Skagit County Public Hospital District No. 2 d/b/a Island Hospital

Anacortes, Washington

Financial Statements

Years Ended December 31, 2018 and 2017

WIPFLi LLP
CPAs and Consultants

Skagit County Public Hospital District No. 2 d/b/a Island Hospital

Financial Statements

Years Ended December 31, 2018 and 2017

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WIPFLI LLP

Independent Auditor's Report

Board of Commissioners
Skagit County Public Hospital District No. 2
d/b/a Island Hospital
Anacortes, Washington

Report on the Financial Statements

We have audited the accompanying financial statements of Skagit County Public Hospital District No. 2 d/b/a Island Hospital (the "Hospital") as of and for the years ended December 31, 2018 and 2017, and the related notes to the financial statements, which collectively comprise the Hospital's financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States; 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.

Auditor's 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 and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. 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 auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Skagit County Public Hospital District No. 2 d/b/a Island Hospital as of December 31, 2018 and 2017, and the changes in its net position and cash flows for the years then ended in accordance with accounting principles generally accepted in the United States.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States require that the management's discussion and analysis on pages 3 through 10 and the Schedule of Changes in Total Other Post-Employment Benefit Liability and Related Ratios on page 53 be presented to supplement the basic financial statements. Such information, although not a part of the financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the 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, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the financial statements, and other knowledge we obtained during our audit of the financial statements. We do not express an opinion or provide any assurance on the information, because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated April 24, 2019, on our consideration of the Hospital's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is solely to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the Hospital's internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Hospital's internal control over financial reporting and compliance.

Wipfli LLP

Wipfli LLP

April 24, 2019
Spokane, Washington

Skagit County Public Hospital District No. 2 d/b/a Island Hospital

Management's Discussion and Analysis

December 31, 2018 and 2017

Using This Annual Report

The Hospital's financial statements consist of three statements: statements of net position; statements of revenue, expenses, and changes in net position; and statements of cash flows. These financial statements and related notes provide information about the activities of Skagit County Public Hospital District No. 2 d/b/a Island Hospital (the "Hospital"), including resources held by the Hospital, but restricted for specific purposes by contributors, grantors, or enabling legislation.

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

Our analysis of the Hospital's finances begins on page 4. One of the most important questions asked about the Hospital's finances is, "Is the Hospital as a whole better or worse off as a result of the year's activities?" The statements of net position and the statements of revenue, expenses, and changes in net position report information about the Hospital's resources and its activities in a way that helps answer this question. These statements include all restricted and unrestricted assets and all liabilities using the accrual basis of accounting. All of the current year's revenues and expenses are taken into account regardless of when cash is received or paid.

Those two statements report the Hospital's net position and changes in net position. You can think of the Hospital's net position—the difference between assets and liabilities—as one way to measure the Hospital's financial health or financial position. Over time, the increases or decreases in the Hospital's net position are one indicator of whether the financial health is improving or deteriorating. You will need to consider other nonfinancial factors, however, such as changes in the Hospital's patient base and measures of the quality of service it provides to the community, as well as local economic factors, to assess the overall health of the Hospital.

Statements of Cash Flows

The final required statements are the statements of cash flows. The statements report cash receipts, cash payments, and net changes in cash resulting from operating, investing, and financing activities. It also describes the sources and uses of cash during the reporting period.

Introduction

The discussion and analysis of the Hospital's financial performance provides an overview of the financial activities for the years ended December 31, 2018 and 2017. The financial statements and notes are to be read in conjunction with this section. The following narrative utilizes approximate amounts unless otherwise specified.

Financial Highlights

For the fiscal year ended December 31, 2018, the Hospital reported a net operating loss of $5,238,000, deficit of revenue over expenses before capital contributions of $458,000, and a margin of (0.5)%. This compares to amounts in 2017 of a net operating loss of $1,841,000, excess of revenue over expenses of $1,309,000, and a margin of 1.4%.

The following significant events had an impact on the operating results for the Hospital:

- In November 2016, the Hospital signed a software and implementation agreement with Meditech to move to their 6.1 EMR. The estimated seven-year total cost of ownership is $12 million. The Hospital went live on the new platform on May 1, 2018, recognizing $436,000 in depreciation expense for the year. Ongoing maintenance costs are projected to be around $2 million annually.

- The Hospital participates in an agent multiple-employer other postemployment benefits plan (OPEB). In accordance with RCW 41.05.085 and RCW 41.05.022, eligible Hospital retirees and spouses are entitled to subsidies associated with postemployment health benefits provided through the Public Employee Benefits Board (PEBB). The PEBB was created within the Washington State Health Care Authority to administer medical, dental, and life insurance plans for public employees and retirees. The Hospital implemented GASB Statement 75 for the year ended December 31, 2017. This statement requires the Hospital to recognize total OPEB liabilities, and the related deferred inflows and outflows for its actuarially determined unfunded liabilities of postemployment plans available to retirees. Amounts that would have been reported as OPEB expense in prior periods are reported as a restatement as required. The prior period adjustment necessary to implement GASB Statement 75 was $8,989,231, adding a 2016 OPEB obligation of $9,077,550 and adding a deferred outflow amount of $88,319. If the District decided to leave the PEBB, the related deferred inflows, outflows, and liabilities would be removed from the statements of net position. The Hospital recognized OPEB expenses of $1,261,698 in 2018 and $1,167,167 in 2017.

- In August 2018, the balloon payments classified as current liabilities as of December 31, 2017, under the Community Development Entity Loans came due. NDC CDE Loan B in the amount of $1,770,800 and Kitsap CDE Loan D in the amount of $729,000 are interest-only loans in the form of a Qualified Equity Investment on the District's New Markets Tax Credit Leveraged Loan and will be forgiven by the Tax Credit Investor upon termination of the seven-year compliance period ending in August 2018. NDC CDE Loan A in the amount of $5,373,200 and Kitsap CDE Loan C in the amount of $2,121,000 were paid off.

- In August 2011, the Hospital entered into a Lease and Services Agreement with Orcas Medical Foundation. The Hospital agreed to lease the 6,000 square foot facility, and Orcas Medical Foundation contracted with Island Hospital to operate and manage the primary care medical facility with federal rural health clinic status. In 2017 and 2016, Orcas Medical Foundation provided support in the amount of $70,000. In June 2016, the Hospital gave notice to the Orcas Medical Foundation that it would be terminating the agreement at the end of 2016. In December, the Hospital signed an agreement extending management of the clinic through June 2017 and in early 2017 signed another extension to September 2017 to allow the Orcas Medical Foundation to allow a smooth transition to the University of Washington.

Financial Highlights (Continued)

- In October 2011, the Hospital entered into a refundable grant agreement in support of professional urology services in Skagit County with Skagit Valley Hospital. The grant calls for an initial grant of $107,000, which was paid in 2011, and an additional $227,000 for the first year of the agreement defined as November 1, 2011 to October 31, 2012. Additional grant funding is determined by a set formula in the agreement based upon the financial performance of the clinic. Additional grant funding was requested in 2018 and 2019 of $70,000 and $280,000, respectively. In August of 2017, the Hospital provided a 180-day notice of termination to Skagit County Public Hospital District No 1. that the Grant Agreement would terminate as of March 1, 2018.

- The Hospital submitted an application to the Office of Management and Budget (OMB) of the United States requesting a reclassification from the Mount Vernon-Anacortes MSA to the Seattle-Tacoma-Olympia MSA for purposes of increasing reimbursement from the Medicare program. The application was approved by the OMB in December 2006 and approved by the Medicare Geographic Review Board in February 2007. The Hospital received extensions in subsequent periods that are effective through September 30, 2022.

- The Hospital received $500,000 in 2010 and $100,000 from 2011 through 2018 from the Island Hospital Foundation for the purpose of funding the Medical Arts Pavilion with a commitment to receive $100,000 per year through 2020. The Hospital also received the following from the Foundation:

Year	Capital	Other Program Support
2010	$ 135,655	$ 90,900
2011	144,200	86,700
2012	148,910	241,851
2013	113,472	175,853
2014	115,000	202,028
2015	2,500	260,917
2016	292,300	306,937
2017	600,740	396,106
2018	661,275	309,803

- In April 2014, the Hospital entered into an Accountable Care Network (ACN) with UW Medicine. The ACN is currently an option for some Boeing beneficiaries, and UW Medicine continues to offer their product on a broader scale. At this time, the Hospital only participates in the Boeing product.

- In June 2016, the Hospital gave notice to the Catherine Washburn Memorial Association that they would not be renewing the operating and lease agreement for the Lopez Medical Center at the end of the current agreement in June 2017. The Hospital agreed to extend the period to September 2017 to allow a smooth transition to the University of Washington.

Financial Highlights (Continued)

- In 2017, the Hospital recruited a pediatric physician to the Fidalgo Medical Associates to replace a retiring physician. In September 2018, the Hospital hired a new family practice provider to the clinic and also recruited an obstetrician that will start in September 2019. The Hospital recruited two new mid-level providers to the clinic to start in February 2019. Recruiting these providers will improve access to primary care in the community.

- In April 2017, the Hospital District Board made the decision to exit from the home health business and found an entity that has experience in providing home health services and was interested in retaining this service in our community. In August 2017, the sale to Glacier Peak Healthcare, Inc. was finalized.

- In May 2017, the Board approved requesting of the district taxpayers a levy lift of $0.31 cents from the current existing $0.19 cents. Proceeds from the levy lift will be used to fund facilities and equipment for the District. In August, the ballot measure passed with 51.77%.

- In February 2018, the Hospital signed an agreement with Northwest Emergency Physicians to provide physician and nonphysician coverage for the Walk In Clinic at Island Hospital beginning in April 2018.

- In February 2018, the Hospital obtained a $4,000,000 line of credit with Washington Federal to fund operating and capital cash flow needs during the implementation of the new electronic medical record. Maturity for the line of credit is 24 months with quarterly interest payments.

- In May 2018, the Hospital entered into a new lease agreement with Challenge Development for additional space for the OB/GYN providers at Fidalgo Medical Clinic. The landlord will build out the space to accomodate the providers. Relocation of these providers to a separate space will give the remaining providers more space.

- In July 2018, the Hospital issued a $15,000,000 bond to fund repayment of the New Market Tax Credit loans A and C as well as facility improvements and other capital equipment.

Net Position

The summarized statements of net position as of December 31, 2018, 2017, and 2016, are as follows:

	2018	2017	2016
	(In Thousands)		
Current assets:			
Cash and cash equivalents	$ 26,878	$ 28,119	$ 27,030
Patient accounts recievable - Net	9,714	8,733	9,055
Other current assets	3,219	2,963	2,948
Total current assets	39,811	39,815	39,033
Capital assets - Net	68,178	65,697	63,613
Other assets	13,373	6,987	7,903
Deferred outflows of resources	1,869	1,615	1,647
Total assets and deferred outflows of resources	$ 123,231	$ 114,114	$112,196
Current liabilities	$ 14,507	$ 22,708	$ 11,816
Long-term debt - Net	47,137	33,891	46,089
Total OPEB liability	11,897	9,864	-
Other liabilities	873	904	854
Total liabilities	74,414	67,367	58,759
Deferred inflows of resources - OPEB	-	389	-
Net position	48,817	46,358	53,437
Total liabilities, deferred inflows of resources, and net position	$ 123,231	$ 114,114	$112,196

Total assets and deferred outflows of resources increased by $9,117,000 in 2018 and increased by $1,918,000 in 2017. Current liabilities increased by $8,201,000 in 2018 and increased by $10,892,000 in 2017.

Long-term debt increased by $13,246,000 in 2018 and decreased by $12,198,000 in 2017.

The Hospital's net position is the difference between its assets and liabilities reported in the statements of net position. The Hospital's net position increased by $2,459,000, or 5.3%, in 2018 and increased by $1,910,000, or 4.3%, in 2017. GASB 75 was adopted in 2017, resulting in a cumulative effect for a change in accounting principal that decreased beginning 2017 net position by $8,989,000.

Statements of Revenue, Expenses, and Changes in Net Position

The summarized statements of revenue, expenses, and changes in net position for the years ended December 31, 2018, 2017, and 2016, are as follows:

	2018	2017	2016
	(In Thousands)		
Operating revenue:			
Net patient service revenue	$ 92,048	$ 93,787	$ 93,989
Other operating revenue	715	914	1,206
Total operating revenue	92,763	94,701	95,195
Operating expenses:			
Salaries, wages, and benefits	52,901	54,061	51,431
Professional and physician fees	4,634	3,833	5,902
Supplies	23,720	23,206	23,566
Purchased services	8,887	8,436	8,492
Depreciation and amortization	4,810	4,101	3,958
Other	3,049	2,905	2,915
Total operating expenses	98,001	96,542	96,264
Operating loss	(5,238)	(1,841)	(1,069)
Nonoperating revenue - Net	4,780	3,150	2,048
Excess (deficit) of revenue over expenses	(458)	1,309	979
Capital contributions	561	601	392
Special items - Debt forgiveness	2,356	-	-
Increase in net position	2,459	1,910	1,371
Net position at beginning of year	46,358	44,448	52,066
Net position at end of year	$ 48,817	$ 46,358	$ 53,437

Statements of Revenue, Expenses, and Changes in Net Position (Continued)

Sources of Revenue

Net patient service revenue decreased by $1,739,000, or 1.9%, in 2018. This was a result of lower inpatient volumes, down 17.5% from budget, as well as lower outpatient revenue, down 1.8%. The collection percentage for the Hospital was 40% and 41% in 2018 and 2017, respectively.

The percentage of revenue by payor class based on total patient service revenue for the years ended December 31, 2018, 2017, and 2016, was as follows:

	2018	2017	2016	2017 to 2018 Change
Medicare and Medicare Managed Care	52.4 %	52.5 %	53.5 %	-0.1 %
Medicaid and Medicaid Managed Care	10.8 %	12.3 %	12.1 %	-1.5 %
Other government	11.7 %	10.6 %	10.3 %	1.1 %
Commercial	23.6 %	23.1 %	22.8 %	0.5 %
Self-pay	1.5 %	1.5 %	1.3 %	0.0 %
Totals	100.0 %	100.0 %	100.0 %	

Bad debt expense decreased by $86,000, or 5%, in 2018 and decreased by $217,000, or 12%, in 2017.

Charity care/financial assistance write-offs decreased by $124,000, or 20%, in 2018 and increased by $232,000, or 59%, in 2017.

Operating Expenses

Total operating expenses in 2018 increased by $1,459,000, or 1.51%, compared to an increase of $278,000, or 0.03%, in 2017. Primary factors in the change in total operating expenses were as follows:

- Salaries, wages, and benefits decreased by 2.1% in 2018, primarily due to the decrease in FTE of 3.1%. Total FTEs decreased by 17 to a total of 551 in 2018.
- Professional and physician fees expense increased by 20.9% in 2018 due to costs related to general surgery, a new Hospitalists agreement and new coverage agreement for the Walk In Clinic.
- Purchased services increased by 5.3% in 2018 due to increases in contracted labor costs.
- Supplies increased by 2.2% in 2018 due to increased surgical implant costs.

Statements of Revenue, Expenses, and Changes in Net Position (Continued)

Operating Expenses (Continued)

- Depreciation increased by 17.3% percent in 2018 largely due to placing a new EMR into service.

- Other operating expenses increased by 4.9% in 2018 due to a increase in rental cost.

Currently Known Facts, Decisions, or Conditions

The Washington State Auditor's Office performed a financial and compliance audit for the year ended December 31, 2017. The Hospital was issued a report with no findings.

In 2010, the Hospital contracted with DNV Healthcare, Inc. (DNV) to conduct the accreditation survey and was issued an accreditation certificate on March 19, 2013, which was renewed in 2016 and is now good through March 2019. In March 2014, the Hospital also received ISO certification through DNV, which is also good through March 2019. The DNV accreditation process requires annual surveys, and DNV was at the Hospital December 11th - December 13th conducting their 2018 survey. The Hospital received its final report of findings and have responded with a corrective action plans to address those findings.

The Medicare cost report for 2017 has been filed and is awaiting final review. The Medicare cost report for 2018 will be filed in May 2019.

Contacting the Hospital's Financial Management

This financial report is designed to provide our patients, suppliers, taxpayers, and creditors with a general overview of the Hospital's finances and to show the Hospital's accountability for the money it receives. If you have questions about this report or need additional financial information, contact Administration, Skagit County Public Hospital District No. 2, 1211 24th Street, Anacortes, Washington 98221.

Skagit County Public Hospital District No. 2 d/b/a Island Hospital

Statements of Net Position

December 31, 2018 and 2017

	2018	2017
Current assets:		
Cash and cash equivalents	$ 26,877,586	$ 28,119,490
Receivables:		
Patient - Net	9,714,394	8,733,362
Other	391,292	241,840
Prepaid expenses	1,190,800	826,373
Inventories	1,614,817	1,649,418
Noncurrent cash, cash equivalents, and investments required for current liabilities	22,077	244,985
Total current assets	39,810,966	39,815,468
Noncurrent cash, cash equivalents, and investments, less current portion:		
Noncurrent cash and cash equivalents, less current portion	11,779,767	5,424,277
Noncurrent investments	463,709	451,556
Total noncurrent cash, cash equivalents, and investments, less current portion	12,243,476	5,875,833
Capital assets:		
Nondepreciable capital assets	5,588,656	10,891,781
Depreciable capital assets - Net	62,589,806	54,805,231
Capital assets - Net	68,178,462	65,697,012
Other assets:		
Intangible assets - Net	598,703	598,703
Purchase option	530,499	512,499
Total other assets	1,129,202	1,111,202
Deferred outflows of resources:		
Loss on refunding of long-term debt	1,390,391	1,518,647
Other post-employment benefits	479,141	96,189
Total deferred outflows of resources	1,869,532	1,614,836
TOTAL ASSETS AND DEFERRED OUTFLOWS OF RESOURCES	$ 123,231,638	$ 114,114,351

Skagit County Public Hospital District No. 2 d/b/a Island Hospital

Statements of Net Position (Continued)

December 31, 2018 and 2017

	2018	2017
Current liabilities:		
Current portion of long-term debt and capital lease obligations	$ 2,132,782	$ 11,857,824
Accounts payable	4,561,501	5,222,756
Line of credit	1,725,000	-
Accrued payroll and related liabilities	4,093,652	4,117,727
Accrued interest	157,561	125,661
Estimated third-party payer settlements	1,481,262	1,209,540
Other current liabilities	355,558	174,957
Total current liabilities	14,507,316	22,708,465
Long-term liabilities:		
Long-term debt and capital lease obligations, less current portion	47,137,451	33,891,376
Deferred compensation payable	470,289	458,104
Professional liability claims payable	402,300	445,927
Total OPEB liability	11,897,237	9,863,713
Total long-term liabilities	59,907,277	44,659,120
Total liabilities	74,414,593	67,367,585
Deferred inflows of resources - Other post-employment benefits	-	388,874
Net position:		
Net investment in capital assets	18,908,229	19,947,812
Restricted, expendable	11,018,226	4,455,094
Unrestricted	18,890,590	21,954,986
Total net position	48,817,045	46,357,892
TOTAL LIABILITIES, DEFERRED INFLOWS OF RESOURCES, AND NET POSITION	$ 123,231,638	$ 114,114,351

See accompanying notes to the financial statements.

Skagit County Public Hospital District No. 2 d/b/a Island Hospital

Statements of Revenue, Expenses, and Changes in Net Position

Years Ended December 31, 2018 and 2017

	2018	2017
Operating revenue:		
Net patient service revenue	$ 92,048,041	$ 93,786,789
Other operating income	715,301	913,620
Total operating revenue	92,763,342	94,700,409
Operating expenses:		
Salaries and wages	41,292,345	42,566,973
Employee benefits	11,608,297	11,493,994
Professional and physician fees	4,633,783	3,832,993
Supplies	23,720,182	23,206,232
Purchased services	8,886,816	8,435,926
Rents and leases	829,287	756,748
Depreciation and amortization	4,809,718	4,101,221
Other expenses	2,221,277	2,147,301
Total operating expenses	98,001,705	96,541,388
Operating loss	(5,238,363)	(1,840,979)
Nonoperating revenue (expense):		
Investment income	582,922	317,262
Interest expense	(2,029,982)	(1,823,910)
Tax levy	5,336,994	3,450,270
Loss from investment in joint venture	-	(83,938)
Other nonoperating revenue - Net	890,507	1,290,362
Total nonoperating revenue - Net	4,780,441	3,150,046
Income (loss) before capital contributions, excess (deficit) of revenue over expenses	(457,922)	1,309,067
Capital contributions	561,275	600,740
Special item - Debt forgiveness	2,355,800	-
Increase in net position	2,459,153	1,909,807
Net position, beginning of year	46,357,892	44,448,085
Net position, end of year	$ 48,817,045	$ 46,357,892

See accompanying notes to the financial statements.

Skagit County Public Hospital District No. 2 d/b/a Island Hospital

Statements of Cash Flows

Years Ended December 31, 2018 and 2017

	2018	2017
Cash flows from operating activities:		
Receipts from and on behalf of patients	$ 91,338,731	$ 94,175,668
Payments to suppliers and contractors	(41,469,785)	(37,588,623)
Payments to and on behalf of employees	(51,662,987)	(52,851,816)
Receipts from other operating revenue	715,301	913,620
Net cash provided by (used in) operating activities	(1,078,740)	4,648,849
Cash flows from noncapital financing activities:		
Other nonoperating receipts, including contributions	1,101,920	772,406
Cash flows from capital and related financing activities:		
Purchase of capital assets	(6,546,936)	(6,206,316)
Proceeds from sale of capital assets	-	545,810
Proceeds from issuance of long-term debt	15,000,000	-
Principal payments on long-term debt and capital lease obligations	(9,572,955)	(1,750,868)
Interest payments on long-term debt and capital lease obligations	(2,195,082)	(2,039,625)
Receipts from tax levy - Debt service	2,435,008	2,399,438
Receipts from tax levy - Maintenance and operations	2,896,266	1,061,170
Contributions for capital assets	561,275	600,740
Net borrowings on line of credit	1,725,000	-
Net cash provided by (used in) capital and related financing activities	4,302,576	(5,389,651)
Cash flows from investing activities:		
Proceeds from interest and dividends on investments	564,922	298,785
Capital contributions for investment in joint venture	-	(83,938)
Net cash provided by investing activities	564,922	214,847
Net increase in cash and cash equivalents	4,890,678	246,451
Cash and cash equivalents - Beginning of year	33,788,752	33,542,301
Cash and cash equivalents - End of year	$ 38,679,430	$ 33,788,752

Skagit County Public Hospital District No. 2 d/b/a Island Hospital

Statements of Cash Flows (Continued)

Years Ended December 31, 2018 and 2017

	2018	2017
Reconciliation of operating loss to net cash provided by (used in) operating activities:		
Operating loss	$ (5,238,363)	$ (1,840,979)
Adjustments to reconcile operating loss to net cash provided by (used in) operating activities:		
Depreciation and amortization	4,809,718	4,101,221
Provision for bad debts	1,535,434	1,621,023
Changes in assets and liabilities:		
Receivables:		
Patient - Net	(2,516,466)	(1,299,528)
Other	(143,732)	155,170
Prepaid expenses	(364,427)	42,909
Inventories	34,601	(108,390)
Accounts payable	(661,255)	671,294
Accrued payroll and related liabilities	(24,075)	45,106
Estimated third-party payor settlements	271,722	67,384
Deferred compensation payable	32	(3,122)
Professional liability claims payable	(43,627)	29,594
Other post-employment benefits and related deferred inflows and outflows of resources	1,261,698	1,167,167
Net cash provided by (used in) operating activities	$ (1,078,740)	$ 4,648,849
Reconciliation of cash and cash equivalents to the statements of net position:		
Cash and cash equivalents in current assets	$ 26,877,586	$ 28,119,490
Noncurrent cash and cash equivalents	11,801,844	5,669,262
Total cash and cash equivalents	$ 38,679,430	$ 33,788,752
Noncash capital and financing activites:		
Equipment acquired under capital lease obligations	$ 775,044	-
Forgiveness of debt	2,355,800	-
Supplemental cash flow information:		
Taxes receivable	$ 49,912	$ 44,192

See accompanying notes to the financial statements.

Skagit County Public Hospital District No. 2 d/b/a Island Hospital

Notes to Financial Statements

Note 1: Summary of Significant Accounting Policies

The Entity

The financial statements include the accounts of Skagit County Public Hospital District No. 2 d/b/a Island Hospital (the "Hospital"), located in Anacortes, Washington, and Island Hospital Medical Properties.

The Hospital is organized as a municipal corporation pursuant to the laws of the state of Washington. As organized, the Hospital is exempt from federal income tax. The Hospital's Board of Commissioners is comprised of five community members elected by local voters to six-year terms. The Hospital is not considered to be a component unit of the County. The Hospital is an acute-care community hospital with 43 licensed beds that provides services for Anacortes and surrounding communities. As of September 22, 2017, the Hospital operates two primary care clinics: Anacortes Family Medicine and Fidalgo Medical Associates at Island Hospital. Prior to that, the Hospital also operated two primary care clinics out in the San Juan Islands, Lopez Island Medical Center and Orcas Medical Clinic.

Island Hospital Medical Properties is a Washington nonprofit corporation organized and operated for the exclusive purpose within the meaning of Internal Revenue Code 501 (c)(2) of holding title to property in support of its sole member, Skagit County Public Hospital District No. 2. The application for acquiring the 501 (c)(2) status was accepted by the Internal Revenue Service (IRS) in June 2012. Island Hospital Medical Properties is a blended component unit of the Hospital, and activity related to Island Hospital Medical Properties is reflected in the financial statements. As of August 2, 2018, this entity was dissolved, with its assets, liabilities, and net assets being absorbed by the Hospital.

Financial Statement Presentation

The financial statements have been prepared in accordance with accounting principles generally accepted in the United States (GAAP) as prescribed by the Governmental Accounting Standards Board (GASB).

The accounting records of the Hospital are maintained in accordance with methods prescribed by the State Auditor under the authority of Chapter 43.09 RCW and the *Washington State Department of Health Accounting and Reporting Manual for Hospitals*.

The Hospital's statements are reported using the economic resources measurement focus and full accrual basis of accounting. Revenue is recorded when earned, and expenses are recorded when the liability is incurred, regardless of the timing of the cash flows. Property taxes are recognized as revenue in the year in which they are levied. Grants and similar items are recognized as revenue as soon as eligibility requirements imposed by the provider have been met.

Note 1: Summary of Significant Accounting Policies (Continued)

Use of Estimates

The preparation of the accompanying financial statements in conformity with GAAP requires management to make certain estimates and assumptions that directly affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results may differ from these estimates.

Cash and Cash Equivalents

The Hospital considers all highly liquid debt instruments, including noncurrent cash and cash equivalents, with an original maturity of three months or less to be cash equivalents.

Patient Accounts Receivable and Credit Policy

Patient accounts receivable are uncollateralized patient obligations that are stated at the amount management expects to collect from outstanding balances. These obligations are primarily from local residents, most of whom are insured under third-party payor agreements. The Hospital bills the third-party payors on the patient's behalf, or, if a patient is uninsured, the patient is billed directly. Once claims are settled with the primary payor, any secondary payor is billed, and patients are billed for copay and deductible amounts that are the patients' responsibility. Payments on patient accounts receivable are applied to the specific claim identified on the remittance advice or statement. The Hospital does not have a policy to charge interest on past due accounts.

Patient accounts receivable are recorded in the accompanying statements of net position net of contractual adjustments and an allowance for uncollectable accounts, which reflect management's estimate of the amounts that will not be collected. The carrying amounts of patient accounts receivable are reduced by allowances that reflect management's estimate of the amounts that will not be collected. Management provides for contractual adjustments under terms of third-party reimbursement agreements through a reduction of gross revenue and a credit to patient accounts receivable. In addition, management provides for probable uncollectable amounts, primarily for uninsured patients and amounts patients are personally responsible for, through a reduction of gross revenue and a credit to the allowance for uncollectable accounts.

In evaluating the collectability of patient accounts receivable, the Hospital analyzes past results and identifies trends for each of its major payor sources of revenue to estimate the appropriate allowance for uncollectable accounts and provision for bad debts. Management regularly reviews data from the major payor sources of revenue in evaluating the sufficiency of the allowance for uncollectable accounts and a provision for bad debts for expected uncollectable deductibles and copayments on accounts for which the third-party payor has not yet paid or for payors who are known to be having financial difficulties that make the realization of amounts due unlikely.

Note 1: Summary of Significant Accounting Policies (Continued)

Patient Accounts Receivable and Credit Policy (Continued)

For receivables associated with self-pay patients (which includes patients without insurance and patients with deductible and copayment balances due for which third-party coverage exists for part of the bill), the Hospital records a significant provision for bad debts in the period of service on the basis of its past experience, which indicates that many patients are unable or unwilling to pay the portion of their bill for which they are financially responsible. The difference between the standard rates (or undiscounted rates, if negotiated) and the amounts actually collected after all reasonable collection efforts have been exhausted is charged off against the allowance for doubtful accounts.

Inventories

Inventories consist of medical, surgical, and pharmaceutical supplies and are stated at the lower of cost, determined by the last-in, first-out method, or net realizable value.

Investments

Investments in debt and equity securities are reported at fair value except for short-term highly liquid investments that have a remaining maturity of one year or less at the time they are purchased. These investments are carried at amortized cost. Interest, dividends, and gains and losses, both realized and unrealized, on investments in debt and equity securities are included in nonoperating revenues when earned.

Fair Value Measurements

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The Hospital measures fair value of its financial instruments using a three-tier hierarchy that prioritizes the inputs used in measuring fair value. These tiers include Level 1, defined as observable inputs such as quoted market prices in active markets; Level 2, defined as inputs other than quoted market prices in active markets that are either directly or indirectly observable; and Level 3, defined as unobservable inputs in which little or no market data exists, therefore requiring an entity to develop its own assumptions. The asset's or liability's fair value measurement level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement.

Noncurrent Cash, Cash Equivalents, and Investments

Noncurrent cash, cash equivalents, and investments include assets set aside for future capital improvements or other designated uses over which the Board of Commissioners retains control and assets restricted by donors or by bond agreements for capital improvements or debt service.

Note 1: Summary of Significant Accounting Policies (Continued)

Capital Assets

Capital assets are stated at historical cost. Equipment under capital leases is stated at the present value of minimum lease payments. Maintenance, repairs, and minor replacements are charged to expense as incurred. The Hospital's policy is to capitalize all capital asset expenditures exceeding $1,000. Depreciation is computed on a straight-line basis over the estimated useful lives of the assets. Equipment held under capital leases and leasehold improvements is amortized using the straight-line method over the shorter of the lease term or estimated useful life of the asset. Such amortization is included in depreciation and amortization expense in the accompanying financial statements. The Hospital estimates the useful lives of assets to be as follows:

Land improvements	15 to 20 years
Buildings and leasehold improvements	13 to 60 years
Equipment	3 to 20 years

Gifts of long-lived assets such as land, buildings, or equipment are reported as unrestricted support and are excluded from excess of revenue over expenses, unless explicit donor stipulations specify how the donated assets must be used. Gifts of long-lived assets with explicit restrictions that specify how the assets are to be used and gifts of cash or other assets that must be used to acquire long-lived assets are reported as restricted support. Absent explicit donor stipulations about how long those long-lived assets must be maintained, the Hospital reports expirations of donor restrictions when the donated or acquired long-lived assets are placed into service.

Impairment of Long-Lived Assets

Capital assets are reviewed for impairment when events or changes in circumstances suggest that the service utility of the capital asset may have significantly and unexpectedly declined. Capital assets are considered impaired if both the decline in service utility of the capital asset is large in magnitude, and the event or change in circumstances is outside the normal life cycle of the capital asset. Such events or changes in circumstances that may be indicative of impairment include evidence of physical damage, enactment or approval of laws or regulations or other changes in environmental factors, technological changes or evidence of obsolescence, changes in the manner or duration of use of a capital asset, and construction stoppage. The determination of the impairment loss is dependent upon the event or circumstance in which the impairment occured. Impairment losses, if any, are reported in the accompanying statments of revenue, expenses, and changes in net position. During 2018 and 2017, the Hospital determined that no evaluations of recoverability were necessary.

Intangible Assets

Intangible assets include goodwill and restrictive covenants related to the purchase of the Island Radiology practice in January 2004, the purchase of Fidalgo Medical Associates in 2008, and the purchase of Island Surgeons in 2009. Goodwill is reviewed annually for impairment. The value of the restrictive covenants was fully amortized in prior fiscal years.

Note 1: Summary of Significant Accounting Policies (Continued)

Deferred Outflows/Inflows of Resources

In addition to assets, the statements of net position will sometimes report a separate section of deferred outflows of resources. This separate financial statement element, deferred outflows of resources, represents a consumption of net position that applies to a future period and so will not be recognized as an outflow of resources (expense) until then. The Hospital reports deferred outflows of resources for contributions to other post-employement benefit plans subsquent to the measurement date of the other post-employment benefits liability. In addition, the Hospital has recognized losses on refunding of long-term debt, resulting from a difference in the carrying value of refunded debt and its reacquisition price. The loss on refunding of long-term debt is recognized as a deferred outflow of resources and amortized over the life of the new debt, using the effective interest method.

In addition to liabilities, the statements of net position will sometimes report a separate section for deferred inflows of resources. This separate financial statement element, deferred inflows of resources, represents the acquisition of net position that applies to a future period and so will not be recognized as an inflow of resources (revenue) until that time. The Hospital reports deferred inflows of resources related to its other post-employment benefits liability.

Compensated Absences

The Hospital's employees earn paid time-off for vacation, holidays, and short-term illnesses at varying rates, depending on years of service. The related liability is accrued during the period in which it is earned.

Net Position

Net position of the Hospital is classified into three components. Net investment in capital assets consists of capital assets net of accumulated depreciation and reduced by the current balances of any outstanding borrowings used to finance the purchase or construction of those assets. Restricted net position is noncapital net position that must be used for a particular purpose as specified by creditors, grantors, contributors external to the Hospital, or laws or regulations of other governments or imposed by law through constitutional provisions or enabling legislation and includes amounts deposited with trustees as required by revenue bond indenture and note payable escrow agreements. Unrestricted net position is remaining net position that does not meet the definition of net investment in capital assets or restricted net position.

When both restricted and unrestricted resources are available for use, it is the Hospital’s policy to use externally restricted resources first.

Note 1: Summary of Significant Accounting Policies (Continued)

Operating Revenue and Expenses

The Hospital's statements of revenue, expenses, and changes in net position distinguish between operating and nonoperating revenue and expenses. Operating revenue results from exchange transactions associated with providing health care services, the Hospital's principal activity. Operating expenses are all expenses incurred to provide health care services, other than financing costs. All other revenue and expenses not meeting these definitions, including property tax revenue, investment income, interest income, and interest expense, are reported as nonoperating revenue and expenses.

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. Estimated uncollectable revenue is reported as provision for bad debts in the financial statements. 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. Some health care is provided with the knowledge that it will not be reimbursed. This is reported under charity care/financial assistance.

For uninsured patients who do not qualify for charity care/financial assistance, the Hospital recognizes revenue on the basis of its standard rates for services provided (or on the basis of discounted rates, if negotiated or provided by policy). On the basis of historical experience, a significant portion of the Hospital's uninsured patients will be unable or unwilling to pay for services provided. Thus, the Hospital records a provision for bad debts related to uninsured patients in the period the services are provided.

Charity Care/Financial Assistance

The Hospital provides care to patients who meet certain criteria under its charity care/financial assistance policy without charge or at amounts less than established rates. The Hospital maintains records to identify the amount of charges foregone for services and supplies furnished under its charity care/financial assistance policy. Because the Hospital does not pursue collection of amounts determined to qualify as charity care/financial assistance, they are not reported as net patient service revenue in the accompanying statements of revenue, expenses, and changes in net position.

Advertising Costs

Advertising costs are expensed as incurred.

Note 1: Summary of Significant Accounting Policies (Continued)

Electronic Health Record Incentive Payments

The American Recovery and Reinvestment Act of 2009 (ARRA) provides for incentive payments under the Medicare and Medicaid programs for certain hospitals and physician practices that demonstrate meaningful use of certified Electronic Health Record technology. These provisions of ARRA, collectively referred to as the Health Information Technology for Economic and Clinical Health Act (the "HITECH Act"), are intended to promote the adoption and meaningful use of health information technology and qualified EHR technology.

The Hospital recognizes revenue for EHR incentive payments when there is reasonable assurance that the Hospital will meet the conditions of the program, primarily demonstrating meaningful use of certified EHR technology for the applicable period. The demonstration of meaningful use is based on meeting a series of objectives. Meeting the series of objectives in order to demonstrate meaningful use becomes progressively more stringent as its implementation is phased in through stages as outlined by the Centers for Medicare & Medicaid Services (CMS).

Amounts recognized under the Medicare and Medicaid EHR incentive programs are based on management's estimates, which are based in part on cost report data that is subject to audit by fiscal intermediaries; accordingly, amounts recognized are subject to change. In addition, the Hospital's attestation of its compliance with the meaningful use criteria is subject to audit by the federal government or its designee. The Hospital incurs both capital expenditures and operating expenses in connection with the implementation of its EHR initiative. The amount and timing of these expenditures does not directly correlate with the timing of the Hospital's receipt or recognition of the EHR incentive payments.

Grants and Contributions

From time to time, the Hospital receives grants from Skagit County and the state of Washington, as well as contributions from individuals and private organizations. Revenue from grants and contributions may be restricted for either specific operating purposes or capital purposes. Amounts that are unrestricted or that are restricted for a specific operating purpose are reported as nonoperating revenue. Amounts restricted for capital acquisitions are reported after nonoperating revenue and expenses.

New Accounting Pronouncements

In June 2018, the GASB issued Statement No. 89, *Accounting for Interest Cost Incurred Before the End of a Construction Period*. The statement requires that interest cost incurred before the end of a construction period be recognized as an expense in the period in which the cost is incurred for financial statements prepared using the economic resources measurement focus. The statement is effective for periods beginning after December 15, 2019, however, early adoption is encouraged. The District adopted the statement for the year ended December 31, 2018. The statement was applied prospectively and had no effect on the District's financial statements as of and for the years ended December 31, 2018 and 2017.

Note 1: Summary of Significant Accounting Policies (Continued)

Subsequent Events

Subsequent events have been evaluated through April 24, 2019, which is the date the financial statements were available to be issued.

Note 2: Deposits and Investments

Credit risk: The *Revised Code of Washington* (RCW), Chapter 39, authorizes municipal governments to invest their funds in a variety of investments, including federal, state, and local government certificates, notes, or bonds; the State of Washington Local Government Investment Pool; savings accounts in qualified public depositories; and certain other investments.

Custodial credit risk: State law requires collateralization of all deposits with federal depository insurance or other acceptable collateral. The Hospital's cash on deposit with banks is insured through the Federal Deposit Insurance Corporation up to $250,000 per financial institution. Cash on deposit with the Washington State Local Government Investment Pool and with qualified public depositaries is protected against loss by the State of Washington Public Deposit Protection Commission, as provided for by RCW 39.58, subject to certain limitations.

The Skagit County Treasurer acts as the treasurer for certain deposits and investments of the Hospital. Deposits that are not covered by depository insurance are collateralized in the name of the County, and uninsured investments are registered in the name of the County.

Interest rate risk: The District does not have a formal investment policy that limits investment maturities as a means of managing its exposure to fair value losses arising from increasing interest rates.

Cash and cash equivalents consisted of the following at December 31:

	2018	2017
Cash on hand	$ 3,250	$ 3,250
Washington Federal Bank, depository accounts	2,300,419	890,389
Skagit County Treasurer's Office	2,045,599	1,348,483
Washington State Local Government Investment Pool	22,528,318	25,877,368
Total cash and cash equivalents	$ 26,877,586	$ 28,119,490

Note 2: Deposits and Investments (Continued)

Average days to maturity of Washington State Local Government Investment Pool assets was 42 days at December 31, 2018.

The Washington State Local Government Investment Pool is not registered with the Securities and Exchange Commission (SEC) as an investment company. It is a voluntary investment vehicle operated by the Washington State Treasurer. Over 530 local governments have participated in the Pool since it was started in 1986 to provide safe, liquid, and competitive investment options for local governments pursuant to the Revised Code of Washington (RCW) 43.250. All investments are subject to written policies and procedures adopted by the State Treasurer's Office. The Washington State Local Government Investment Pool is considered extremely low risk. Funds are invested in a portfolio of securities in a manner generally consistent with the SEC's Rule 2A-7 of the Investment Company Act of 1940 as it currently stands. The Washington State Local Government Investment Pool functions as a demand deposit account where the County receives an allocation of its proportionate share of pooled earnings using an amortized cost methodology. Unrealized gains and losses due to changes in the fair values are not distributed to the District.

The Washington State Local Government Investment Pool manages a portfolio of securities that meet the maturity, quality, diversification, and liquidity requirements set forth by the Governmental Accounting Standards Board (GASB) for external investment pools that elect to measure, for financial reporting purposes, investments at amortized cost.

The Washington State Local Government Investment Pool transacts with its participants at a stable net asset value per share of $1.00, the same method used for reporting. Participants may contribute and withdraw funds on a daily basis. Participants must inform the Office of the State Treasurer (OST) of any contribution or withdrawal over one million dollars no later than 9am on the same day the transaction is made. Contributions or withdrawals for one million dollars or less can be requested at any time prior to 10am on the day of the transaction. However, participants may complete transactions greater than one million dollars when notification is made between 9am and 10am, at the sole discretion of OST. All participants are required to file with the State Treasurer documentation containing the names and titles of the officials authorized to contribute or withdraw funds. The Washington State Local Government Investment Pool does not impose liquidity fees or redemption gates on participant withdrawals.

The Washington State Local Government Investment Pool is not subject to the fair value hierarchy disclosures and is considered cash for purposes of presenting cash flows.

Note 2: Deposits and Investments (Continued)

Noncurrent cash, cash equivalents, and investments consisted of the following at December 31:

	2018	2017
Internally designated by Board:		
Cash and cash equivalents - Capital improvements	$ 109,745	$ 131,952
Accrued interest - Capital improvements	59,183	33,131
Washington State Local Government Investment Pool - Capital improvements	614,690	1,049,085
Investments - Deferred compensation arrangements	463,709	451,556
Total internally designated by the Board	1,247,327	1,665,724
Restricted:		
Proceeds of 2004/2012 Unlimited Tax General Obligation bonds to be used for capital improvements		
Cash and cash equivalents	177,891	165,454
Washington State Local Government Investment Pool	227,879	210,385
Totals	405,770	375,839
Restricted for the repayment of 2005/2014 Refunding Limited Tax General Obligation Bonds:		
Cash and cash equivalents	214,837	75,789
Washington State Local Government Investment Pool	2,707,422	1,046,641
Totals	2,922,259	1,122,430
Restricted proceeds of 2014 Limited Tax General Obligation issues to be used for capital improvements - Washington State Local Government Investment Pool	701	223,957
Restricted for the repayment of new market tax credit loans - Cash and cash equivalents	1,700,972	2,732,868
Restricted proceeds of 2018 Limited Tax General Obligation Bonds to be used for capital improvements - Cash and cash equivalents	5,988,524	-
Total restricted	11,018,226	4,455,094
Total noncurrent cash, cash equivalents, and investments	12,265,553	6,120,818
Less - Current portion	22,077	244,985
Noncurrent cash, cash equivalents, and investments - Less current portion	$ 12,243,476	$ 5,875,833

Note 3: Fair Value Measurements

The following is a description of the valuation methodologies used for assets measured at fair value.

Money market funds: Valued using a net asset value (NAV) of $1.

Mutual funds: Valued at the daily closing price as reported by the fund. Mutual funds held by the Hospital are open-end mutual funds that are registered with the U.S. Securities and Exchange Commission. These funds are required to publish their daily NAV and to transact at that price. The mutual funds held by the Hospital are deemed to be actively traded.

Equities: The fair value for equities is determined based on quoted market prices and other observable market data.

The Hospital's investments by level within the fair value hierarchy were as follows at December 31, 2018:

	Level 1	Level 2	Level 3	Total Assets at Fair Value
Money market funds	$ 129,527	$ -	$ -	$ 129,527
Mutual funds	290,120	-	-	290,120
Equities	44,062	-	-	44,062
Total investments at fair value	$ 463,709	$ -	$ -	$ 463,709

The Hospital's investments by level within the fair value hierarchy were as follows at December 31, 2017:

	Level 1	Level 2	Level 3	Total Assets at Fair Value
Money market funds	$ 243,865	$ -	$ -	$ 243,865
Mutual funds	146,573	-	-	146,573
Equities	61,118	-	-	61,118
Total investments at fair value	$ 451,556	$ -	$ -	$ 451,556

Note 4: Patient Accounts Receivable

The Hospital has a concentration of credit risk with respect to unsecured patient accounts receivable. The majority of the Hospital's patients are local residents and are insured under third-party payor agreements.

Patient accounts receivable consisted of the following at December 31:

	2018	2017
Patients and their insurance carriers	$ 6,995,166	$ 5,240,661
Medicare	3,170,275	3,253,133
Medicaid	1,339,343	1,018,314
Total patient accounts receivable, net of contractual allowances	11,504,784	9,512,108
Less - Allowance for doubtful accounts	1,790,390	778,746
Patient receivables - Net	$ 9,714,394	$ 8,733,362

Note 5: Reimbursement Arrangements With Third-Party Payors

The Hospital has agreements with third-party payors that provide for reimbursement at amounts that vary from the Hospital's established rates. A summary of the basis of reimbursement with major third-party payors follows:

Medicare

Inpatient acute care services provided by the Hospital rendered to Medicare program beneficiaries are paid primarily at prospectively determined rates per discharge. These rates vary according to a patient classification system that is based on clinical, diagnostic, and other factors. Outpatient services provided to Medicare program beneficiaries are reimbursed on a prospective payment methodology, also based on a patient classification system, and fee schedules.

Medicaid

Medicaid reimbursement for Hospital inpatient services is based on a cost-reimbursement methodology whereby the Hospital's costs are estimated using a cost-to-charge ratio from an established base-year. Medicaid reimbursement for most outpatient hospital and clinic services is prospectively set based on the ratio of estimated aggregate costs to aggregate charges. Certain outpatient services and physician services are reimbursed based on predetermined fee schedules.

Note 5: Reimbursement Arrangements With Third-Party Payors (Continued)

Other

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

Physician and Professional Services in Rural Health Clinics

Certain physician and professional services rendered to Medicare and Medicaid beneficiaries qualify for reimbursement as Medicare-approved rural health clinic services. Qualifying services are reimbursed based on a cost-reimbursement methodology. Under federal law, rural health clinics also are entitled to receive an additional payment for the difference between cost and the amount paid by Medicaid managed-care health plans. All other physician and professional services rendered to Medicare and Medicaid beneficiaries are paid based on prospectively determined fee schedules.

Accounting for Contractual Arrangements

The Hospital is reimbursed for certain cost-reimbursable items at an interim rate, and final settlements are determined after an audit of the Hospital's related annual cost reports by the respective Medicare and Medicaid fiscal intermediaries. Estimated provisions to approximate the final expected settlements after review by the intermediaries are included in the accompanying financial statements. Differences between the Hospital's estimates and subsequent final settlements by the Medicare and Medicaid fiscal intermediary will be included in future statements of revenue, expenses, and changes in net position. The cost reports for the Hospital have been audited by Medicare intermediaries through December 31, 2014.

Medicare and Medicaid EHR Incentive Funding

The Hospital has applied for and received funding from the Medicare and Medicaid EHR incentive program. The funding period for the EHR incentive program is based on eligible hospitals submitting applications to the program prior to each federal fiscal year ending September 30.

Under the program, the Hospital recognized $29,296 and $140,369 in incentive revenue for the years ended December 31, 2018 and 2017, respectively. The revenue has been recognized as other operating revenue in the statements of revenue, expenses, and changes in net position.

Note 5: Reimbursement Arrangements With Third-Party Payors (Continued)

Compliance

The health care industry is subject to numerous laws and regulations of federal, state, and local governments. These laws and regulations include, but are not necessarily limited to, matters such as licensure, accreditation, government health care program participation requirements, reimbursement for patient services, and billing regulations. Government activity with respect to investigations and allegations concerning possible violations of such regulations by health care providers has increased. Violations of these laws and regulations could result in expulsion from government health care programs, together with the imposition of fines and penalties, as well as repayments for patient services previously billed. 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.

CMS uses recovery audit contractors (RAC) as part of its efforts to ensure accurate payments. RACs search for potentially inaccurate Medicare payments that might have been made to health care providers and that were not detected through existing CMS program integrity efforts. Once the RAC identifies a claim it believes is inaccurate, it makes a deduction from or addition to the provider's Medicare reimbursement in an amount estimated to equal the overpayment or underpayment. Certain states also have hired Medicaid Integrity Contractors (MIC) to perform audits similar to RACs. The Hospital will have the ability to appeal adjustments before final settlement of the claim is made. As of December 31, 2018, the Hospital has not been notified by any RAC or MIC of any potential significant reimbursement adjustments.

Note 6: Capital Assets

Capital assets activity for the year ended December 31, 2018, was as follows:

	Beginning Balance	Additions	Transfers	Retirements	Ending Balance
Depreciable capital assets:					
Land improvements	$ 2,130,330	$ -	$ -	$ -	$ 2,130,330
Buildings and leasehold improvements	70,037,832	-	3,155,070	-	73,192,902
Fixed equipment	8,808,918	-	-	-	8,808,918
Major moveable equipment	28,995,534	1,181,584	8,285,265	(3,248,386)	35,213,997
Total depreciable capital assets	109,972,614	1,181,584	11,440,335	(3,248,386)	119,346,147
Less accumulated depreciation for :					
Land improvements	1,583,532	270,764	-	-	1,854,296
Buildings and leasehold improvements	23,541,051	1,740,083	-	-	25,281,134
Fixed equipment	6,769,087	365,724	-	-	7,134,811
Major movable equipment	23,273,713	2,433,147	-	(3,220,760)	22,486,100
Total accumulated depreciation	55,167,383	4,809,718	-	(3,220,760)	56,756,341
Depreciable capital assets - Net	54,805,231	(3,628,134)	11,440,335	(27,626)	62,589,806
Nondepreciable capital assets:					
Artwork	314,539	2,192	-	(3,186)	313,545
Land	4,708,577	-	-	-	4,708,577
Construction in progress	5,868,665	6,138,204	(11,440,335)	-	566,534
Total nondepreciable capital assets	10,891,781	6,140,396	(11,440,335)	(3,186)	5,588,656
Capital assets - Net	$ 65,697,012	$ 2,512,262	$ -	$ (30,812)	$ 68,178,462

Construction in progress at December 31, 2018, consisted of facilities improvement projects and various small improvement projects within the Hospital.

Note 6: Capital Assets (Continued)

Capital assets activity for the year ended December 31, 2017, was as follows:

	Beginning Balance	Additions	Transfers	Retirements	Ending Balance
Depreciable capital assets:					
Land improvements	$ 2,130,330	$ -	$ -	$ -	$ 2,130,330
Buildings and leasehold improvements	69,647,251	41,662	348,919	-	70,037,832
Fixed equipment	8,707,357	-	101,561	-	8,808,918
Major movable equipment	28,658,057	762,409	236,886	(661,818)	28,995,534
Total depreciable capital assets	109,142,995	804,071	687,366	(661,818)	109,972,614
Less accumulated depreciation for :					
Land improvements	1,501,355	82,177	-	-	1,583,532
Buildings and leasehold improvements	21,985,527	1,555,524	-	-	23,541,051
Fixed equipment	6,356,192	412,895	-	-	6,769,087
Major movable equipment	21,864,141	2,050,625	-	(641,053)	23,273,713
Total accumulated depreciation	51,707,215	4,101,221	-	(641,053)	55,167,383
Depreciable capital assets - Net	57,435,780	(3,297,150)	687,366	(20,765)	54,805,231
Nondepreciable capital assets:					
Artwork	311,906	2,633	-	-	314,539
Land	4,708,577	-	-	-	4,708,577
Construction in progress	1,156,418	5,399,613	(687,366)	-	5,868,665
Total nondepreciable capital assets	6,176,901	5,402,246	(687,366)	-	10,891,781
Capital assets - Net	$ 63,612,681	$ 2,105,096	$ -	$ (20,765)	$ 65,697,012

Note 6: Capital Assets (Continued)

The Hospital's net investment in capital assets included the following at December 31:

	2018	2017
Capital assets - Net	$ 68,178,462	$ 65,697,012
Less:		
Long-term debt and capital lease obligations	49,270,233	45,749,200
Totals	$ 18,908,229	$ 19,947,812

Note 7: Purchase Option

The Hospital entered into an option agreement to purchase real property in March 2006. As part of the purchase option agreement, the Hospital made an initial payment to the seller of $300,000 as additional consideration for the rights granted to the Hospital under the agreement. If the Hospital exercises the purchase option, the Hospital will have a credit against the purchase price of $300,000 plus accrued interest earned at an annual rate of 6%. The Hospital has not exercised the purchase option as of December 31, 2018.

Note 8: Long-Term Liabilities

Long-term liabilities activity for the year ended December 31, 2018, was as follows:

	Beginning Balance	Additions	Reductions	Ending Balance	Amounts Due Within One Year
Long-term debt:					
2018 LTGO Bonds	$ -	$15,000,000	$ -	$ 15,000,000	$ -
2012 Refunding UTGO Bonds	22,390,000	-	(1,375,000)	21,015,000	1,480,000
2014 Refunding LTGO Bonds	10,575,000	-	(435,000)	10,140,000	460,000
NDC CDE Loan A	5,373,200	-	(5,373,200)	-	-
NDC CDE Loan B	1,770,800	-	(1,770,800)	-	-
Kitsap CDE Loan C	2,121,000	-	(2,121,000)	-	-
Kitsap CDE Loan D	729,000	-	(729,000)	-	-
Long-term debt before unamortized premiums	42,959,000	15,000,000	(11,804,000)	46,155,000	1,940,000
Unamortized premiums on long-term debt	2,624,297	-	(325,256)	2,299,041	-
Total long-term debt	45,583,297	15,000,000	(12,129,256)	48,454,041	1,940,000
Capital lease obligations - Medical equipment	165,903	775,044	(124,755)	816,192	192,782
Total long-term debt and capital lease obligations	45,749,200	15,775,044	(12,254,011)	49,270,233	2,132,782
Other long-term liabilities:					
Deferred compensation payable	458,104	12,185	-	470,289	-
Professional liability claims payable	445,927	-	(43,627)	402,300	-
Total other long-term liabilities	904,031	12,185	(43,627)	872,589	-
Total long-term liabilities	$ 46,653,231	$15,787,229	$(12,297,638)	$ 50,142,822	$ 2,132,782

Note 8: Long-Term Liabilities (Continued)

Long-term liabilities activity for the year ended December 31, 2017, was as follows:

	Beginning Balance	Additions	Reductions	Ending Balance	Amounts Due Within One Year
Long-term debt:					
2012 Refunding UTGO Bonds	$ 23,670,000	$ -	$ (1,280,000)	$ 22,390,000	$ 1,375,000
2014 Refunding LTGO Bonds	10,995,000	-	(420,000)	10,575,000	435,000
NDC CDE Loan A	5,373,200	-	-	5,373,200	5,373,200
NDC CDE Loan B	1,770,800	-	-	1,770,800	1,770,800
Kitsap CDE Loan C	2,121,000	-	-	2,121,000	2,121,000
Kitsap CDE Loan D	729,000	-	-	729,000	729,000
Long-term debt before unamortized premiums	44,659,000	-	(1,700,000)	42,959,000	11,804,000
Unamortized premiums on long-term debt	2,963,620	-	(339,323)	2,624,297	-
Total long-term debt	47,622,620	-	(2,039,323)	45,583,297	11,804,000
Capital lease obligations - Medical equipment	216,771	-	(50,868)	165,903	53,824
Total long-term debt and capital lease obligations	47,839,391	-	(2,090,191)	45,749,200	11,857,824
Other long-term liabilities:					
Deferred compensation payable	437,604	244,915	(224,415)	458,104	-
Professional liability claims payable	416,333	29,594	-	445,927	-
Total other long-term liabilities	853,937	274,509	(224,415)	904,031	-
Total long-term liabilities	$ 48,693,328	$ 274,509	$ (2,314,606)	$ 46,653,231	$11,857,824

Note 8: Long-Term Liabilities (Continued)

The terms and due dates of the Hospital's long-term debt and capital lease obligations are as follows:

2018 LTGO Bonds

Limited tax general obligation (LTGO) bonds of $15,000,000, dated June 11, 2018, were issued to fund repayment of the NDC CDE Loan A and Kitsap CDE Loan C, fund facility improvements, and other capital purchases.

Interest is payable semiannually on June 1 and December 1, beginning December 1, 2018, at 3.7%. The bonds mature in principal installments ranging from $560,000 in 2020 to $1,255,000 in 2038. Scheduled maturities will be subject to redemption at the option of the Hospital on any date, in whole or in part, at par plus accrued interest to the date of redemption.

2012 Refunding UTGO Bonds

Unlimited tax general obligation (UTGO) bonds of $26,550,000, dated September 26, 2012, were issued to advance refund and in substance defease the principal amounts totaling $26,730,000 of the 2004 unlimited tax general obligation bonds. The 2004 bonds were used to finance capital improvements for the Hospital.

Interest is payable semiannually on June 1 and December 1, beginning December 1, 2012, at rates that range from 2% to 5%. The bonds mature in principal installments ranging from $440,000 in 2012 to $2,850,000 in 2028. Scheduled maturities on and after December 1, 2023, will be subject to redemption at the option of the Hospital on and after December 1, 2023, in whole or in part, at par plus accrued interest to the date of redemption.

The Hospital irrevocably pledged to levy and collect taxes annually in sufficient amounts to pay the bond principal and interest payments when due. Such collections are reported as noncurrent cash and investments.

The recorded balance at the time of issuance included a bond premium of $3,585,459, which is being amortized using the effective interest method over the term of the bonds. The unamortized bond premium balance was $1,699,987 and $1,987,607 at December 31, 2018 and 2017, respectively.

As part of the advance refunding, a loss on refunding was incurred, considering the refunding of the 2004 bonds, actual cash received as part of the issuance, and unamortized premiums and issuance costs related to the 2004 and 2012 bonds. The loss on refunding in the original amount of $2,070,898 is being amortized using the effective interest rate method through 2028. The unamortized loss on refunding balance was $1,075,987 and $1,184,490 at December 31, 2018 and 2017, respectively.

2014 Refunding LTGO Bonds

LTGO bonds of $12,090,000, dated November 12, 2014, were issued to advance refund and in substance defease the principal amounts totaling $9,190,000 of the 2005 limited tax general obligation bonds plus additional funds. The 2005 bonds were used to finance capital improvements for the Hospital and advance refund 1996 limited tax general obligation bonds.

Note 8: Long-Term Liabilities (Continued)

2014 Refunding LTGO Bonds (Continued)

Interest is payable semiannually on June 1 and December 1, beginning December 1, 2014, at rates that range from 2% to 5%. The bonds mature in principal installments ranging from $320,000 in 2014 to $960,000 in 2033. Scheduled maturities on and after December 1, 2023, will be subject to redemption at the option of the Hospital on and after December 1, 2023, in whole or in part, at par plus accrued interest to the date of redemption.

The Hospital irrevocably pledged to levy and collect taxes annually in sufficient amounts to pay the bond principal and interest payments when due. Such collections are reported as noncurrent cash and investments.

The recorded balance at the time of issuance included a bond premium of $752,738, which is being amortized using the effective interest method over the term of the bonds. The unamortized bond premium balance was $599,054 and $636,690 at December 31, 2018 and 2017, respectively.

As part of the advance refunding, a loss on refunding was incurred, considering the refunding of the 2005 bonds, actual cash received as part of the issuance, and unamortized premiums and issuance costs related to the 2005 and 2014 bonds. The loss on refunding in the original amount of $393,417 is being amortized using the effective interest rate method through 2033. The unamortized loss on refunding balance was $314,404 and $334,157 at December 31, 2018 and 2017, respectively.

Community Development Entity (CDE) Loans

In August 2011, IHMP secured financing utilizing the New Market Tax Credit program. Washington Federal is the tax credit investor with NDC New Markets Investment LXIII, LLC and Kitsap County NMTC Subsidiary Allocatee Three, LLC. The terms of the CDE loans are as follows:

NDC CDE Loan A: Original amount of $5,373,200; interest-only payments at 4.829% through August 2018; balloon principal payment due August 2018. This loan was paid-in-full with proceeds from the issuance of the 2018 LTGO bonds.

NDC CDE Loan B: Original amount of $1,770,800; interest-only payments at 4.829% through August 2041; balloon principal payment due August 2041. The balance of this loan was forgiven in August 2018.

Kitsap CDE Loan C: Original amount of $2,121,000; interest-only payments at 4.829% through August 2018; balloon principal payment due August 2018. This loan was paid-in-full with proceeds from the issuance of the 2018 LTGO bonds.

Kitsap CDE Loan D: Original amount of $729,000; interest-only payments at 4.829% through August 2041; balloon principal payment due August 2041. The balance of this loan was forgiven in August 2018.

Note 8: Long-Term Liabilities (Continued)

Capital Lease Obligations

The Hospital has entered into several agreements for the lease of various pieces of medical equipment. The agreements expire on various dates through 2028. The interest rates vary from 4.81% to 6.65%. Depreciation of the assets recorded under capital leases is included in depreciation in the accompanying statements of revenue, expenses, and changes in net position.

Equipment under capital lease obligations as of December 31 is as follows:

	2018	2017
Historical cost	$ 1,032,302	$ 257,258
Less: Accumulated amortization	194,156	107,087
Equipment acquired under capital lease obligations - Net	$ 838,146	$ 150,171

Aggregate future annual principal and interest payments related to long-term debt and capital lease obligations are as follows:

	Long-Term Debt		Capital Lease Obligations	
	Principal	Interest	Principal	Interest
2019	$ 1,940,000	$ 1,958,625	$ 192,782	$ 38,978
2020	2,645,000	1,881,025	198,203	28,403
2021	2,800,000	1,776,905	147,966	19,333
2022	2,965,000	1,666,630	35,831	14,308
2023	3,155,000	1,531,435	37,852	12,287
2024-2028	18,975,000	5,329,950	203,558	27,085
2029-2033	7,830,000	2,106,763	-	-
2034-2038	5,845,000	664,520	-	-
Total long-term debt and capital lease obligations	$ 46,155,000	$ 16,915,853	$ 816,192	$ 140,394

Note 9: Line of Credit

The Hospital entered into a secured revolving line of credit agreement dated Februray 1, 2018, with a maximum principal amount of up to $4,000,000 and an interest rate equal to the three month London Inter-bank Offer Rate plus 2.00%, resetting every three months on January 1, April 1, July 1, and October 1 of each year. Interest-only payments are due quarterly, with principal due at maturity on February 1, 2020. The lender has the option to extend the maturity an additional 12 months on each anniversary of the closing date. There was $1,725,000 in outstanding borrowings on the line of credit as of December 31, 2018.

Note 10: Net Patient Service Revenue

Net patient service revenue consisted of the following for the years ended December 31:

	2018	2017
Gross patient service revenue	$ 230,662,942	$ 230,567,903
Less: Charity care/financial assistance	503,872	628,278
Totals	230,159,070	229,939,625
Contractual adjustments:		
Medicare	77,964,473	77,926,456
Medicaid	15,831,180	17,405,942
Other	42,779,942	39,199,415
Total contractual adjustments	136,575,595	134,531,813
Provision for bad debts	1,535,434	1,621,023
Net patient service revenue	$ 92,048,041	$ 93,786,789

Gross patient service revenue by payor was as follows for the years ended December 31:

	2018	2017
Medicare	52 %	53 %
Medicaid	11 %	12 %
Other government	12 %	11 %
Other third-party payors	24 %	23 %
Self-pay	1 %	1 %
Totals	100 %	100 %

Note 11: Charity Care/Financial Assistance

The Hospital provides health care services and other financial support through various programs that are designed, among other matters, to enhance the health of the community, including the health of low-income patients. Consistent with the mission of the Hospital, health care is provided to patients regardless of their ability to pay, including providing services to those persons who cannot afford health insurance because of inadequate resources.

Patients who meet certain criteria for charity care/financial assistance, generally based on federal poverty guidelines, are provided care based on criteria defined in the Hospital's charity care/financial assistance policy. The Hospital maintains records to identify and monitor the level of charity care/financial assistance it provides. The amount of charges foregone for services and supplies furnished under the Hospital's charity care/financial assistance policy aggregated $503,872 and $628,278 for the years ended December 31, 2018 and 2017, respectively.

The estimated cost of providing care to patients under the Hospital's charity care/financial assistance policy aggregated approximately $219,000 and $268,000 for the years ended December 31, 2018 and 2017, respectively. The cost was calculated by multiplying the ratio of cost to gross charges for the Hospital times the gross uncompensated charges associated with providing charity care/financial assistance.

Note 12: Pension Plan and Deferred Compensation

Pension Plan

The Hospital has a defined contribution 401(a) and 403(b) plan that covers all of its eligible full-time benefited employees, called the Island Hospital Employees' Pension Plan (the "Plan"). The plan also includes a 457 plan for casual/part-time employees. The Plan is administered by VALIC Retirement Services Company. Plan terms are established and amended under the authority of the Hospital.

For the 401(a) plan, employees who have completed 18 months of employment, attained the age of 21, and are participating in the 403(b) plan are generally eligible to receive a 401(a) contribution under the Plan. The Plan provides for employer contributions based on a percentage of employee length of service. For eligible employees who defer at least 5% of their compensation, the Hospital makes contributions ranging from 6.1% to 6.5%. Employee contributions to the Plan were $3,050,890 and $2,580,970 for the years ended December 31, 2018 and 2017, respectively. The Hospital recognized pension plan expenses of $1,676,395 and $1,627,009 for the years ended December 31, 2018 and 2017, respectively.

All participating employees are 100% vested upon participation.

The Hospital has accrued a liability for pension contributions of $72,969 and $66,292 as of December 31, 2018 and 2017, respectively.

Note 12: Pension Plan and Deferred Compensation (Continued)

Deferred Compensation

The Hospital provides the Skagit County Public Hospital District No. 2 Supplemental Executive Retirement Plan (SERP), a 457(f) deferred compensation plan, to key employees under Section 457 of the Internal Revenue Code. Key employees are those specifically designated by the Hospital who qualify as a member of the "select group of management or highly compensated employees" for purposes of the Employee Retirement Income Security Act of 1974 and enter into a salary reduction agreement. This plan is administered by a compensation committee formed by the Hospital. The deferred compensation plan is funded by Hospital contributions of 7.64% of participating employees' compensation.

Participating employees are vested in the SERP upon the earlier of (a) completion of five full calendar years of service under the SERP, (b) reaching normal retirement age, (c) death, or (d) permanent disability. Any participant not vested who ceases to be an employee and ceases to earn benefit service shall forfeit the participant's right to benefits under the SERP. Forfeited amounts, if any, are used first to pay the SERP's administrative expenses, then to reduce the current-period contribution of the employer.

Hospital contributions to the plan were $89,194 for 2018 and $86,395 for 2017.

Note 13: Other Postemployment Benefits

The Hospital participates in an agent multiple-employer other postemployment benefits plan. In accordance with RCW 41.05.085 and RCW 41.05.022, eligible Hospital retirees and spouses are entitled to subsidies associated with postemployment health benefits provided through the Public Employee Benefits Board (PEBB). The PEBB was created within the Washington State Health Care Authority to administer medical, dental, and life insurance plans for public employees and retirees.

The subsidies provided by PEBB include the following:

- Explicit medical subsidy for post-65 retirees and spouses
- Implicit medical subsidy
- Implicit dental subsidy

The explicit subsidies are monthly amounts paid per post-65 retiree and spouse. As of the valuation date, the explicit subsidy for post-65 retirees and spouses is the lesser of $150 or 50% of the monthly premiums. As of January 1, 2019, the subsidy will be increased to $168 per month. The retirees and spouses currently pay the premium minus $150 when the premium is over $300 per month and pay half the premium when the premium is lower than $300 per month.

The implicit medical subsidy is the difference between the total cost of medical benefits and the premiums. For pre-65 retirees and spouses, the retiree pays the full premium amount, but that amount is based on a pool that includes active employees, who can be expected to have lower average health costs than retirees. For post-65 retirees and spouses, the retiree does not pay the full premium due to the subsidy discussed above.

Note 13: Other Postemployment Benefits (Continued)

As of the valuation date, the membership includes 585 active participants, 33 retirees and surviving spouses, and 15 spouses of current retirees.

Total OPEB Liability

	2018	2017
Total OPEB liability	$ 11,897,237	$ 9,863,713
Covered employee payroll	42,904,547	41,380,603
Total OPEB liablity as a % of covered employee payroll	27.73 %	23.84 %

The total OPEB liability was determined by an actuarial valuation as of the valuation date, calculated based on the discount rates below, and then projected to the measurement dates. There have been no significant changes between the valuation date and fiscal year-ends.

	2018	2017
Valuation date	January 1, 2017	January 1, 2017
Measurement date	December 31, 2017	December 31, 2016

Discount Rate

	2018	2017
Discount rate	3.44 %	3.78 %
20-year tax exempt municipal bond yield	3.44 %	3.78 %

The discount rate was based on the Bond Buyer General Obligation 20-bond municipal bond index for bonds that mature in 20 years.

Other Key Actuarial Assumptions

Census date	January 1, 2017
Price inflation	3.00%
Salary increase	3.75%
Actuarial cost method	Entry Age

Note 13: Other Postemployment Benefits (Continued)

Changes in Total OPEB Liability

	2018	2017
Beginning of year balance	$ 9,863,713	$ 9,077,550
Changes for the year:		
Service cost	927,542	949,231
Interest on total OPEB liability	406,108	356,394
Effect of assumptions changes or inputs	796,063	(431,143)
Expected benefit payments	(96,189)	(88,319)
End of year balance	$ 11,897,237	$ 9,863,713

Sensitivity Analysis

The following presents the total OPEB liability of the Hospital, as of the measurement date, calculated using the discount rates of 3.44% and 3.78%, as well as what the Hospital's total OPEB liability would be if it were calculated using a discount rate that is 1 percentage point lower or 1 percentage point higher than the current rate.

	2018	2017
1% decrease	2.44 %	2.78 %
Total OPEB liability	$ 14,700,648	$ 12,148,056
Discount rate	3.44 %	3.78 %
Total OPEB liability	$ 11,897,237	$ 9,863,713
1% increase	4.44 %	4.78 %
Total OPEB liability	$ 9,742,277	$ 8,101,961

The following presents the total OPEB liability of the Hospital, as of the measurement date, calculated using the current healthcare cost trend rates, as well as what the Hospital's total OPEB liability would be if it were calculated using trend rates that are 1 percentage point lower or 1 percentage point higher than the current trend rates. Health care trend rates are disclosed on page 45.

	2018	2017
1% decrease	$ 9,379,479	$ 7,881,721
Current trend rate	$ 11,897,237	$ 9,863,713
1% increase	$ 15,345,936	$ 12,545,330

Note 13: Other Postemployment Benefits (Continued)

OPEB Expense

For the years ended December 31, 2018 and 2017, the Hospital recognized OPEB expense of $1,261,698 and $1,167,167, respectively.

Schedule of Deferred Inflows and Deferred Outflows of Resources

At December 31, 2018, the Hospital reported deferred outflows of resources and deferred inflows of resources related to pensions as follows:

	Deferred Outflows of Resources	Deferred Inflows of Resources
Assumption changes or inputs	$ 371,413	$ -
Benefit payments subsequent to the measurement date	107,728	-
Total	$ 479,141	$ -

At December 31, 2017, the Hospital reported deferred outflows of resources and deferred inflows of resources related to pensions as follows:

	Deferred Outflows of Resources	Deferred Inflows of Resources
Assumption changes or inputs	$ -	$ 388,874
Benefit payments subsequent to the measurement date	96,189	-
Total	$ 96,189	$ 388,874

Economic/demographic (gains)/losses and assumption changes or inputs are recognized over the average remaining service life for all active and inactive members.

$107,728 reported as deferred outflows related to other postemployment benefits resulting from the Hospital's benefit payments subsequent to the measurement date will be recognized as a reduction of the total OPEB liability in the year ending December 31, 2019.

Note 13: Other Postemployment Benefits (Continued)

Other amounts currently reported as deferred outflows of resources and deferred inflows of resources related to other postemployment benefits will be recognized in OPEB expense as follows:

2019	$	35,776
2020		35,776
2021		35,776
2022		35,776
2023		35,776
Thereafter		192,533

Note that additional future deferred inflows and outflows of resources may impact these numbers.

Demographic Assumptions

Demographic assumptions regarding retirement, mortality, turnover, and marriage are based on assumptions used in the 2017 actuarial valuation of Washington State Public Employee Retirement System (PERS), and modified for the Hospital.

The assumed disability rates under PERS tier 2 and 3 from the 2017 actuarial valuation are less than 0.1% for ages 50 and below and continue to be low after that. The disability rate was assumed to be 0% for all ages.

For service retirement, post-2013, plans 2 and 3 were used, with less than 30 years of service assumptions from the 2017 actuarial valuation for PERS.

For mortality, the assumptions from the 2017 actuarial valuation for PERS (RP-2000 base mortality table, adjusted by -1 year for both males and females, with generational mortality adjustments using projection scale BB) were used.

For other termination of employment, the assumptions from the 2017 actuarial valuation for PERS were used, but no less than 2% per year.

Retirement eligibility: Members are eligible for service retirement at age 55 with 20 years of service or age 65 with 5 years of service.

Election assumption: 40% of members are assumed to elect medical benefits upon retirement. 40% of members are assumed to elect dental benefits upon retirement.

Election assumption (spouses): 45% of members are assumed to enroll eligible spouses as of the retirement date.

Medicare coverage: 100% of members are assumed to enroll in Medicare, once eligible, after initial participation.

Note 13: Other Postemployment Benefits (Continued)

Demographic Assumptions (Continued)

Spouse age: A male member is assumed to be three years older than his spouse, and female member is assumed to be one-year younger than her spouse.

Selection of carrier: All current and future retirees who elect medical and dental coverage are assumed to elect carriers based on the weighted average of selection of carriers by PEBB retirees.

Health Cost Trend

The health cost trend assumptions used in this valuation, assumed for both current and future retirees, are as follows:

Year	Pre-65	Post-65
2018	6.70 %	7.40 %
2019	7.00 %	7.40 %
2020	5.50 %	5.40 %
2025	5.90 %	5.60 %
2035	6.60 %	5.80 %
2045	6.20 %	5.70 %
2055	5.90 %	6.00 %
2065	5.60 %	5.60 %
2075	4.80 %	5.00 %
2085	4.80 %	4.90 %
2095+	4.80 %	4.90 %

Note 13: Other Postemployment Benefits (Continued)

2017 Premium Levels

The 2017 assumed annual medical retiree contributions used in the valuation are displayed below. These represent a weighted average of 2017 PEBB retiree contributions by medical plan, based on overall PEBB current retiree medical plan election. These contributions are assumed for both current retirees and future retirees. Contributions are the same for retirees and spouses of retirees. The contributions exclude the administration charge, the state surcharge reduction, the Limeade administration charge, the Consumer Directed Health Plan employer contribution, the Health Savings Account (HSA) administration fee, and the HSA wellness fee, as these are direct pass-through expenses that are 100% paid by retirees.

	Subscriber or Spouse	
Medical plan:	Non-Medicare	Medicare
Weighted average based on current PEBB retirees	$ 7,414.96	$ 2,631.95

The 2017 assumed annual dental retiree contributions are displayed below. These represent a weighted average of 2017 PEBB retiree contributions by dental plan, based on overall PEBB current retiree dental plan election. These contributions are assumed for both current retirees and future retirees.

Dental plan:	Subscriber	Spouse
Weighted average based on current PEBB retirees	$ 535.90	$ 542.79

Participant Data

The following participant data as of the valuation date was used:

	Attained Age At		
	Hire	Valuation	Count
Actives	39.5	46.6	585
Retirees	n/a	68.6	33

Note 14: Commitments Under Noncancelable Operating Leases

The Hospital is committed under various noncancelable operating leases, all of which are for buildings and equipment. These expire in various years through 2029. Future minimum operating lease payments are as follows:

	Amount
2019	$ 623,246
2020	623,246
2021	623,246
2022	623,246
2023	623,246
Total	$ 3,116,230

Note 15: Contingencies

Malpractice

The Hospital has professional liability insurance coverage with Washington Casualty Company. The policy provides protection on a "claims made" basis whereby only malpractice claims reported to the insurance carriers in the current year are covered by the current policies.

If there are unreported incidents that result in a malpractice claim in the current year, such claims will be covered in the year the claim is reported to the insurance carriers only if the Hospital purchases claims-made insurance in that year or the Hospital purchases "tail" insurance to cover claims incurred before but reported to the insurance carrier after cancellation or expiration of a claims-made policy.

The current malpractice insurance provides $1,000,000 per claim of primary coverage with a $5,000,000 annual aggregate limit plus $10,000,000 annual excess coverage per claim with a $10,000,000 annual aggregate. There are no significant deductibles or coinsurance clauses.

A liability of $402,300 has been accrued at December 31, 2018, for future coverage for acts occurring in this or prior years. Also, it is possible that claims may exceed coverage available in any given year.

Risk Management

The Hospital 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; natural disasters; and employee health, dental, and accident benefits. Commercial insurance coverage is purchased for claims arising from such matters. Settled claims have not exceeded this coverage in any of the three preceding years.

Health Care Reform

As a result of recently enacted federal health care reform legislation, substantial changes are anticipated in the United States' health care system. Such legislation includes numerous provisions affecting the delivery of health care services, the financing of health care costs, reimbursement of health care providers, and the legal obligations of health insurers, providers, and employers. These provisions are currently slated to take effect at specified times over approximately the next decade. The federal health care reform legislation does not affect the financial statements for the years ended December 31, 2018 and 2017.

Note 16: Functional Expenses

The Hospital provides general health care services to residents within its geographic location. Expenses related to providing these services, including interest expense, consisted of the following for the year ended December 31:

	2018	2017
Health care services	$ 92,175,577	$ 90,963,471
Management and administrative	7,856,110	7,401,827
Total expenses	$ 100,031,687	$ 98,365,298

Note 17: Tax Levy

The Hospital is permitted to levy an annual expense fund levy on the taxable property within the district without a vote of the taxpayers. In addition, taxes are levied annually on the taxable property within the district to service bond principal and interest payments on the 2012 UTGO Bonds, 2014 LTGO Bonds, and 2018 LTGO Bonds. Taxes to finance debt service on the UTGO bonds may be levied without limit as to rate and amount. The Hospital records property taxes on the accrual method.

Property taxes are levied by the County on the Hospital's behalf on January 1 and are intended to finance the Hospital's activities of the same calendar year. Amounts levied are based on assessed property values as of the preceding May 31. The state assessed a value base for the taxing district of approximately $5.7 billion with a maximum levy rate of 0.9316 and 0.6394 per $1,000 assessed value for the years ended December 31, 2018 and 2017, respectively.

The property tax calendar includes these dates:

Levy date	January 1
Lien date	January 1
Tax bill mailed	February 14
First installment payment due	April 30
Second installment payment due	October 31

Property taxes are considered delinquent on the day following each payment due date, and interest must be paid on delinquent taxes. No allowance for uncollectable taxes receivable was considered necessary at the statements of net position dates.

Note 17: Tax Levy (Continued)

The Hospital received approximately 5.3% and 3.4% of its financial support from property taxes in 2018 and 2017. These funds were available for the following:

	2018	2017
Maintenance and operations	$ 2,896,266	$ 1,061,170
Debt service	2,440,728	2,389,100
Total tax levy	$ 5,336,994	$ 3,450,270

Note 18: Investment in Joint Venture

Investment in Medical Information Network-North Sound

The Hospital has an investment in Medical Information Network-North Sound (MIN-NS) to develop, implement, and maintain an electronic health record system for health care providers in Skagit County. The Hospital has a 50% interest in the joint venture. The interest is accounted for using the equity method of accounting.

The operations of MIN-NS have resulted in a loss on investment in joint venture of $0 and $83,938 for the years ended December 31, 2018 and 2017, respectively, and a residual investment of $0. Upon withdrawal, members are required to fund their respective portion of current year losses, if any, incurred by the joint venture. This joint venture is scheduled to be closed as of March 31, 2019.

Copies of the MIN-NS financial statements are available upon request.

Note 19: Foundation

The Island Hospital Foundation (the "Foundation") is a nonprofit entity that was organized to solicit and accept charitable contributions in order to provide support for the Hospital. The Foundation provided contributions to the Hospital for various capital and other projects in the amounts of $971,078 and $996,846 during the years ended December 31, 2018 and 2017, respectively.

The Foundation's financial position was as follows at December 31:

	2018	2017
Assets	$ 2,938,528	$ 2,909,989
Liabilities	$ 59,056	$ 2,545
Net assets	2,879,472	2,907,444
Liabilities and net assets	$ 2,938,528	$ 2,909,989

Required Supplementary Information

Skagit County Public Hospital District No. 2 d/b/a Island Hospital

Required Supplementary Information

Schedule of Changes in Total OPEB Liability and Related Ratios - Other Postemployment Benefits

Total OPEB Liability	2018	2017
Service cost	$ 927,542	$ 949,231
Interest on total OPEB liability	406,108	356,394
Effect of assumption changes or inputs	796,063	(431,143)
Expected benefit payments	(96,189)	(88,319)
Net change in total OPEB liability	2,033,524	786,163
Total OPEB liability, beginning	9,863,713	9,077,550
Total OPEB liability, ending	$ 11,897,237	$ 9,863,713

GASB Statement 75 requires this information to be provided for 10 years. Because this is the second year of implementation, 10 years is not available.

Notes to Schedule

There are no changes of benefit terms.

Changes of assumptions and other inputs reflect the effects of changes in the discount rate each period.

WIPFLI LLP

Independent Auditor's Report on Internal Control Over Financial Reporting and on Compliance and Other Matters

Board of Commissioners
Skagit County Public Hospital District No. 2
d/b/a Island Hospital
Anacortes, Washington

We have audited, in accordance with auditing standards generally accepted in the United States and the standards applicable to financial audits contained in *Government Auditing Standards,* issued by the Comptroller General of the United States, the financial statements of Skagit County Public Hospital District No. 2 d/b/a Island Hospital (the "Hospital"), which comprise the statements of net position as of December 31, 2018 and 2017, and the related statements of revenue, expenses, and changes in net position and cash flows for the years then ended, and the related notes to the financial statements, and have issued our report thereon dated April 24, 2019.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Hospital's internal control over financial reporting ("internal control") to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Hospital's internal control. Accordingly, we do not express an opinion on the effectiveness of the Hospital's internal control.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented or detected and corrected on a timely basis. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit, we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Hospital's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Purpose of This Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the Hospital's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Hospital's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Wipfli LLP

Wipfli LLP

April 24, 2019
Spokane, Washington