The legislation sunset by June 30, 2013.

Under this program, most Washington State hospitals are assessed a fee on all non-Medicare patient days. This fee is collected by the State and the State then uses these funds to obtain new federal Medicaid matching funds. Hospitals receive increased Medicaid rates to cover the assessments they paid and to restore a portion of the cuts enacted during the 2009 legislative session.

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

VMC received increased reimbursements of $1.5 million and $1.4 million under this program for the years ended June 30, 2013 and 2012, respectively. These payments are included in net patient service revenue in the statements of revenues, expenses, and changes in net position.

(d) Meaningful Use Incentives

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

VMC recorded meaningful use incentives of $5,210,579 and $1,348,873 for the years ended June 30, 2013 and 2012, respectively, which is included in other operating revenue in the statements of revenues, expenses, and changes in net position. These amounts may be subject to future audits.

(4) Property Tax Revenues

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

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

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

In late January 2013, the District received notification from the King County Assessor's Office that the overall statutory aggregate limit (which is $5.90 per assessed $1,000 in property value) had been exceeded in certain District tax levy codes for the calendar year ended December 31, 2012. Under Washington state statute, the Assessor's Office must recalculate the property tax levy rates when it is found the aggregate rate of certain senior and junior taxing districts within a given levy code area exceeds the $5.90 limit established by RCW 84.52.043. Any required rate recalculations are performed in a specific order specified within RCW 84.52.010(2). In summary, within these priorities, a hospital district receives the first $0.50 of its levy.

Consequently, as a result of this required rate recalculation, the District's tax levy rate was decreased from $0.57 per assessed $1,000 in property value pursuant to the District's authorized tax levy in November 2012, to $0.50 per assessed $1,000 in property value, resulting in a revised tax levy of $16,052,045. That is a reduction of $2,404,914, or 13%, from the original tax levy, in property tax revenues during calendar year 2013.

Property taxes are recorded as receivables when levied. Because State law allows for the sale of property for failure to pay taxes, no estimate of uncollectible taxes is made. Given property taxes are recorded on a calendar year basis, the property tax receivable balance at June 30, 2013 and 2012 was $8,028,079 and $8,481,694, respectively, and is shown as a current asset on the statements of net position.

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

(5) Capital Assets

(a) VMC's Capital Assets

The activity in VMC's capital asset and related accumulated depreciation accounts for years ended June 30, 2013 and 2012 is set forth below:

	Balance June 30, 2012	Additions	Transfers	Retirements	Balance June 30, 2013
Nondepreciable capital assets:					
Land	$ 13,299,497	—	—	—	13,299,497
Construction in progress	71,151,194	29,364,152	(67,452,995)	—	33,062,351
Total capital assets, not being depreciated	84,450,691	29,364,152	(67,452,995)	—	46,361,848
Capital assets, being depreciated:					
Land improvements	18,250,335	18,543	429,981	—	18,698,859
Buildings, renovations and furnishings	370,655,858	34,532	16,942,950	(231,861)	387,401,479
Fixed equipment	25,550,850	—	15,967	(627,269)	24,939,548
Movable equipment	135,952,077	4,320,375	49,782,688	(17,111,570)	172,943,570
Minor equipment	13,648,712	—	281,409	(41,449)	13,888,672
Total capital assets, being depreciated	564,057,832	4,373,450	67,452,995	(18,012,149)	617,872,128
Total capital assets at historical cost	648,508,523	33,737,602	—	(18,012,149)	664,233,976
Less accumulated depreciation for:					
Land improvements	(10,179,619)	(344,898)	—	—	(10,524,517)
Buildings, renovations and furnishings	(123,930,835)	(12,522,735)	—	215,068	(136,238,502)
Fixed equipment	(20,829,271)	(720,862)	—	627,269	(20,922,864)
Movable equipment	(100,283,678)	(17,938,438)	—	16,845,704	(101,376,412)
Minor equipment	(7,674,740)	(1,357,351)	—	39,374	(8,992,717)
Total accumulated depreciation	(262,898,143)	(32,884,284)	—	17,727,415	(278,055,012)
Total capital assets, net	$ 385,610,380	853,318	—	(284,734)	386,178,964

(Continued)

	June 30, 2011	Additions	Transfers	Retirements	June 30, 2012
Nondepreciable capital assets:					
Land	$ 13,299,497	—	—	—	13,299,497
Construction in progress	19,257,070	74,586,257	(22,692,133)	—	71,151,194
Total capital assets, not being depreciated	32,556,567	74,586,257	(22,692,133)	—	84,450,691
Capital assets, being depreciated:					
Land improvements	18,186,387	—	63,948	—	18,250,335
Buildings, renovations and furnishings	365,032,812	—	6,160,066	(537,020)	370,655,858
Fixed equipment	27,555,536	—	341,745	(2,346,431)	25,550,850
Movable equipment	136,873,447	755,640	14,481,656	(16,158,666)	135,952,077
Minor equipment	12,237,789	575,585	1,644,718	(809,380)	13,648,712
Total capital assets, being depreciated	559,885,971	1,331,225	22,692,133	(19,851,497)	564,057,832
Total capital assets at historical cost	592,442,538	75,917,482	—	(19,851,497)	648,508,523
Less accumulated depreciation for:					
Land improvements	(9,866,059)	(313,560)	—	—	(10,179,619)
Buildings, renovations and furnishings	(111,105,062)	(13,218,190)	—	392,417	(123,930,835)
Fixed equipment	(21,409,370)	(1,004,247)	—	1,584,346	(20,829,271)
Movable equipment	(98,940,348)	(16,930,115)	—	15,586,785	(100,283,678)
Minor equipment	(6,862,758)	(1,541,364)	—	729,382	(7,674,740)
Total accumulated depreciation	(248,183,597)	(33,007,476)	—	18,292,930	(262,898,143)
Total capital assets, net	$ 344,258,941	42,910,006	—	(1,558,567)	385,610,380

Included in major movable equipment at June 30, 2013 and 2012 is $4,619,239 and $4,619,239, respectively, of equipment under capital lease. Accumulated amortization of the equipment under capital lease totaling $4,485,793 and $4,403,143 is included in accumulated depreciation at June 30, 2013 and 2012, respectively.

Total additions to accumulated depreciation of $32,884,284 and $33,007,476 as of June 30, 2013 and 2012, respectively, include $444,417 and $478,535 of nonoperating depreciation expense. These assets are medical office buildings rented or leased to physician practices and others and, therefore, are not considered within the operations of VMC. Therefore, $32,439,867 and 32,528,941 in depreciation expense is reflected in the operating expenses section of the statements of revenues, expenses, and changes in net position as of June 30, 2013 and 2012, respectively.

(b) Discretely Presented Component Unit's Capital Assets

The activity in the component unit's capital asset accounts and the related accumulated depreciation accounts for the year ended June 30, 2013 is as follows:

	Balance June 30, 2012	Additions	Transfers	Retirements	Balance June 30, 2013
Nondepreciable capital assets:					
Land	$ —	—	—	—	—
Construction in progress	—	—	—	—	—
Total capital assets, not being depreciated	—	—	—	—	—
Capital assets, being depreciated:					
Land improvements	—	—	—	—	—
Buildings, renovations and furnishings	93,472	133,583	—	—	227,055
Fixed equipment	—	—	—	—	—
Movable equipment	6,985,676	479,159	—	—	7,464,835
Total capital assets, being depreciated	7,079,148	612,742	—	—	7,691,890
Total capital assets at historical cost	7,079,148	612,742	—	—	7,691,890
Less accumulated depreciation for:					
Land improvements	—	—	—	—	—
Buildings, renovations and furnishings	(48,519)	(14,080)	—	—	(62,599)
Fixed equipment	—	—	—	—	—
Movable equipment	(5,648,858)	(455,541)	—	—	(6,104,399)
Total accumulated depreciation	(5,697,377)	(469,621)	—	—	(6,166,998)
Total capital assets, net	$ 1,381,771	143,121	—	—	1,524,892

	Balance June 30, 2011	Additions	Transfers	Retirements	Balance June 30, 2012
Nondepreciable capital assets:					
Land	$ —	—	—	—	—
Construction in progress	—	—	—	—	—
Total capital assets, not being depreciated	—	—	—	—	—
Capital assets, being depreciated:					
Land improvements	—	—	—	—	—
Buildings, renovations and furnishings	88,347	5,125	—	—	93,472
Fixed equipment	—	—	—	—	—
Movable equipment	6,836,398	149,278	—	—	6,985,676
Total capital assets, being depreciated	6,924,745	154,403	—	—	7,079,148
Total capital assets at historical cost	6,924,745	154,403	—	—	7,079,148
Less accumulated depreciation for:					
Land improvements	—	—	—	—	—
Buildings, renovations and furnishings	(47,754)	(765)	—	—	(48,519)
Fixed equipment	—	—	—	—	—
Movable equipment	(5,224,065)	(424,793)	—	—	(5,648,858)
Total accumulated depreciation	(5,271,819)	(425,558)	—	—	(5,697,377)
Total capital assets, net	$ 1,652,926	(271,155)	—	—	1,381,771

(6) Deposits and Investments

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

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

(Continued)

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

At June 30, 2013 and 2012, deposits and investments of VMC consist of the following:

		2013	2012
Unrestricted cash and cash equivalents	$	11,589,565	6,005,939
Unrestricted investments:			
U.S. Treasury securities and bonds		105,829,760	112,995,432
U.S. government mutual funds		218,961	220,096
Investment pools		9,258,845	17,637,880
Tax-exempt issues		1,457,907	487,942
		116,765,473	131,341,350
Restricted assets:			
Cash and cash equivalents		352,266	389,608
U.S. Treasury securities and bonds		—	13,863,657
U.S. government mutual funds		13,233,475	13,826,998
Tax-exempt issues		—	504,028
Other assets		5,582,954	5,390,222
		19,168,695	33,974,513
	$	147,523,733	171,321,802

Interest income included in other nonoperating revenue totaled approximately $4.0 million and $3.9 million for the years ended June 30, 2013 and 2012, respectively.

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

(a) Credit Risk

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

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

According to GASB Statements No. 40, *Deposit and Investment Risk Disclosures – an amendment of GASB Statements No. 3*, unless there is information to the contrary, obligations of the U.S. government or obligations explicitly guaranteed by the U.S. government are not considered to have credit risk and do not require disclosure of credit quality.

As of June 30, 2013 and 2012, VMC's investment in the Pool was not rated by a NRSRO. In compliance with state statutes, Pool policies authorize investments in U.S. Treasury securities, U.S. agency and mortgage-backed securities, municipal securities (rated at least A by two NRSROs), commercial paper (rated at least the equivalent of A-1 by two NRSROs), certificates of deposit issued by qualified public depositories, repurchase agreements, and the LGIP managed by the Washington State Treasurer's Office.

As of June 30, 2013 and 2012, all impaired commercial paper investments have completed enforcement events. The King County Impaired Investment Pool (Impaired Pool) held one commercial paper asset where the Impaired Pool accepted an exchange offer and is receiving the cash flows from the investment's underlying securities, and the residual investments in four commercial paper assets that were part of completed enforcement events where the Impaired Pool accepted the cash out option.

The composition of investments, reported at fair value by investment type and rating at June 30, 2013 and excluding cash balances of $11,941,831 is as follows:

Investment type		**Fair value**	**Ratings**	**Percentage of totals**
Money market mutual fund	$	1,389,076	AAA	1.0%
U.S. Treasury		58,009,688	Not rated	42.8%
U.S. agency securities		22,286,807	AAA	16.4%
U.S. agency mortgages		25,533,265	AAA	18.8%
Tax-exempt issues		1,457,907	AAA	1.1%
Mutual funds invested in				0.0%
U.S. government securities		12,063,360	AAA	8.9%
King County investment pool		9,235,024	Not rated	6.8%
State (LGIP) investment pool		23,842	Not rated	0.0%
Other assets		5,582,954	Not rated	4.1%
Total	$	135,581,923		100.0%

The composition of investments, reported at fair value by investment type and rating at June 30, 2012 and excluding cash balances of $6,395,547, is as follows:

Investment type		Fair value	Ratings	Percentage of totals
Money market mutual fund	$	1,849,090	AAA	1.1%
U.S. Treasury		60,030,117	Not rated	36.4
U.S. agency securities		40,231,832	AAA	24.4
U.S. agency mortgages		26,597,141	AAA	16.1
Tax-exempt issues		991,970	AAA	0.6
Mutual funds invested in U.S. government securities		12,198,003	AAA	7.4
King County investment pool		17,614,086	Not rated	10.7
State (LGIP) investment pool		23,794	Not rated	—
Other assets		5,390,222	Not rated	3.3
Total	$	164,926,255		100.0%

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

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

There are no investments exceeding 5% of total investments that are with any one issuer other than the U.S. Treasury, U.S. agency, or U.S. government-sponsored entities. As of June 30, 2013 and 2012, for those investments that require composition disclosure, VMC holds investments in U.S. government-sponsored entities totaling 18% and 14% of its total investments in Federal National Mortgage Association securities, 8% and 9% of its total investments in Federal Home Loan Mortgage Corporation securities, and 5% and 5% of its total investments in Government National Mortgage Association securities.

(b) Custodial Credit Risk

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

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

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

(c) Interest Rate Risk

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

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

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

Issuer/instrument	Maximum length of maturity
U.S. Treasury bonds, certificates, and bills	10 years
Other obligations of the U.S. government or its agencies	10 years
Mutual funds consisting of only U.S. government bonds or U.S. guaranteed bonds	Average maturity < 4 years
Statutorily allowed certificates of deposit	24 months
Commercial paper	180 days
General obligation bonds of any state/local government	10 years

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

The LGIP is an unrated 2a-7 pool, as defined by GASB Statements No. 31. Balances in the LGIP are not subject to material interest rate risk, as the weighted average maturity of the portfolio will not exceed 90 days.

(Continued)

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

		Remaining maturity (in months)			
Investment type	**Fair value**	**12 months or less**	**13 to 24 months**	**25 to 48 months**	**More than 48 months**
Money market mutual fund	$ 1,389,076	1,389,076	—	—	—
U.S. Treasury	58,009,688	18,200,427	19,368,229	17,459,521	2,981,511
U.S. agency securities	22,286,807	1,001,007	2,993,446	13,840,229	4,452,125
U.S. agency mortgages	25,533,265	1,004,589	153,462	391,280	23,983,934
Tax-exempt issues	1,457,907	466,375	—	991,532	—
Mutual funds invested in U.S. government securities	12,063,360	—	—	12,063,360	—
King county investment pool	9,235,024	—	9,235,024	—	—
State investment pool	23,842	23,842	—	—	—
Other assets	5,582,954	—	—	—	5,582,954
	$ 135,581,923	22,085,316	31,750,161	44,745,922	37,000,524

(7) Long-Term Debt and Capital Lease Obligations

(a) Primary Government's Long-Term Debt

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

	2013	2012
Limited tax general obligation bonds:		
2011 term bond, 2.19%, due in June and December, in yearly amounts from $4,085,000 in fiscal year 2013 to $2,035,517 in fiscal year 2022, plus interest due semiannually, net of unamortized loss on refinance of $719,746	$ 29,616,666	33,532,148
2008 series A and B, 4.0% to 5.25%, due serially in December, in amounts from $880,000 in fiscal year 2013 to $17,365,000 in fiscal year 2038, plus interest due semiannually, net of unamortized premium of $681,927 and unamortized loss on refinancing of $2,607,328	214,229,599	215,207,453
2004 series, 3.75% to 4.25%, due serially in December, in amounts from $1,030,000 in fiscal year 2013 to $1,260,000 in fiscal year 2018, plus interest due semiannually, net of unamortized premiums of $21,729 and unamortized loss on refinance of $127,930	5,723,799	6,722,974
Revenue bonds:		
2010 series A, 3.00% to 5.125%, due serially in June, in amounts from $1,445,000 in 2013 to $2,395,000 in 2024, plus interest due semiannually, net of unamortized premium of $37,708, unamortized discount of $179,562, and unamortized loss on refinance of $685,101	20,158,045	21,387,281
Build America bonds:		
2010 series B, 7.90% to 8.00%, due serially in June, in amounts from $2,520,000 in 2025 to $5,485,000 in 2040, plus interest due semiannually	61,155,000	61,155,000
Bonds	330,883,109	338,004,856

		2013	2012
Capital lease obligations, stated at present value of future minimum lease payments	$	143,746	229,224
Note payable:			
2011 note payable, 2.25%, due in two payments in 2013 and 2014, plus interest due annually.		480,100	960,200
Total long-term debt		331,506,955	339,194,280
Less current portion		(8,225,472)	(8,005,578)
Total long-term debt, net of current portion	$	323,281,483	331,188,702

(i) Long-term Debt Overview

Series 2011 Bond Issue

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

The Series 2011 Term Bond was issued with fixed interest rates of 2.19%, and has eleven annual maturities of varying amounts between 2011 and 2021. The refunding resulted in a difference between the reacquisition price and the net carrying amount of the old debt of $719,746 and $889,264 for the years ended June 30, 2013 and 2012, respectively, which will be deferred and amortized over the life of the new bonds. The refunding resulted in an economic gain (difference between the present values of the old and new debt service payments) of $5,000,704.

The District has pledged tax revenues to secure the bonds.

2011 Note Payable

In March 2011, the District purchased an infusion center and medical oncology practice from a private physician group. The purchase price for the assets was $3,705,200 and a portion of the purchase price was funded with a note. As of June 30, 2013 and 2012, the outstanding note payable was $480,100 and $960,200, which has payments in years 2013 and 2014, with a fixed interest rate of 2.25%.

Series 2010 Revenue Bond Issue

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

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

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

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

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

Under the BAB bonds, the District receives a direct cash subsidy payment from the United States Department of the Treasury equal to 35% of the interest payable on the Series 2010B Bonds as of each Interest Payment Date. For the years ending June 30, 2013 and 2012, the District received $1,632,070 and $1,706,294, respectively, in subsidy payments, which are recorded in other nonoperating revenues in the statements of revenues, expenses, and changes in net position.

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

Series 2008 Bond Issue

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

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

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

The District has pledged tax revenues to secure the bonds.

(ii) Debt Compliance

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

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

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

Management is not aware of any violations with its debt covenants for the years ending June 30, 2013 and 2012.

(iii) Long-Term Debt Maturities

The following schedule shows debt service requirements, excluding capital leases, for the next five years and thereafter, as of June 30, 2013, using the fixed interest rates, for both principal and interest:

		Principal	Interest	Total
2014	$	8,145,100	17,833,873	25,978,973
2015		7,905,000	17,572,202	25,477,202
2016		8,185,000	17,292,025	25,477,025
2017		8,500,000	16,976,784	25,476,784
2018		8,810,000	16,659,555	25,469,555
2019 – 2023		42,286,412	78,499,375	120,785,787
2024 – 2028		60,835,000	65,766,003	126,601,003
2029 – 2033		78,515,000	45,877,699	124,392,699
2034 – 2038		101,070,000	20,332,344	121,402,344
2039 – 2042		10,690,000	1,294,000	11,984,000
Total payments	$	334,941,512	298,103,860	633,045,372

(iv) Capital Leases

VMC acquired certain equipment under capital lease obligations. The imputed interest rate on the equipment under capital lease is 3.5%. These leases are collateralized by the related equipment.

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

Fiscal year ending June 30:		
2014	$	84,816
2015		64,491
Total minimum lease payments		149,307
Less amount representing interest		(5,561)
Net		143,746
Less current portion		(80,372)
Present value of capital lease, net of current portion	$	63,374

(v) Change in Noncurrent Liabilities

Changes in noncurrent liabilities during the fiscal years ended June 30, 2013 and 2012 are summarized below:

	Balance June 30, 2012	Increases	Decreases	Balance June 30, 2013	Due within one year
Limited tax general obligation bonds:					
2011 series	$ 33,532,148	—	(3,915,482)	29,616,666	4,550,000
2008 series	215,207,453	—	(977,854)	214,229,599	540,000
2004 series	6,722,974	—	(999,175)	5,723,799	1,055,000
Revenue bonds:					
2010 Series A	21,387,281	—	(1,229,236)	20,158,045	1,520,000
Build America bonds:					
2010 Series B	61,155,000	—	—	61,155,000	—
Note payable	960,200	—	(480,100)	480,100	480,100
Capital lease obligations	229,224	—	(85,478)	143,746	80,372
Total long-term debt and capital lease obligations	339,194,280	—	(7,687,325)	331,506,955	8,225,472
Deferred compensation	3,255,699	543,506	(273,947)	3,525,258	—
Total noncurrent liabilities	$ 342,449,979	543,506	(7,961,272)	335,032,213	8,225,472

	Balance June 30, 2011	Increases	Decreases	Balance June 30, 2012	Due within one year
Limited tax general obligation bonds:					
2011 series	$ —	35,636,412	(2,104,264)	33,532,148	4,085,000
2008 series	216,919,118	—	(1,711,665)	215,207,453	880,000
2004 series	7,695,895	—	(972,921)	6,722,974	1,030,000
2001 series	37,405,795	—	(37,405,795)	—	—
Revenue bonds:					
2010 Series A	22,459,850	—	(1,072,569)	21,387,281	1,445,000
Build America bonds:					
2010 Series B	61,155,000	—	—	61,155,000	—
Note payable	2,330,200	—	(1,370,000)	960,200	480,100
Capital lease obligations	400,092	—	(170,868)	229,224	85,478
Total long-term debt and capital lease obligations	348,365,950	35,636,412	(44,808,082)	339,194,280	8,005,578
Deferred compensation	3,036,090	487,524	(267,915)	3,255,699	—
Total noncurrent liabilities	$ 351,402,040	36,123,936	(45,075,997)	342,449,979	8,005,578

(vi) Line of Credit

VMC has an unsecured $2.0 million line of credit with its banking institution, with an interest rate set at 1.75% above the daily 3-month LIBOR (London Interbank Offered Rate) in effect at the time the line of credit is utilized. The line of credit was unused during fiscal years 2013 and 2012, and there was no outstanding balance as of June 30, 2013 and 2012. This line of credit is in effect until September 2013.

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

The component unit has no outstanding long-term debt. The capital lease obligation as of June 30, 2013 and 2012 consists of an equipment lease with a present value of $476,039 and $675,151, with total monthly payments of $19,613, including imputed interest of 6.2%, maturing in 2015.

The schedule of changes in capital leases is as follows:

	Balance June 30, 2012	Increases	Decreases	Balance June 30, 2013	Due within one year
Capital lease obligations	$ 675,151	—	(199,112)	476,039	211,806

	Balance June 30, 2011	Increases	Decreases	Balance June 30, 2012	Due within one year
Capital lease obligations	$ 862,330	—	(187,179)	675,151	199,112

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

Fiscal year ending June 30:		
2014	$	235,356
2015		235,356
		39,226
Total minimum lease payments		509,938
Less amount representing interest		(33,899)
Net		476,039
Less current portion		(264,233)
Present value of capital lease, net of current portion	$	211,806

(8) Risk Management

VMC is exposed to risk of loss related to professional and general liability, employee medical, dental, and pharmaceutical claims, and injuries to employees. VMC maintains a program of purchased insurance and excess insurance coverage for professional and general liability, as well as self-insurance reserves. VMC is exposed to various risks of loss from torts; theft of, damage to, and destruction of assets; business interruption; errors and omissions; employee injuries and illnesses; and natural disasters. Commercial insurance coverage is purchased for claims arising from such matters and no claims have exceeded such coverage.

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

(a) Professional and General Liability

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

$8,500,000 on a claims-made basis with a limit of liability of $25,000,000 per occurrence and $25,000,000 annual aggregate.

Settlement amounts have not exceeded insurance coverage in the last three years.

(b) Employee Medical

VMC is self-insured for medical and dental benefits. The accrued liabilities for the self-insured component of the plan include the unpaid portion of claims that have been reported and estimates for claims that have been incurred but not reported. VMC also carries stop-loss coverage for claims in excess of the $225,000 specific deductible for 2013 and 2012. VMC has recorded an actuarially estimated liability for health claims that have been incurred but not reported of $3,527,662 and $3,347,421 as of June 30, 2013 and 2012, respectively. These liabilities are included in accrued salaries, wages, and employee benefits in the accompanying VMC statements of net position. The health benefit claims reserve at June 30, 2013 and 2012 is based on undiscounted calculations.

(c) Workers' Compensation

VMC is self-insured for workers' compensation claims. The self-insured retention under the workers' compensation program was $500,000 per claim in 2013 and 2012. Excess insurance coverage is purchased for risk above the per claim self-insured retention level. The accrued liabilities for the self-insured components of this plan include the unpaid portion of claims that have been reported and estimates for claims that have been incurred but not reported. VMC has recorded an actuarially determined estimated liability for workers' compensation claims of $3,498,599 and $3,396,736 at June 30, 2013 and 2012, respectively, which is included in accrued salaries, wages, and benefits in the accompanying VMC statements of net position. The workers' compensation reserve at June 30, 2013 and 2012 is based on undiscounted calculations.

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

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

Changes in the self-insurance reserve as it relates to the tail liability for professional liability insurance as of June 30, 2013 and 2012 are noted below:

Reserve at June 30, 2011	$	1,440,000
Incurred claims and changes in estimates		—
Claims payments		(150,000)
Reserve at June 30, 2012		1,290,000
Incurred claims and changes in estimates		—
Claims payments		(30,000)
Reserve at June 30, 2013	$	1,260,000

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

(9) Retirement Plans

VMC maintains a defined contribution plan, the Money Purchase Pension Plan, that covers substantially all of its employees. The plan is administered by VMC. VMC's contribution is based on the salaries of active participants in accordance with formulas specified in the plan. Plan provisions and contribution requirements are established by VMC and may be amended by VMC's Board of Trustees. Actuarial assumptions are not used in the determination of costs because benefits are payable only to the extent of available assets derived from contributions and plan earnings.

Employer contributions to the plan were $14,674,893 and $13,764,208 for the years ended June 30, 2013 and 2012, respectively. Employee contributions are permitted within the plan in an amount up to 10% of pay period earnings, capped at the annual amount allowed by federal law, and totaled $911,354 and $735,515 for the years ended June 30, 2013 and 2012, respectively.

VMC offers its employees two deferred compensation plans created in accordance with IRC Sections 403(b) and 457. The plans, available to all employees, permit them to defer a portion of their salary until future years. Employee contributions to the plans totaled $7,521,069 and $7,180,386 for the years ended June 30, 2013 and 2012, respectively. The deferred compensation is payable to employees upon termination, retirement, death, or unforeseen emergency.

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

(Continued)

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

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

(10) Related-Party Transactions

VMC is a discretely presented component unit of the University of Washington and a member of UW Medicine, a network of healthcare organizations owned or operated by the University of Washington. Other members of UW Medicine include UW Medical Center, Harborview Medical Center (Harborview), Northwest Hospital and Medical Center (Northwest Hospital), UW Medicine Neighborhood Clinics (the Clinics), UW Physicians (UWP), the UW School of Medicine (the School) and Airlift Northwest (ALNW).

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

(a) University of Washington

A total of $1,131,538 and $570,550 was paid by VMC to divisions of University of Washington for the years ending June 30, 2013 and 2012, respectively, for transactions primarily related to reference laboratory work, providing contracted nursing assistance with the Valley Nurse Line, and management assistance with the various pharmacies

(b) Intra-Governmental Transactions

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

Lease of Medical Office Space

The component unit has several lease agreements with VMC. Office space for three different locations is leased from VMC for approximately $923,000 and $910,000 for the years ending June 30, 2013 and 2012, respectively. The leases expire in December 2014, April 2015, and December 2017, respectively. Of the component unit's $3,235,000 in total outstanding minimum lease payments, $3,104,000 is due to VMC.

Operational Services

During the years ended June 30, 2013 and 2012, IPV provided radiology services on behalf of VMC, which reimburses IPV for those services. Net patient service revenue for these services was approximately $9.6 million and $13.5 million, respectively. Complete financial statements for IPV for the year ended June 30, 2012 can be obtained by contacting the IPV's Administrator at vrads.com. In April 2013, the contract between VMC and IPV was modified. VMC now bills for all IPV patients seen at the Olympic Building location. VMC pays IPV for services rendered, which is represented by the $1.8 million in other operating revenue for 2013.

(11) Commitments and Contingencies

(a) Operating Leases

VMC leases certain medical office space and equipment under operating lease arrangements with its discretely presented component unit and third parties. Similarly, the discretely presented component unit leases certain medical office space and equipment under operating leases with VMC and third parties. Total rental expense in the year ended June 30, 2013 was $10,155,178 and $1,015,385 for VMC and the discretely presented component unit, respectively. Total rental expense in the year ended June 30, 2012 was approximately $10,264,608 and $1,091,691 for VMC and the discretely presented component unit, respectively.

The following schedule shows future minimum lease payments by fiscal year for VMC and the discretely presented component unit as of June 30, 2013:

	VMC	Component unit
2014	$ 7,527,981	901,000
2015	5,868,176	574,000
2016	4,672,421	257,000
2017	4,261,577	257,000
2018	4,014,403	—
Thereafter	11,601,899	—
Total minimum lease payments	$ 37,946,457	1,989,000

(b) Construction Commitments

VMC has current commitments at June 30, 2013 of $5.1 million related to various construction projects, equipment purchases and information technology implementations. VMC intends to use capital funds for these commitments.

(c) Regulatory Environment

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

(d) Litigation

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

(e) Collective Bargaining Agreements

VMC has a total of approximately 2,878 employees. Of this total, approximately 73% and 73% are covered collective bargaining agreements as of June 30, 2013 and 2012, respectively. Nurses are represented by SEIU 1199 and other healthcare and support workers are represented by OPEIU, UFCW, and IUOE Operating Engineers. The collective bargaining agreements with SEIU 1199 and OPEIU, UFCW, and IUOW Operating Engineers expire on June 30, 2105; June 30, 2014; March 31, 2014 and December 31, 2013, respectively.

(12) Healthcare Reform

As enacted, the Health Reform Law will change how healthcare services are covered, delivered and reimbursed through expanded coverage of uninsured individuals, reduced growth in Medicare program spending, reductions in Medicare and Medicaid Disproportionate Share Hospital (DSH) payments, and the establishment of programs in which reimbursement is tied to quality and integration. In addition, the law reforms certain aspects of health insurance, expands existing efforts to tie Medicare and Medicaid payments to performance and quality, and contains provisions intended to strengthen fraud and abuse enforcement. Further, it provides for a value-based purchasing program, the establishment of Accountable Care Organizations (ACOs) and bundled payment pilot programs, which may create sources of additional revenue. On June 28, 2012, the United States Supreme Court upheld the constitutionality of the individual mandate provisions of the Health Reform Law but struck down the provisions that would have allowed Health and Human Services (HHS) to penalize states that do not implement the Medicaid expansion provisions with the loss of existing federal Medicaid funding. States that choose not to implement the Medicaid expansion will forego funding established by the Health Reform Law to cover most of the expansion costs. The State of Washington has elected to implement Medicaid expansion in order to take advantage of all opportunities associated with healthcare reform. A Health Care Cabinet has been established by the State of Washington and tasked with implementing the policies and rules necessary to carry out healthcare reform statewide for all affected state agencies. On October 1, 2013, the Washington Health Benefit Exchange began open enrollment for Washington State residents through Washington Healthplanfinder. The insurance exchange, coupled with penalties for individuals electing to not obtain health insurance and subsidies for individuals meeting certain income thresholds, will result in reductions of uninsured and underinsured patients and significantly change hospital payor mix. The reduction of uninsured and underinsured patients will also have an impact on Medicare and Medicaid Disproportionate Share (DSH) reimbursement methodologies. VMC has not yet determined the financial impact that this legislation might cause as further provisions become effective.

(13) Subsequent Event

On September 16, 2013, the Board of Trustees passed two resolutions related to VMC's retirement plans. Effective September 29, 2013 and October 27, 2013, respectively, for certain employee groups, the VMC Money Purchase Pension Plan was terminated. As the pension plan was a defined contribution plan, and fully funded, there were no outstanding liabilities related to this termination. Effective the same dates, VMC will contribute a 5% employer contribution into the 403B plan for all eligible employees (10% in excess of the taxable wage base), with an additional 2% employer match on a 2% employee contribution.

On October 21, 2013, the Board of Trustees passed a resolution terminating the Money Purchase Pension Plan for all remaining employee groups, effective November 10, 2013.

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

Supplementary Information

Aggregating Statements of Net Position

Year ended June 30, 2013

Assets	VMC	Component unit – IPV	Eliminations	Aggregated
Current assets:				
Cash and cash equivalents	$ 22,557,276	1,108,028	—	23,665,304
Short-term investments	20,724,208	—	—	20,724,208
Restricted unspent bond proceeds	—	—	—	—
Accounts receivable, less allowance for uncollectible accounts	52,914,600	302,219	—	53,216,819
Property tax receivable	8,028,709	—	—	8,028,709
Due from:				
Primary government	—	1,836,989	(1,836,989)	—
Component unit	1,420,241	—	(1,420,241)	—
Noncurrent assets, required for current obligations	26,476,410	—	—	26,476,410
Supplies inventory	4,224,793	—	—	4,224,793
Prepaid expenses and other assets	6,946,482	55,647	—	7,002,129
Total current assets	143,292,719	3,302,883	(3,257,230)	143,338,372
Long-term investments	31,264,465	—	—	31,264,465
Noncurrent assets:				
Unrestricted for general capital improvements and operations	55,298,974	—	—	55,298,974
Restricted for self-insurance reserve funds	6,686,547	—	—	6,686,547
Restricted unspent bond proceeds	—	—	—	—
Restricted under deferred compensation arrangements	3,613,518	—	—	3,613,518
Restricted under revenue bond indenture agreements	7,378,745	—	—	7,378,745
	72,977,784	—	—	72,977,784
Less amounts required for current obligations	(26,476,410)	—	—	(26,476,410)
Total noncurrent assets	46,501,374	—	—	46,501,374
Capital assets:				
Land	13,299,497	—	—	13,299,497
Construction in progress	33,062,351	—	—	33,062,351
Depreciable capital assets, net of accumulated depreciation	339,817,116	1,524,892	—	341,342,008
Total capital assets	386,178,964	1,524,892	—	387,703,856
Deferred financing costs	3,443,495	—	—	3,443,495
Goodwill, intangible assets & other	4,414,454	—	—	4,414,454
Total assets	$ 615,095,471	4,827,775	(3,257,230)	616,666,016

(Continued)

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

Supplementary Information

Aggregating Statements of Net Position

Year ended June 30, 2013

Liabilities and Net Position		**VMC**	**Component unit – IPV**	**Eliminations**	**Aggregated**
Current liabilities:					
Accounts payable	$	10,570,098	512,790	—	11,082,888
Accrued salaries, wages and benefits		35,275,544	22,802	—	35,298,346
Due to:					
Primary government		—	1,420,241	(1,420,241)	—
Component unit		1,836,989	—	(1,836,989)	—
Other accrued liabilities, including estimated third-party payor settlements		3,448,968	—	—	3,448,968
Interest, patient refunds and other		11,606,792	9,285	—	11,616,077
Deferred property tax revenue		8,023,310	—	—	8,023,310
Current portion of long-term debt and capital lease obligations		8,225,472	211,806	—	8,437,278
Total current liabilities		78,987,173	2,176,924	(3,257,230)	77,906,867
Deferred compensation		3,525,258	—	—	3,525,258
Long-term debt and capital lease obligations, net of current portion		323,281,483	264,233	—	323,545,716
Total liabilities		405,793,914	2,441,157	(3,257,230)	404,977,841
Net position:					
Invested in capital assets net of related debt		53,946,246	1,048,853	—	54,995,099
Restricted:					
For debt service		7,378,745	—	—	7,378,745
Expendable for specific operating activities		348,374	—	—	348,374
Unrestricted		147,628,192	1,337,765	—	148,965,957
Total net position		209,301,557	2,386,618	—	211,688,175
Total liabilities and net position	$	615,095,471	4,827,775	(3,257,230)	616,666,016

See accompanying independent auditors’ report.

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

Supplementary Information

Aggregating Statements of Revenues, Expenses and Changes in Net Position

Year ended June 30, 2013

	VMC	Component unit – IPV	Eliminations	Aggregated
Operating revenues:				
Net patient service revenue (net of allowance for uncollectible accounts of $35,924,268 for VMC)	$ 416,324,353	9,564,159	—	425,888,512
Other operating revenue	27,284,521	1,846,042	(4,006,787)	25,123,776
Total operating revenues	443,608,874	11,410,201	(4,006,787)	451,012,288
Operating expenses:				
Salaries and wages	203,576,730	1,940,753	—	205,517,483
Employee benefits	68,019,926	830,361	—	68,850,287
Supplies and other expenses	157,399,230	3,843,611	(3,104,120)	158,138,721
Depreciation	32,439,867	469,621	—	32,909,488
Total operating expenses	461,435,753	7,084,346	(3,104,120)	465,415,979
Operating income (loss)	(17,826,879)	4,325,855	(902,667)	(14,403,691)
Nonoperating income (expense):				
Revenue from taxation	16,253,562	—	—	16,253,562
Interest income	4,009,173	—	—	4,009,173
Interest and amortization expense	(17,904,892)	(36,242)	—	(17,941,134)
Investment income (loss)	(1,059,459)	—	—	(1,059,459)
Other, net	(420,944)	—	(23,658)	(444,602)
Members’ cash distributions	—	(3,725,109)	926,325	(2,798,784)
Net nonoperating income (expense)	877,440	(3,761,351)	902,667	(1,981,244)
(Decrease) increase in net position	(16,949,439)	564,504	—	(16,384,935)
Net position, beginning of year	226,250,996	1,822,114	—	228,073,110
Net position, end of year	$ 209,301,557	2,386,618	—	211,688,175

See accompanying independent auditors’ report.