REPORT OF INDEPENDENT AUDITORS
AND FINANCIAL STATEMENTS

PUBLIC HOSPITAL DISTRICT NO. 1 OF SKAGIT COUNTY, WASHINGTON

December 31, 2018 and 2017

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Report of Independent Auditors

To the Board of Commissioners
Public Hospital District No. 1 of Skagit County, Washington

Report on the Financial Statements

We have audited the accompanying financial statements of Public Hospital District No. 1 of Skagit County, Washington (the District) as of and for the years ended December 31, 2018 and 2017, and the related notes to the financial statements, which collectively comprise the District's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; 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 of America 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 Public Hospital District No. 1 of Skagit County, Washington, as of December 31, 2018 and 2017, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As discussed in Notes 2 and 10 to the financial statements, in 2018 the District adopted the accounting requirements of Governmental Accounting Standards Board Statement No. 75, Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions. Our opinion is not modified with respect to this matter.

Other Matter

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the accompanying Management's Discussion and Analysis on pages 3 through 19 and the Schedule of Changes in Total Other Post-Employment Benefits and Related Ratios on page 51 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, which considers it to be an essential part of financial reporting for placing the basic financial statements in the appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated April 18, 2019, on our consideration of the District'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 District'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 District's internal control over financial reporting and compliance.

Moss Adams LLP

Everett, Washington
April 18, 2019

This discussion and analysis provides an overview of the financial position and financial activities of Public Hospital District No. 1 of Skagit County, Washington (the District). The District, doing business as Skagit Valley Hospital (SVH), added the clinic division on July 1, 2010. The clinic division, which is known as Skagit Regional Clinics (SRC), was acquired when Skagit Valley Hospital employed the physicians of the former Skagit Valley Medical Center (SVMC) and started operations. On January 1, 2011, the District created the system name Skagit Regional Health (SRH). This name encompasses both SVH and the SRC operations. On June 1, 2016, the District began leasing the facilities of Public Hospital District No. 3 of Snohomish County and providing hospital and clinic services under the name Cascade Valley Hospital and Clinics (CVH).

Please read this discussion and analysis in conjunction with the accompanying financial statements and accompanying notes, which follow this section.

The statement of net position and the statement of revenues, expenses, and changes in net position report information about the District's resources and its activities. 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. These two statements report the District's net position and changes in it. Over time, increases or decreases in the District's net position are one indicator of whether its financial health is improving or deteriorating.

Financial Highlights

- SRH's total operating revenue grew by 6.7%, or $25.2 million, from $373.5 million in 2017 to $398.6 million in 2018. Over the same period, total operating expenses grew by 1.8%, or $7.1 million, from $388.1 million in 2017 to $395.2 million in 2018.

- SRH ended 2018 with operating income of $3.4 million. This represents a $18.0 million improvement over the 2017 operating loss of $14.6 million. SHR also added net nonoperating income of $5.3 million, a gain on sale of the outpatient kidney dialysis operations of $9.2 million, a gain on transfer of assets of $2.0 million, and capital contributions of $69 thousand.

- The District issued $62.7 million of series 2016 revenue and refunding bonds in November 2016. Approximately $42.7 million of the proceeds of the bonds were used to carry out the refunding of the District's 2005 and 2007 series hospital revenue bonds. The remaining $20.0 million in bond proceeds has been used to pay or reimburse costs to acquire, construct, remodel, renovate, equip, and furnish the District's health facilities in conformance with the District's 2016–2018 capital budgets.

- The District is making a strategic investment of approximately $72 million for the five-year span of 2016–2020 to build a new Electronic Health Record (EHR) and selected Epic as the vendor in 2015. The new EHR is a powerful, state-of-the-art tool that provides system interoperability, connectivity with patients, access to information, and data sharing across the District's entire system, including SVH, SRC, and CVH. The EHR became operable across the system in October 2017.

Financial Highlights (continued)

- The District Board voted unanimously, on Nov. 17, 2017, to select Brian Ivie, a highly experienced health care leader, as the new President, Chief Executive Officer (CEO), and Superintendent of SRH. Former President and CEO Mike Liepman retired in December 2017 after more than five years of service with the District and a 41-year career in health care. Mr. Ivie most recently served as President and CEO of three health care facilities operated by Dignity Health in the Sacramento, California area.

- Paul Ishizuka, MBA, CPA, joined the District in October 2017 as Chief Financial Officer (CFO). Ishizuka takes on the role held by CFO Tom Litaker who retired at the end of October 2017 after serving the District for 23 years. Mr. Ishizuka most recently served as CFO for Samaritan Healthcare in Moses Lake, Washington, since 2015. Prior to Samaritan, he served in a variety of senior executive roles for the University of Washington, including Medical Center Financial Officer for UW Medicine and CFO for University of Washington Medical Center in Seattle.

- Danny Vera, PharmD, MBA, became the Chief Operating Officer of the District in November 2018. Danny is an accomplished healthcare executive with 17 years of leadership and operational management experience. He most recently served as Vice President of Operations with Dignity Health Mercy San Juan Medical Center in Carmichael, California, a 370-bed, Level II trauma facility with 2,500 employees where he has worked since 2015. Mr. Vera holds an MBA from the California State University, Fresno Craig School of Business and a Doctor of Pharmacy from the University of California, San Francisco, School of Pharmacy. He started his healthcare career in pharmacy and moved into operations in 2012.

- The District board approved the purchase of the $2 million da Vinci® Xi™ Surgical System, which began operating in September 2018. The system is used in a variety of minimally invasive surgeries and is shown to improve patient outcomes, reduce recovery time and shorten hospital stays. The da Vinci® Xi™ Surgical System was installed at the Skagit Valley Hospital in Mount Vernon and is the first robotic tool system offered by Skagit Regional Health to combine technology and services to improve outcomes for patients.

- The District passed a resolution in November 2018 authorizing the sale of the outpatient kidney dialysis operations to Fresenius Medical Care Ventures, LLC. Fresenius offers outpatient dialysis services out of the space previously occupied by the Skagit Valley Kidney Center near Skagit Valley Hospital in Mount Vernon, WA. Fresenius leases the space from the District and has purchased some assets as part of the transaction. Fresenius has employed the majority of Skagit Regional Health's dialysis employees. Moving to a specialty vendor, such as Fresenius, to provide dialysis services is a trend in industry care models for dialysis across the United States. The District looks forward to collaborating with Fresenius, which has outstanding quality scores and is an industry leader offering wrap-around patient services. The sale closed December 17, 2018, with the District recognizing a gain on sale of operations of $9.2 million, net of associated costs. The District will continue to offer inpatient dialysis services at Skagit Valley Hospital.

Financial Highlights (continued)

- The District approved a letter of intent, dated April 6, 2015, with the University of Washington, acting through UW Medicine, and Public Hospital District No. 3 of Snohomish County (PHD No. 3), d/b/a Cascade Valley Hospital and Clinics in Arlington, Washington. The three parties (the Parties) approved the affiliation agreement (the Agreement) on May 29, 2015. The Agreement establishes the general principles and conditions that will guide the clinical integration between UW Medicine, SVH, and CVH. This Agreement is not a merger, acquisition, corporate restructure, or lease and does not constitute a change in governance or change in mission for any organization. This Agreement defines a process for joint efforts to seek clinical integration to increase efficiency in the delivery of patient care, monitor and utilize health care services to provide quality patient outcomes, and make care more affordable to the extent consistent with applicable law. The Parties are committed to working with each other to seek to increase their level of clinical integration, including but not limited to; standardized clinical protocols, patient safety programs, connectivity of electronic health information, cost and quality benchmarks, collection of quality and cost data, and a commitment to providing continuity of care for patients by remaining within the clinically integrated programs for their entire episode of care.

- Pursuant to this Agreement, UW Medicine will serve as SVH's and CVH's complex tertiary and quaternary health system for specialty care services not available in mutually designated communities and provided by UW Medicine. UW Medicine will be available as a resource for these services and is committed to providing rapid and efficient access to advanced medical care that could not otherwise be provided locally.

- The District and PHD No. 3 also entered into an Affiliation Agreement regarding the lease and operation of Cascade Valley Hospital and Clinics, dated December 4, 2015 (the Affiliation Agreement). Under the terms of the Affiliation Agreement and effective as of the closing date, June 1, 2016, the District began leasing and operating all of PHD No. 3's health care facilities, including its hospital and clinic facilities. Please see the "Affiliation Agreement with Snohomish County PHD No. 3" at the end of this Management Discussion and Analysis for further information on the Affiliation Agreement.

Financial Highlights (continued)

Following are key operating statistics for the years ended December 31, 2018, 2017, and 2016:

	Comments	2018	2017	2016
Utilization Statistics				
Skagit Valley Hospital				
Admissions - Acute Care		6,736	6,043	5,249
Admissions - Behavioral Health		369	382	338
Admissions - Obstetrics		977	1,054	1,188
Average Length of Stay		4.31	4.40	4.56
Patient Days - Acute		28,977	27,156	25,890
Patient Days - Behavioral Health		4,156	3,836	2,890
Patient Days - Obstetrics		1,797	1,942	2,108
Occupancy		69.9%	65.9%	61.6%
Emergency Room Visits	(1)	34,324	34,571	34,514
Billable Clinic Visits	(2)	303,646	260,904	297,720
Cascade Valley Hospital and Clinics	(3)			
Admissions - Acute Care		1,268	937	553
Admissions - Obstetrics		155	170	113
Average Length of Stay		3.95	4	4
Patient Days - Acute		5,369	4,277	2,718
Patient Days - Obstetrics		290	290	178
Occupancy		32.3%	26.1%	28.2%
Emergency Room Visits	(1)	18,834	19,822	10,911
Billable Clinic Visits	(2)	20,568	20,814	13,454

(1) Includes those patients who are later admitted
(2) Office visits resulting in a charge
(3) Skagit Regional Health began operating Cascade Valley Hospital on June 1st of 2016, volume represents only those months operated by SRH

Financial Highlights (continued)

	Comments	2018	2017	2016
Select Patient Volumes - Skagit Valley Hospital	(4)			
Skagit Valley Hospital				
Family Birth Center - Deliveries		927	989	1,106
Surgery - Total Minutes		571,389	520,494	544,973
Surgery - Cases		5,533	5,086	5,430
Surgery - Inpatient Cases		1,294	1,131	1,184
Surgery - Outpatient Cases		4,239	3,955	4,246
Emergency Room - Visits	(5)	26,347	27,454	28,124
Special Imaging - Procedures		2,961	2,489	2,593
CT Scan - Procedures		20,688	20,053	18,230
Radiology - Procedures		69,673	69,119	68,127
MRI - Procedures		9,367	8,567	7,198
Nuclear Medicine - Procedures		2,625	2,815	2,632
Physical Therapy - Visits		15,678	14,664	15,279
Occupational Therapy - Visits		4,543	4,626	5,295
Speech Therapy - Visits		8,512	8,083	7,860
Wound Care - Visits		8,577	8,153	8,409
Endoscopy - Cases		4,700	5,646	4,703
Kidney Dialysis - Outpatient Procedures	(7)	13,421	13,643	15,054
Peritoneal Dialysis - Procedures		5,029	4,538	5,602
Oncology Medical - Visits		15,197	16,919	15,895
Oncology Medical - Visits - Arlington		2,727	2,614	2,662
Oncology Radiation - Visits		11,097	12,075	11,586
Sleep Therapy - Studies		1,087	1,140	880
Skagit Regional Clinics				
Urgent Care Clinic - Billable Clinic Visits		59,750	61,417	62,356
Cardiology - Billable Clinic Visits		27,941	16,263	19,354
Family Practice Clinic - Billable Clinic Visits		66,514	57,380	56,417
Pediatrics Clinic - Billable Clinic Visits		16,748	19,879	15,497
Residency Clinic - Billable Clinic Visits		21,106	18,488	10,834
Cascade Valley Hospital and Clinics				
Family Birth Center - Deliveries		135	158	97
Surgery - Total Minutes	(6)	125,991	113,272	69,688
Surgery - Cases		2,059	1,666	905
Surgery - Inpatient Cases		543	455	236
Surgery - Outpatient Cases		1,516	1,211	669
Emergency Room - Visits	(5)	17,270	18,236	10,669

(4) Volumes include all patients unless otherwise noted
(5) Excludes those patients who are later admitted
(6) Does not include minutes in the ambulatory surgical center
(7) Outpatient kidney dialysis operations sold to Fresenius Medical Care Ventures, LLC in December 2018

Performance Overview

The following is a comparison of 2018 actual revenues, expenses, and changes in net position results to 2017 and 2016 results (in thousands):

	2018	2017	2016
Operating revenues			
Net patient service revenue	$ 374,835	$ 349,024	$ 329,786
Other operating revenues	20,457	22,193	18,600
Income from joint ventures	3,356	2,254	2,205
Total operating revenues	398,648	373,471	350,591
Operating expenses			
Wages and benefits	216,383	211,591	182,460
Professional fees	17,185	22,416	21,001
Supplies	58,817	51,203	51,063
Purchased services, maintenance, and other	73,209	77,676	72,161
Insurance and taxes	7,009	5,444	6,131
Depreciation	16,557	14,289	15,034
Interest and amortization	6,038	5,435	6,801
Total operating expenses	395,198	388,054	354,651
Operating income (loss)	3,450	(14,583)	(4,060)
Net nonoperating income	5,343	3,333	2,792
Gain on disposal of operations	9,240	-	-
Gain on transfer of assets	2,011	7,827	15,531
Capital contributions	69	287	758
Increase (decrease) in net position	20,113	(3,136)	15,021
Net position, beginning of year	135,150	155,332	140,311
Cumulative effect of restatement	-	(17,046)	-
Net position, beginning of year, restated	135,150	138,286	140,311
Net position, end of year	$ 155,263	$ 135,150	$ 155,332

Health Care Outlook

In keeping with industry trends, Skagit Regional Health continues along the journey to achieving the Triple Aim. We have continued our participation with the UW Medicine Accountable Care Network (UWACN) and now participate in three commercial products where focus on cost containment, clinical quality, and patient satisfaction is paramount. In 2017, the UWACN and its members renegotiated the terms of the Boeing agreement, which now extends through December 2021. The Washington State Health Care Authority entered Skagit County in 2017, and we experienced small gains in associated patient volumes. SRH continues to participate in the Premera agreement as well, which has not yet incurred volumes that generate risk for the organization.

Skagit Regional Health believes part of our future success depends on performing well in value-based agreements. As such, the organization applied for, and was accepted into, the Medicare Accountable Care Organization (ACO) program for participation beginning in 2018. The ACO, named Cascadia Care Network (CCN), begins its operations with a focus on employed providers. As the CCN infrastructure is built, we anticipate opening up the ACO to other independent practices. Through 2020, SRH will participate in the Medicare Track 1 Medicare Shared Savings Program (MSSP) with no downside risk. SRH services approximately 6,400 lives in its ACO.

SRH is acutely aware of the change from volume to value in the healthcare marketplace. We continue to enter into Value Based Payment arrangements with our payer community while at the same time investing in the infrastructure required to successfully make this shift.

Operating Revenue (in thousands)

Net Patient Revenue

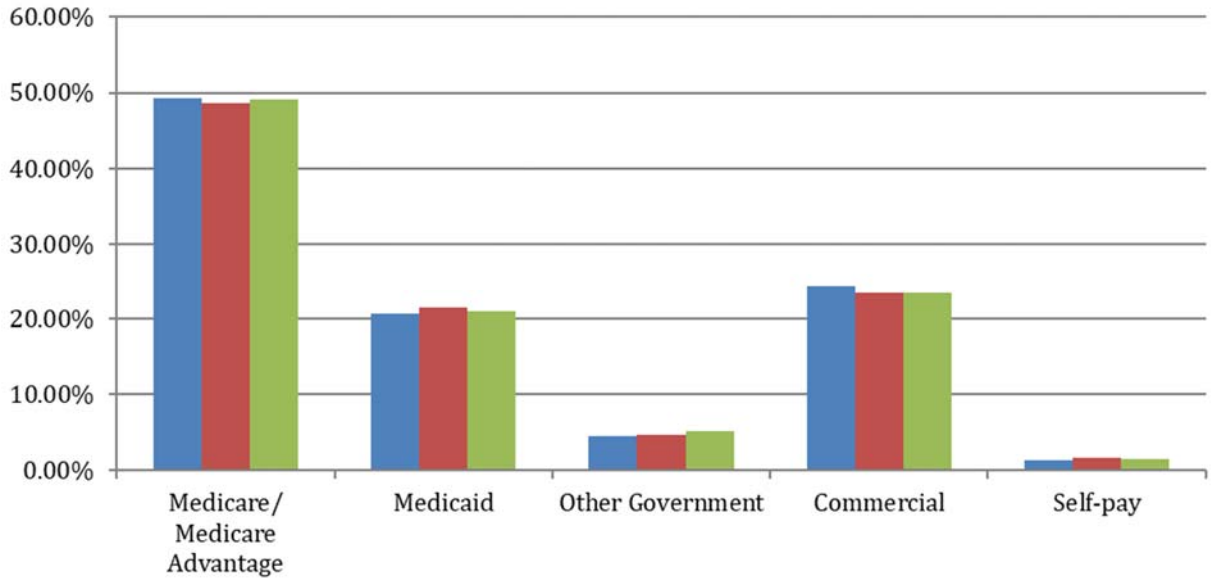
Net patient revenue consists of gross patient charges less contractual adjustments, charity care, and a provision for bad debt. Contractual adjustments represent the difference between gross patient charges at established rates and expected contracted payments from third-party payors with which the District has entered into agreements. In addition, the District provides care to patients, at no charge or reduced rates, who meet certain criteria under its charity care policies. The District also estimates the collectability of accounts receivable and records a provision for bad debt. The resulting net patient revenue is highly dependent on the District's payor mix.

Operating Revenue (in thousands) (continued)

The table and graph below illustrate the three-year trend in SRH's payor mix, based on gross patient charges, for the years ended December 31, 2016 through 2018.

Payor Mix Trend

	Years Ended December 31,		
	2016	2017	2018
Payor Mix			
Medicare	36.24%	35.66%	33.85%
Medicare Advantage	12.97%	12.97%	15.21%
Subtotal: Medicare	**49.22%**	**48.63%**	**49.06%**
Medicaid	20.56%	21.51%	20.99%
Other Government	4.49%	4.63%	5.08%
Commercial	24.40%	23.49%	23.39%
Self Pay	1.33%	1.74%	1.48%
	100.00%	**100.00%**	**100.00%**



Operating Revenue (in thousands) (continued)

Reduction in uninsured associated with the individual mandate provision in the Affordable Care Act (ACA) has leveled off and the uninsured self-pay payors have increased after a low of 1.25% in 2015. The District expects this trend to accelerate into 2019 as the impact of the repeal of the individual mandate provision takes effect. Additionally, the prevalence of high-deductible consumer-directed health plans has increased the patient financial obligation for those with insurance. The District continues to see the effects of the aging population in Skagit and northern Snohomish Counties through increased Medicare and lower commercial payor mix. Management continues to measure and monitor these trends and evaluate the appropriate response and action to mitigate the financial impact while continuing to improve the health of the communities the District serves.

Net patient revenue at SRH grew by $25,811 from $349,024 in 2017 to $374,835 in 2018. Successful recruitment of both primary and specialty care providers drove growth in clinic visit volume of 15%. Strong growth in surgical and special imaging volumes bolstered acute and ancillary services revenue throughout the system. This volume growth combined with rate increases offset volume reductions in oncology and endoscopy associated with provider departures.

2017 saw net patient revenue at SRH grow by $19,238 from $329,786 in 2016. A full year of operations at CVH accounted for approximately $16,138 of this increase. Volume and rate increases at SVH partially offset increased revenue adjustments related to the deteriorating payor mix, adding $2,461 in 2017. At SRC, growth in the orthopedic, urgent care, family medicine, and gastroenterology practices offset decreases in internal medicine and dermatology.

Other Operating Revenue

Other operating revenue decreased by $1,736 or 7.8%, from $22,193 in 2017 to $20,457 in 2018. Sales at the three retail pharmacies, which closed in the first quarter of 2018, decreased by $3,002. The 340B contracted pharmacy program continued to expand increasing revenue from the program by $3,340 in 2018 over 2017. Revenue from the 340B contract program totaled $10,518 in 2018. Investment income increased $519 in 2018 related to higher cash and short-term investment balances and improved returns.

Other operating revenue increased by $3,593, or 19.3%, in 2017 from $18,600 in 2016, related primarily to the addition of several specialty pharmacies to the 340B contracted pharmacy program.

Income generated for the District from its ownership in several joint ventures increased by $1,102, from $2,254 in 2017 to $3,356 in 2018. In 2017, income from joint ventures increased by $49, from $2,205 in 2016.

Total operating revenue for 2018 was $398,648, an increase of $25,177, or 6.7%, over the 2017 total operating revenue of $373,471. The increase in 2017 over the 2016 total of $350,591 is $22,880, or 6.5%.

Operating Expenses (in thousands)

Total operating expenses in 2018 increased by $7,144 or 1.8%, from $388,054 in 2017 to $395,198 in 2018. Total operating expenses increased by $33,403 in 2017 from $354,651 in 2016.

SRH wages and benefits increased by $29,131, or 16%, from $182,460 in 2016 to $211,591 in 2017, and by $4,792, or 2.3%, to $216,383 in 2018. Excluding providers, the District employed 1,898 full time equivalents (FTEs) in 2018, an increase of 56 from the 1,842 FTEs employed in 2017 and a two-year increase of 229 from 1,669 FTEs employed in 2016. Growth from 2016 to 2018 is related to volume increases within CVH and SVH Hospitals, and Clinics. Provider staff support also increased proportionately with their growth. This combined growth was offset, in early 2018, by a reduction in force.

At year-end 2018, SRH employed 160 providers, comprised of 104 doctors and 56 mid-level providers. This is an increase of 38 employed providers from year-end 2017, comprised of 26 doctors and 12 mid-level providers.

The salary and benefits dollar increases not associated with the added FTEs are accounted for by contracted union and non-contracted staff, and provider annual increases.

Professional fees decreased by $5,231, from $22,416 in 2017 to $17,185 in 2018. Restructuring of the outsourced ER physicians program that coincided with the implementation of the Epic EHR, accounted for $3,520 of this reduction. Lower usage of locum providers further reduced professional fees by $446. Oncology professional fees decreased $128, due to the departure of two providers during the year. Reduced usage of registry nurses and other outsourced personnel account for much of the remaining variance.

Professional fees increased by $1,415, from $21,001 in 2016 to $22,416 in 2017. Nurse registry, outsourced medical, and non-medical support staff increased by $1,708. The outsourcing of the CVH Anesthesia program and a staffing shortage, backfilled with registry personnel in Case Management, were the largest drivers of this increase. Consulting, legal, and audit fees decreased from $2,293 in 2016 to $2,160 in 2017. SRH physician fees decreased by $165 to $14,762 in 2017 from $14,927 in 2016. Increases in Orthopedic, Pulmonary, and Women's Health locum's expenses were offset by reductions in Mental Health and Gastroenterology, and restructuring of the outsourced ER physicians program.

Patient supply expense, including pharmaceutical, medical devices and medical supplies, increased by $7,532, from $47,224 in 2017 to $54,756 in 2018. From 2016 to 2017, supply expense increased by $400, from $46,824 in 2016. Pharmaceutical expense increased by $4,522 in 2018, from $24,305 to $28,827, associated with increased spending on pharmaceuticals at SVH related to higher oncology drug usage, inflation, and 340B purchases, and offset by reductions in retail pharmacy cost of goods sold expenses due to the closure of the Sedro-Woolley, Mount Vernon, and Riverbend retail pharmacies in early 2018. Medical device and supply expense related to direct patient care increased by $3,010, from $22,919 in 2017 to $25,929 in 2018. The addition of a surgical robot and the insourcing of lab services at SVH at the end of the third quarter 2018 accounted for much of the increase.

Other supply expense, which includes minor equipment, cleaning, food, and office expenses, decreased from $4,239 in 2016 to $3,979 in 2017 and increased to $4,060 in 2018. The decrease in 2017 was due to a reduction in minor equipment expense after a buildup in 2016 related to the upgrade of information technology infrastructure. In 2018, SRH saw a slight increase in minor equipment related to the purchase of the surgical robot at SVH OR and new instruments sets for CVH operating room. Information technology minor equipment expense continued its downward trend in 2018 after the buildup in 2016.

Operating Expenses (in thousands) (continued)

Purchased services, maintenance, rental and lease, utilities, and other expense decreased $4,467, from $77,676 in 2017 to $73,209 in 2018. This variance and reduction in expenses was primarily attributed to savings in the SVH hospitalist program, reduction in information systems purchased services and license fees and the insourcing of the SVH Lab. Purchased services, maintenance, rental and lease, utilities, and other expense increased $5,515 in 2017, from $72,161 in 2016. The increase in 2017 was related to a mix of one-time go-live support and ongoing maintenance, licensing, and hosting expenses related to for the Epic EHR, as well as additional increases related to backfill support for legacy systems and the impact of operating CVH for a full year.

Insurance and tax expense was $7,009 in 2018, an increase of $1,565 from $5,444 in 2017. This is attributable to an increase of professional liability loss reserves of $963. The reserves, developed by an actuary based on historical loss runs, are reviewed and updated yearly. The remaining increase is related to higher insurance premiums, including the purchase of a tail liability policy for an acquired practice. In 2017, insurance and tax expense decreased by $687 from $6,131 in 2016. This was primarily related to reductions on reserves.

Depreciation expense of $16,557 was $2,268 higher than the 2017 expense of $14,289. Depreciation related to the Epic EHR increased $2,523 from $1,110 in 2017 to $3,633 in 2018 related to a full year's depreciation compared to only three months in 2017. Depreciation expense in 2017 was $745 lower than the 2016 expense of $15,034. The increase related to Epic was offset by several of the movable equipment assets that were acquired in the 2007 hospital expansion along with additional assets acquired in the final closing of the Skagit Valley Medical Center acquisition reaching full depreciation in 2016 and early 2017.

Interest and amortization expense increased by $603 to $6,038 in 2018 from $5,435 in 2017 after a decrease of $1,366 from $6,801 in 2016. The increase is primarily related to interest on the 2016 Revenue and Refunding bonds. Interest from these bonds related to the Epic EHR project was capitalized during the build of Epic in 2017. The one-time costs associated with the issuance of the 2016 Revenue and Refunding bonds, recognized in 2016, account for the decrease from 2016 to 2017.

Net Nonoperating Income and Changes in Net Position (in thousands)

Net nonoperating income and other changes in net position increased by $5,216, from $11,447 in 2017 to $16,663 in 2018 and decreased in 2017 by $7,634, from $19,081 in 2016. Improved returns on restricted fund investments increased nonoperating revenue in 2018 by $1,497, while the remaining increase came from improved tax collections and a gain on sale of assets. Transfers of assets related to the affiliation agreement with PHD 3 has continued to wind down, falling $5,816 from $7,827 in 2017 down to $2,011 in 2018. Transfers of assets fell $7,704 from $15,531 in 2016. Additional information about this transfer can be found in the "Affiliation Agreement with Snohomish County PUD No. 3" section below. The sale of the outpatient KD operating in December 2018 added $9,240. Donations received for capital contributions were $69 in 2018, compared with $287 in 2017, a decrease of $217. The majority of the donations were gifts from the hospital foundation for various projects.

Statements of Net Position (in thousands)

The following is a presentation of certain financial information derived from the District's statement of net position (in thousands):

	2018	2017	2016
Current assets			
Cash and short-term investments	$ 40,246	$ 19,112	$ 23,622
Accounts receivable, net	54,708	57,289	62,503
Other current assets	16,820	16,299	16,737
Total current assets	111,774	92,700	102,862
Assets whose use is limited, net of current portion	127,829	126,288	136,166
Capital assets, net	151,991	153,742	134,317
Investments in joint ventures	12,212	12,707	13,305
Total assets	403,806	385,437	386,650
Deferred outflows of resources	5,491	4,434	4,851
Total assets and deferred outflows of resources	$ 409,297	$ 389,871	$ 391,501
Current liabilities	$ 57,942	$ 55,193	$ 52,585
Long-term debt, net of current portion	166,953	175,728	179,581
OPEB liability	23,465	18,992	-
Estimated professional liability	4,983	4,037	4,003
Total liabilities	253,343	253,950	236,169
Deferred inflows of resources	691	772	-
Net position			
Net investment in capital assets	11,073	5,388	2,451
Restricted for debt service	12,887	12,838	13,192
Unrestricted	131,303	116,924	139,689
Total net position	155,263	135,150	155,332
Total liabilities, deferred inflows of resources, and net position	$ 409,297	$ 389,871	$ 391,501

Statements of Net Position (in thousands) (continued)

Assets

Total current assets of $111,774 at December 31, 2018, were $19,074 higher than at year-end 2017. This increase is comprised of a $21,134 increase in cash and short-term investments, a decrease of $2,581 in net accounts receivable, and an increase of $521 in other current assets. The increase in cash and short-term assets were related to the positive operating margin, the improvement in AR days outstanding, and the proceeds from the sale of the outpatient kidney dialysis operations.

Net patient accounts receivable average days outstanding at year-end 2018 were 48.1, versus 50.8 days in 2017. The decrease in 2018 is due to systematic improvements across the revenue cycle, including consolidation of revenue cycle leadership and consolidation of multiple billing platforms to the Epic EHR. Net patient accounts receivable average days outstanding at year-end 2016 were 62.2 days. The decrease in 2017 is due to improvements in payments associated with CVH. CVH experienced an initial delay in 2016 associated with the change in ownership that increased average days outstanding at year-end 2016. Additionally, an effort to reduce AR from legacy billing systems prior to the commencement of the Epic EHR contributed to the reduced days outstanding in 2017.

Assets whose use is limited increased from $126,288 in 2017 to $127,829 in 2018, an increase of $1,541, after decreasing by $9,878 from $136,166 in 2016. The 2017 decrease relates to the project fund portion of the 2016 Revenue and Refunding Bonds and use of those funds for various capital projects including the Epic EHR. The increase in 2018 relates to transfers into funds designated by the board for capital improvements.

Net capital assets decreased in 2018 by $1,751, from $153,742 to $151,991. This decrease is made up of $14,806 of new capital assets, offset by $585 in retirements and a $15,973 increase in accumulated depreciation. Major capital projects in 2018 were the purchase of the da Vinci® Xi™ Surgical System, the addition of a third state of the art catheterization lab, a patient monitoring system upgrade, and purchases of land around the SVH campus. Net capital assets increased in 2017 by $19,425, from $134,317 in 2016. This increase is made up of $33,713 of new capital assets, offset by $1,065 in retirements and a $13,223 increase in accumulated depreciation. Of the new capital assets, $25,301 is related to the Epic EHR.

Investments in joint ventures declined from $12,707 in 2017 to $12,212 in 2018, a decrease of $495. From 2016 to 2017, joint venture investments decreased by $598. Distributions from the joint ventures accounted for the change in all years examined.

Liabilities

Current liabilities increased $2,749, from $55,193 in 2017 to $57,942 in 2018. This increase is made up of an increase of $493 in payables, an increase of $2,363 in payments due to third-party payors, and a decrease in the current portion of long-term debt of $666. Current liabilities in 2017 increased by $2,608 over 2016. Financing of the Epic EHR License as well go-live support is the main driver for the increase in current portion of long-term debt.

Long-term debt, net of current portion decreased by $8,775 in 2018 to $166,953 from $175,728 in 2017. In 2017, long-term debt, net of current portion decreased by $3,853 from $179,581 in 2016. Normal scheduled principal payments account for the decrease in both years. Increased debt related to the Epic EHR accounted for the higher principal payment in 2018.

Statements of Net Position (in thousands) (continued)

The Governmental Accounting Standards Board (GASB) issued new standards in 2015 that define how other post-employment benefit (OPEB) liabilities were measured and reported. These standards, GASB 74 and GASB 75, came into effect for plan fiscal years beginning after June 15, 2017. GASB 75, requires a liability to be recognized for OPEB plans that are not pre-funded. Changes in the OPEB liability are recognized as expense in the Statements of Revenue, Expenses, and Changes in Net position or reported as deferred inflows/outflows of resources on the Statements of Net Position, depending on the nature of those changes. The District's OPEB liability was $18,992 in 2017 and $23,465 in 2018. Further detail of the Districts OPEB liability can be found in Note 10 to the financial statements.

Professional malpractice liability reserve increased by $946 in 2018, from $4,037 to $4,983. This increase is based on an actuarial estimate of the professional malpractice liability, based on historic claims and changes in volume. In 2017, professional liabilities reserves increased by $34, from $4,003 in 2016.

Affiliation Agreement with Snohomish County PUD No. 3

In accordance with the Affiliation Agreement, which was dated December 4, 2015, the District began operating Cascade Valley Hospital on June 1, 2016. The Affiliation Agreement is structured as a long-term lease (the Lease) between Snohomish PHD No. 3 d/b/a Cascade Valley Hospital and Clinics and the District. Pursuant to the Affiliation Agreement, Snohomish PHD No. 3 leased substantially all of its assets, including Cascade Valley Hospital, certain other clinic facilities, Snohomish PHD No. 3's interest as lessor in certain land leases, and intangible assets, to the District for a term of 30 years. The District will pay Snohomish PHD No. 3 an annual base rent of $10.00 and is responsible for all costs and expenses associated with the leased assets, including maintenance and capital improvements.

Financial Arrangement

Pursuant to the Affiliation Agreement, Snohomish PHD No. 3 will transfer all of its cash and cash equivalents in excess of a retained amount to the District by June 2017. The retained amount is equal to Snohomish PHD No. 3's known and contingent liabilities and debts plus a minimum cash balance of $1,000,000. Thereafter, Snohomish PHD No. 3 will continue to levy and collect excess and regular property tax levies, as well as collect revenues from a lease of a medical office building owned by Smokey Point LLC. Smokey Point LLC is owned 50% by the District and 50% by Snohomish PHD No. 3. The Smokey Point LLC building is a two-story, 40,000-square-foot ambulatory center. Approximately one quarter of the space is leased to UW Medicine, which operates a primary care physician practice and a maternal fetal medicine clinic. The rest of the building is leased to the District, which operates an outpatient chemotherapy unit, an urgent care clinic, an occupational medicine clinic, and laboratory and imaging services. Snohomish PHD No. 3's excess property tax levy funds will be used solely for the purpose of paying the debt service on Snohomish PHD No. 3's outstanding unlimited tax general obligation bonds. The proceeds from the Snohomish PHD No. 3 regular property tax levy and the Smokey Point LLC lease will be used to pay Snohomish PHD No. 3's expenses, including the annual debt service on Snohomish PHD No. 3's outstanding limited tax general obligation bonds, and to fund the minimum cash balance of $1,000,000. To the extent the amount collected by Snohomish PHD No. 3 from its regular property tax levy and the Smokey Point LLC lease exceeds Snohomish PHD No. 3's existing obligations in any year, and the Snohomish PHD No. 3 cash balance is equal to $1,000,000, the excess funds will be transferred to the District.

Affiliation Agreement with Snohomish County PUD No. 3 (continued)

In accordance with the Affiliation Agreement, the transferred funds will be deposited in Pool A of the "PHD No. 3 Support Fund." The funds in Pool A will be used by the District to: (1) support the provision of health care services rendered in Snohomish County; (2) pay for capital improvements and equipment located in Snohomish County; (3) pay for health information technology and other capital investments that may be located outside of Snohomish County if it serves both the District facilities and the Cascade Valley Hospital facilities, provided that only that portion of the costs of such improvement and equipment that reasonably relate to Snohomish PHD No. 3's usage of the capital investment shall be allocated to Snohomish PHD No. 3; and (4) to cover any losses incurred by the District in the operation of Cascade Valley Hospital services.

At the end of each fiscal year, the District will deposit into a special fund designated as Pool B of the "PHD No. 3 Support Fund" a portion of the District's net cash flow generated from the District's operations, calculated according to a formula set forth in the Affiliation Agreement but in no case less than 1.5% of the annual net revenue generated by the District's operation of the Cascade Valley Hospital services still in operation, which will be calculated based on a three-year rolling average. The funds in Pool B may generally be used and expended by the District in the following order of priority: (1) to cover any Cascade Valley Hospital operating losses, as defined in the Affiliation Agreement, to the extent the loss is not covered by any remaining funds in Pool A; (2) to reimburse the District for expenses incurred in prior years to cover such operating losses that were not reimbursed in prior years because there were insufficient funds in Pool A or Pool B; (3) to reimburse the District for expenses incurred by the District in prior years to fund capital improvements or equipment located at the Cascade Valley Hospital facilities or for health information technology or other capital investments located elsewhere to the extent it serves both the District and Cascade Valley Hospital facilities, but only for such portion that reasonably relate to Snohomish PHD No. 3's usage of the health information technology or other capital investment, to the extent that such expenses were not reimbursed in prior years because there were insufficient funds available in Pool A or Pool B; (4) to reimburse the District for expenses incurred by the District in the current year to fund Cascade Valley Hospital capital improvements, as defined by the Affiliation Agreement; and (5) subject to certain limitations, for other expenditures that support the provision of health care services in Snohomish County.

Required Services

The Affiliation Agreement obligates the District to provide certain required services in North Snohomish County (identified by zip codes 98223, 98241, 98292, 98271, 98270, 98258, and 98252) for five, 10, and 30-year periods. The District has the right to determine the appropriate level of required services to meet the needs of the residents of North Snohomish County, such as the number of medical/surgical beds, ICU beds, observation beds, emergency department bays, operating rooms, procedure rooms, examination and treatment rooms, and staffing levels, provided it does so reasonably after appropriate evaluation and analysis of any impact a reduction in level of service may have on the residents of North Snohomish County.

During the five-year period following affiliation (the Five-Year Period), the District must provide OB/GYN, pediatric physician, and related Cascade Valley Hospital facilities services at any location within North Snohomish County, which the District reasonably believes will appropriately serve the needs of the residents of North Snohomish County. The District must, however, continue to provide or cause to be provided primary care services at the Darrington and Granite Falls clinics during the Five-Year Period.

Affiliation Agreement with Snohomish County PUD No. 3 (continued)

During the 10-year period following the affiliation (the Ten-Year Period), the District must provide inpatient and outpatient surgery, general inpatient acute services, and orthopedic general surgeons in North Snohomish County. In order to satisfy the Ten-Year Period commitment, the District is required to continuously maintain and operate Cascade Valley Hospital as a general acute care hospital duly licensed by the state of Washington and certified under the Medicare and Medicaid programs, with at least the following services: general inpatient acute services, inpatient surgery, a 24-hour emergency department, observation unit, ancillary medical services to the extent required to maintain state acute care hospital licensure, and an organized medical staff consisting, at a minimum, of primary care physicians, orthopedic surgeons, and general surgeons. The District is granted the right during the Ten-Year Period to modify or reduce the level of service provided at Cascade Valley Hospital provided: (1) it continues to provide an appropriate level of such services in North Snohomish County to meet the needs of residents; and (2) it has given notice to Snohomish PHD No. 3 and allowed Snohomish PHD No. 3 to provide input before said service is eliminated, relocated, modified, or reduced. Nonetheless, if the District elects to discontinue outpatient surgery services at Cascade Valley Hospital during the Ten-Year Period, the District must provide such services during remainder of the Ten-Year Period at an alternative location within North Snohomish County at appropriate levels to meet the needs of residents.

During the Thirty-Year Period following the affiliation, the District must provide a 24-hour emergency department, observation unit, ancillary medical services, and primary care physicians in North Snohomish County. After the Ten-Year Period, the District is entitled to relocate the required services that were subject to the Ten-Year Period commitment and that continue to be subject to the Thirty-Year Period commitment to any location within North Snohomish County that it reasonably believes will appropriately meet the needs of the residents of North Snohomish County.

In the event that the District intends to eliminate, reduce, relocate, or change any required service in a manner not described above, it must give Snohomish PHD No. 3 90 days' advance written notice of such intent (the Change Notice). The Change Notice must include a detailed statement of the reasons for the intended action and must be accompanied by an analysis prepared by a qualified independent health care consultant analyzing the potential impact on the accessibility and availability of health care services for residents of North Snohomish County. Snohomish PHD No. 3 is granted the right to determine, in its sole and absolute discretion, whether it will permit the District to proceed with the requested change. Snohomish PHD No. 3 must notify the District within 90 days of receipt of the Change Notice whether it will permit or deny the requested change. If Snohomish PHD No. 3 fails to respond in writing within 90 days of receipt of the Change Notice, Snohomish PHD No. 3 will be deemed to have approved the proposed service change.

Dispute Resolution

Subject to the parties' right to equitable relief, all controversies, claims, and disputes arising in connection with the Affiliation Agreement must be settled by mutual consultation between the parties, but failing amicable settlement must be settled finally by arbitration, conducted in Seattle, Washington, in accordance with the rules and procedures promulgated by Judicial Dispute Resolution before one arbitrator. The decision of the arbitrator is final and binding on the parties.

Affiliation Agreement with Snohomish County PUD No. 3 (continued)

Termination and Unwinding

The Affiliation Agreement permits termination of the Affiliation Agreement and an unwinding of the affiliation upon the happening of certain conditions. The Affiliation Agreement may be terminated: (1) by mutual written consent of the District and Snohomish PHD No. 3; (2) by either the District or Snohomish PHD No. 3 in the event of an uncured breach of the Affiliation Agreement or the Lease by the other party; (3) by the District in the event that a catastrophic event occurs that was not caused by the District and makes it no longer viable to continue operating Cascade Valley Hospital services as originally contemplated; (4) by either the District or Snohomish PHD No. 3 if Snohomish PHD No. 3 requires the District to purchase the leased facilities and assets as set forth in a certain provision of the Affiliation Agreement governing damages to the facilities related to the District's negligence; and (5) after six years, by the District if the District has incurred sustained operating losses, as defined in the Affiliation Agreement, in the operation of Cascade Valley Hospital services.

To effect an unwind, the District will transfer all of the facilities and assets owned by Snohomish PHD No. 3 back to Snohomish PHD No. 3 following a process consistent with how they were originally transferred. In addition, the District will transfer to Snohomish PHD No. 3 any remaining cash balance in Pool A or Pool B and will assign in part or grant sublicenses under any electronic health records software license, maintenance, and support services agreements in effect at Cascade Valley Hospital facilities immediately prior to termination.

All of the commitments by Snohomish PHD No. 3 to provide any cash or similar support to the District will terminate after the date the District provides written notice of termination of the Affiliation Agreement or concurrent with the termination of the definitive agreements for any other reason, provided that Snohomish PHD No. 3 will remain obligated to provide any cash or similar support on a pro rata basis for the applicable period of time prior to the notice of termination. The Affiliation Agreement provides provisions for certain operating commitments and specific provisions in event the agreement is discontinued.

2016 Hospital Revenue Improvement and Refunding Bonds

In November 2016, the District issued $62,730,000 in Revenue Improvement and Refunding Bonds. Approximately $42,730,000 of these proceeds were used to carry out the advanced refunding of the District's 2005 and 2007 hospital revenue bonds. The remaining $20,000,000 in bond proceeds was used to pay or reimburse costs to acquire, construct, remodel, renovate, equip, and furnish the District's health facilities in conformance with the District's 2016–2018 capital budgets, including the Epic Electronic Health Record System.

Contacting the District's Financial Management

This financial report is designed to provide our patients, suppliers, taxpayers, and creditors with a general overview of Skagit Regional Health's finances and to show the District's accountability for the money it receives. If you have questions about this report or need additional financial information, contact the District's financial management at Skagit Regional Health Business Center, 1415 East Kincaid Street, Mount Vernon, Washington 98273.

Public Hospital District No. 1 of Skagit County, Washington
Statements of Net Position

ASSETS AND DEFERRED OUTFLOWS OF RESOURCES

	December 31, 2018	December 31, 2017 (Restated)
CURRENT ASSETS		
Cash	$ 873,722	$ 1,142,196
Short-term investments	39,371,984	17,970,128
Patient accounts receivable, less allowance for uncollectible accounts of $11,227,726 and $9,044,158	49,340,624	48,585,898
Other receivables	5,367,826	8,703,345
Assets limited as to use, required for current liabilities	7,320,318	6,936,466
Supplies inventory	4,791,940	5,311,720
Prepaid expenses and other assets	4,120,505	3,790,423
Interest receivable	587,311	260,031
Total current assets	111,774,230	92,700,207
ASSETS LIMITED AS TO USE		
Board-designated for capital improvements	106,598,565	104,646,170
Board-designated for professional liability	1,653,490	1,644,447
Restricted for CVH project funds A & B	14,007,579	14,093,301
Restricted bond reserve funds held by trustee	9,548,782	9,499,263
Restricted for construction project fund	2,832	2,784
Restricted for bond redemption fund	3,337,916	3,338,850
	135,149,164	133,224,815
Less amounts required for current liabilities	(7,320,318)	(6,936,466)
	127,828,846	126,288,349
CAPITAL ASSETS		
Land	11,712,330	10,066,771
Construction in progress	2,278,516	108,520
Depreciable capital assets, net of accumulated depreciation	138,000,500	143,567,166
	151,991,346	153,742,457
INVESTMENTS IN JOINT VENTURES	12,211,850	12,706,638
Total assets	403,806,272	385,437,651
DEFERRED OUTFLOWS OF RESOURCES		
Deferred OPEB outflows	1,473,342	-
Deferred losses on refundings	4,017,164	4,433,839
	5,490,506	4,433,839
Total assets and deferred outflows of resources	$ 409,296,778	$ 389,871,490

See accompanying notes.

LIABILITIES, DEFERRED INFLOWS OF RESOURCES, AND NET POSITION

	December 31, 2018	December 31, 2017 (Restated)
CURRENT LIABILITIES		
Accounts payable	$ 18,385,854	$ 17,827,715
Accrued salaries, wages, and employee benefits	21,452,512	20,923,534
Estimated third-party payor settlements	8,162,108	5,798,762
Accrued interest payable	650,318	686,466
Current portion of long-term debt	9,290,692	9,956,836
Total current liabilities	57,941,484	55,193,313
LONG-TERM DEBT, net of current portion	166,953,354	175,727,612
OPEB LIABILITY	23,464,988	18,991,781
ESTIMATED PROFESSIONAL LIABILITY	4,983,404	4,036,788
Total liabilities	253,343,230	253,949,494
DEFERRED INFLOWS OF RESOURCES		
Deferred OPEB inflows	690,481	771,714
NET POSITION		
Net investment in capital assets	11,072,864	5,388,222
Restricted for debt service	12,886,698	12,838,113
Unrestricted	131,303,505	116,923,947
Total net position	155,263,067	135,150,282
Total liabilities, deferred inflows of resources, and net position	$ 409,296,778	$ 389,871,490

See accompanying notes.

Public Hospital District No. 1 of Skagit County, Washington
Statements of Revenues, Expenses, and Changes in Net Position

	Years Ended December 31,	
	2018	2017 (Restated)
OPERATING REVENUES		
Net patient service revenue (net of provision for bad debts of $21,677,341 and $21,720,708)	$ 374,835,432	$ 349,023,832
Other operating revenues	23,812,302	24,447,464
Total operating revenues	398,647,734	373,471,296
OPERATING EXPENSES		
Salaries and wages	176,381,740	170,653,757
Employee benefits	40,000,808	40,937,694
Professional fees	17,185,235	22,416,239
Supplies	58,816,600	51,202,622
Purchased services	55,246,793	57,401,198
Other	24,971,709	25,719,542
Depreciation and amortization	16,557,366	14,288,610
Interest and amortization	6,038,007	5,434,898
Total operating expenses	395,198,258	388,054,560
Operating income (loss)	3,449,476	(14,583,264)
NONOPERATING INCOME, net		
Investment income	2,910,619	1,413,277
Revenues from tax levies for general obligation bonds	4,512,981	4,174,538
Interest and amortization expense	(2,103,781)	(2,198,698)
Other income (expense)	22,642	(56,083)
Nonoperating income, net	5,342,461	3,333,034
Excess (deficiency) of revenues over expenses before capital contributions and transfers	8,791,937	(11,250,230)
CAPITAL CONTRIBUTIONS	69,153	287,196
GAIN ON DISPOSAL OF OPERATIONS	9,240,364	-
GAIN ON TRANSFER OF ASSETS	2,011,331	7,826,554
INCREASE (DECREASE) IN NET POSITION	20,112,785	(3,136,480)
NET POSITION, beginning of year	135,150,282	155,332,355
CUMULATIVE EFFECT OF RESTATEMENT	-	(17,045,593)
NET POSITION, beginning of year, restated	135,150,282	138,286,762
NET POSITION, end of year	$ 155,263,067	$ 135,150,282

See accompanying notes.

Increase (Decrease) in Cash and Cash Equivalents

	Years Ended December 31, 2018	2017 (Restated)
CASH FLOWS FROM OPERATING ACTIVITIES		
Cash received from and on behalf of patients	$ 376,444,052	$ 355,547,195
Cash paid to suppliers	(154,525,884)	(159,204,529)
Cash paid to employees	(212,934,938)	(205,364,693)
Other cash receipts	23,113,573	19,753,503
Net cash from operating activities	32,096,803	10,731,476
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Purchase of capital assets	(13,328,607)	(25,754,878)
Principal payments on long-term debt	(10,091,286)	(7,572,474)
Interest paid on long-term debt	(8,588,025)	(8,062,348)
Cash received from tax revenues for general obligation bonds	4,509,087	4,191,233
Cash received from disposal of operations	9,240,364	-
Cash received from transfer of assets	2,011,331	7,826,554
Other	91,795	231,113
Net cash from capital and related financing activities	(16,155,341)	(29,140,800)
CASH FLOWS FROM INVESTING ACTIVITIES		
Cash distributions from joint ventures	3,849,612	2,851,893
Net change in investments and assets limited as to use	(32,313,849)	23,226,552
Investment income	3,383,300	1,653,457
Net cash from investing activities	(25,080,937)	27,731,902
NET CHANGE IN CASH AND CASH EQUIVALENTS	(9,139,475)	9,322,578
CASH AND CASH EQUIVALENTS, beginning of year	12,197,231	2,874,653
CASH AND CASH EQUIVALENTS, end of year	$ 3,057,756	$ 12,197,231
RECONCILIATION OF CASH AND CASH EQUIVALENTS TO THE STATEMENTS OF NET POSITION		
Cash	$ 873,722	$ 1,142,196
Cash and cash equivalents in assets limited as to use	2,184,034	11,055,035
	$ 3,057,756	$ 12,197,231

Increase (Decrease) in Cash and Cash Equivalents

	Years Ended December 31, 2018	2017 (Restated)
RECONCILIATION OF OPERATING INCOME TO NET CASH FROM OPERATING ACTIVITIES		
Operating income (loss)	$ 3,449,476	$ (14,583,264)
Adjustments to reconcile operating income to net cash from operating activities		
Net change in OPEB liability	2,918,632	2,717,902
Investment income considered an investing activity	(679,424)	(160,291)
Interest expense considered a capital financing activity	6,038,007	5,434,898
Depreciation and amortization	16,557,366	14,288,610
Income recognized from joint ventures	(3,354,824)	(2,253,933)
Changes in operating assets and liabilities		
Accounts receivable, net	(754,726)	7,493,889
Other receivables	3,335,519	(2,279,737)
Supplies inventory	519,780	(27,208)
Prepaid expenses	(330,082)	852,393
Accounts payable	558,139	(3,323,656)
Accrued salaries, wages, and employee benefits	528,978	3,508,856
Estimated third-party payor settlements	2,363,346	(970,526)
Reserve for professional liability costs	946,616	33,543
Net cash from operating activities	$ 32,096,803	$ 10,731,476
DISCLOSURE OF NONCASH INVESTING ACTIVITIES		
Capital assets financed with capital lease obligation	$ 1,477,648	$ 6,154,087
Capital assets financed through vendor	$ -	$ 1,804,739

See accompanying notes.

Note 1 – Organization

Organization – Public Hospital District No. 1 of Skagit County, Washington (the District), is organized as a municipal corporation pursuant to the laws of the state of Washington. The District is governed by an elected five-member board. The District, doing business as Skagit Valley Hospital (SVH), added the clinic division on July 1, 2010. The clinic division is known as Skagit Regional Clinics (SRC). On January 1, 2011, the District created the system name Skagit Regional Health (SRH). This name encompasses both SVH's and SRC's operations. SVH is a licensed 137-bed acute care hospital in Mount Vernon, Washington. The District also operates Camano Rural Health Clinic on Camano Island, Washington.

UW Medicine and Public Hospital District No. 3 of Snohomish County (PHD No. 3), which operated Cascade Valley Hospital and Clinics (CVH) in Arlington, Washington, entered into a long-term alliance with UW Medicine with respect to clinical and other ventures and a lease by the District of PHD No. 3's health care facilities (UW Affiliation Agreement).

Pursuant to the UW Affiliation Agreement, UW Medicine serves as SVH's and CVH's complex tertiary and quaternary health system for specialty care services not available in mutually designated communities and provided by UW Medicine. UW Medicine is available as a resource for these services and is committed to providing rapid and efficient access to advanced medical care that could not otherwise be provided locally.

The District and PHD No. 3 also entered into an Affiliation Agreement Regarding the Lease and Operation of CVH, (the Affiliation Agreement). CVH is a 48-bed facility that is approximately 20 miles southeast of SVH's main campus. In accordance with Affiliation Agreement, the District began operating CVH on June 1, 2016. The Affiliation Agreement is structured as a long-term lease (the Lease) between PHD No. 3 and the District. PHD No. 3 leased substantially all of its assets, certain other clinic facilities, PHD No. 3's interest as lessor in certain leases, and intangible assets to the District for a term of 30 years. The District will pay PHD No. 3 an annual base rent of $10 and is responsible for all costs and expenses associated with the leased assets, including maintenance and capital improvements.

Pursuant to the Affiliation Agreement, PHD No. 3 transferred all of its cash and cash equivalents of a retained amount to the District in 2017. The retained amount is equal to PHD No. 3's known and contingent liabilities and debts plus a minimum cash balance of $1,000,000. Thereafter, PHD No. 3 will continue to levy and collect excess and regular property tax levies, as well collect revenues from a lease of a medical office building owned by Smokey Point LLC. Smokey Point LLC is owned 50% by the District and 50% by PHD No. 3. The proceeds from PHD No. 3's regular property tax levy and the Smokey Point LLC lease will be used to pay PHD No. 3's expenses, including the annual debt service on outstanding limited tax general obligations, and to fund the minimum cash balance of $1,000,000. To the extent the amount collected by PHD No. 3 from its regular property tax levy and the Smokey Point LLC lease exceeds PHD No. 3's existing obligations in any year, and the PHD No. 3 cash balance is equal to $1,000,000, the excess funds will be transferred to the District. Cash transferred by PHD No. 3 to the District was $2,011,331 and $7,826,554 in 2018 and 2017. This resulted in a gain on transfer of assets of $2,011,331 and $7,826,554 in 2018 and 2017, respectively.

The Affiliation Agreement provides provisions for certain operating commitments and specific provisions in event the agreement is discontinued.

Note 2 – Summary of Significant Accounting Policies

Accounting standards – The District reports its financial information in a form that complies with the pronouncements of the Governmental Accounting Standards Board (GASB).

Basis of presentation – The accompanying financial statements have been prepared on the accrual basis of accounting using the economic resources measurement focus. Under this method of accounting, revenues are recognized when earned and expenses are recorded when liabilities are incurred without regard to receipt or disbursement of cash.

Use of estimates – The preparation of financial statements in accordance with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Change in accounting principle – During 2018, the District adopted Governmental Accounting Standards Board Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions* (GASB 75). For plans that are not prefunded, GASB 75 requires a liability for OPEB obligations, known as the total OPEB liability, to be recognized on the statement of net position of participating employers. The District adopted and retroactively applied GASB 75 to all years presented. The changes in the District's statements of net position and statements of revenue, expenses and changes in net position as a result of the retroactive application of GASB 75 are as follows:

	As Previously Reported	Effect of Change	As Adjusted
Statement of Net Position			
Total liabilities	$ 234,957,713	$ 18,991,781	$ 253,949,494
Deferred inflows of resources	-	771,714	771,714
Net position	154,913,777	(19,763,495)	135,150,282
Statement of Revenues, Expenses and Changes in Net Position			
Total operating expense	385,336,658	2,717,902	388,054,560

Cash and cash equivalents – Cash and cash equivalents include demand and interest-bearing deposits with an original maturity of three months or less.

Note 2 – Summary of Significant Accounting Policies (continued)

Patient accounts receivable – Accounts receivable are reduced by an allowance for doubtful accounts. In evaluating the collectibility of accounts receivable, the District analyzes its past history and identifies trends for each of its major payor sources of revenue to estimate the appropriate allowance for doubtful accounts and provision for bad debts. Management regularly reviews data about these major payor sources of revenue in evaluating the sufficiency of the allowance for doubtful accounts. For receivables associated with services provided to patients who have third-party coverage, the District analyzes contractually due amounts and provides an allowance for doubtful accounts and a provision for bad debts, if necessary (for example, for expected uncollectible 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). For receivables associated with self-pay patients' balances (which include both patients without insurance and patients with deductible and copayment balances due for which third-party coverage exists for part of the bill), the District 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 the discounted 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.

Supplies inventory – Supplies inventory, consisting of medicine and medical supplies, is valued at the lower of cost (computed on the first-in, first-out basis), or net realizable value.

Capital assets – Land, buildings, and equipment acquisitions are recorded at cost. Improvements and replacements of land, buildings, and equipment are capitalized. The District's capitalization threshold is $1,000 per item and a useful life of at least three years. Maintenance and repairs are expensed. The cost of land, buildings, and equipment sold or retired and the related accumulated depreciation are removed from the accounts, and any resulting gain or loss is recorded.

Depreciation is recorded over the estimated useful life of each class of depreciable asset using the American Hospital Association's guidelines and is computed using the straight-line method over the shorter period of the lease term or the estimated useful life of the equipment. The estimated useful lives used by the District are as follows:

Land improvements	3 – 40 years
Buildings	26 – 40 years
Fixed equipment	3 – 25 years
Major movable and minor equipment	3 – 20 years

Interest on borrowed funds less any interest earned on temporarily invested funds is capitalized on construction projects as a cost of the related project from the date of borrowing until the construction period ends and the related asset is placed in service. Capitalized interest is depreciated over the estimated useful life of the related asset.

Federal income taxes – The District, as a political subdivision of the state of Washington, is not subject to federal income taxes under Section 115 of the Internal Revenue Code.

Note 2 – Summary of Significant Accounting Policies (continued)

Assets limited as to use and short-term investments – Periodically, the Board of Commissioners sets aside cash resources for the funding of future capital improvements and self-insurance reserves. In addition, certain funds are restricted by bond indentures to be used solely for debt service or for the funding of future capital projects. Pool A and Pool B funds are restricted for capital improvements and operations of CVH as defined in the Affiliation Agreement. These funds are invested in bankers' acceptances, obligations of the United States Government, the State Treasurer's Investment Pool, and certificates of deposit with financial institutions in accordance with state guidelines.

All District investments are carried at market value. Investment income earned on self-insurance funds and the revenue bond indenture agreements are reported as other operating revenue. Realized and unrealized investment income or losses on other investments are reported as nonoperating gains and losses.

Investments in joint ventures – The District has investments in several different joint ventures providing health care services and accounts for these investments using the equity method, under which the District's share of net income is reported in other operating revenues.

Risk management – The District is exposed to various risks of loss from torts; theft of, damage to, and destruction of assets; business interruption; errors and omissions; employee injuries and illness; natural disasters; medical malpractice; and employee accident benefits. Commercial insurance coverage is purchased for claims arising from such matters. Settled claims have not exceeded this commercial coverage in any of the three preceding years. The District pays certain workers' compensation claims on a self-insured basis. The District has purchased stop-loss insurance to cover workers' compensation claims that exceed stated limits and has recorded an estimated reserve for incurred but not reported claims based on an actuarial estimate, which was $2,839,000 and $3,093,000 at December 31, 2018 and 2017, respectively. These amounts are recorded in accrued salaries, wages, and employee benefits on the statements of net position. The District also pays certain professional liability claims on a self-insured basis (Note 11).

Postemployment Benefits Other Than Pensions (OPEB) – The net OPEB liability is measured at the actuarial present value of projected benefit payments for the District's covered members. Deferred outflows of resources and deferred inflows of resources related to OPEB, and OPEB expense are recognized as they occur and are based on the changes in the net OPEB liability between measurement dates (Note 10).

Net position – Net position of the District is classified into three components. The net investment in capital assets component of net position consists of capital assets, net of accumulated depreciation, reduced by the outstanding balances of related debt that is attributable to the acquisition, construction, or improvement of those assets. The restricted component of net position represents noncapital assets that must be used for a specific purpose. The unrestricted component of net position is the remaining net amount of the assets and liabilities that are not included in the determination of net investment in capital assets or the restricted components of net position.

Note 2 – Summary of Significant Accounting Policies (continued)

Operating revenues and expenses – The District's statements of revenues, expenses, and changes in net position distinguish between operating and nonoperating revenues and expenses. Operating revenues, such as patient service revenue, result from exchange transactions associated with providing health care services—the District's primary business. Nonexchange revenues, such as revenues for tax levies and contributions for other than capital asset acquisition, are reported as nonoperating revenues. Operating expenses are all expenses incurred to provide health care services, other than financing costs related to general obligation bonds. Tax levy income and debt service related to general obligation bonds and peripheral or incidental transactions are reported as nonoperating gains and losses.

Net patient service revenue – Patient service revenue is recorded at established rates. Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered. Preliminary settlements under reimbursement agreements with Medicare and Medicaid are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods, as final settlements are determined.

Reimbursements received from certain third-party payors are subject to audit and retroactive adjustment. Provision for possible adjustment as a result of audits is recorded in the financial statements. When reimbursement settlements are received, or when information becomes available with respect to reimbursement changes, any variations from amounts previously accrued are accounted for in the period in which the settlements are received or the change in information becomes available.

Charity care – The District provides care to patients who meet certain criteria under its charity care policies. Because the District does not pursue collection of amounts determined to qualify as charity care, they are not reported as net patient service revenue. Forgone revenue for charity care provided during 2018 and 2017 measured by the District's standard charges was $8,171,661 and $4,141,519, respectively.

Subsequent events – Subsequent events are events or transactions that occur after the statements of net position date but before financial statements are issued. The District recognizes in the financial statements the effects of all subsequent events that provide additional evidence about conditions that existed at the date of the statements of net position, including the estimates inherent in the process of preparing the financial statements. The District's financial statements do not recognize subsequent events that provide evidence about conditions that did not exist at the date of the statements of net position but arose after the statements of net position date and before the financial statements are available to be issued.

The District has evaluated subsequent events through April 18, 2019, which is the date the financial statements are available to be issued.

Note 3 – Net Patient Service Revenue

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

Medicare – Inpatient acute care services rendered to Medicare program beneficiaries are paid at predetermined, specific rates for each hospital discharge. Discharges are classified according to a list of Medicare severity diagnosis-related groups (MS-DRGs). Each MS-DRG has a payment weight assigned to it, based on the average resources used to treat Medicare patients in that MS-DRG. The District's classification of MS-DRGs and the appropriateness of their admission are subject to an independent review by a peer review organization. Most outpatient services to Medicare beneficiaries are paid prospectively based on ambulatory payment classifications (APCs). The District's cost reports have been reviewed and/or audited by the Medicare fiscal intermediary through 2015. Net revenue billed under Medicare totaled approximately $154,489,000 and $138,613,000 for 2018 and 2017, respectively. Unsecured net patient accounts receivable due from Medicare at December 31, 2018 and 2017, were approximately $16,500,000 and $17,074,000, respectively.

Medicaid – Beginning July 1, 2005, a new inpatient Medicaid reimbursement methodology for all noncritical access Washington State governmental hospitals was implemented called "Certified Public Expenditures." Under this program, the District is paid for inpatient Medicaid services based on certain costs as determined by Medicaid. The estimated costs for inpatient care are calculated as a ratio of cost to charges from a base year (two years before the service year). Under this program, the District will be reimbursed the higher of the cost of service or "baseline" reimbursement that would have been received based on the pre-July 1 inpatient payment system. Outpatient services are paid on a fee schedule or a percentage of allowed charges based on a ratio of the District's allowable operating expenses to total allowable revenue. The District has finalized the Medicaid CPE cost reports through 2011. Net revenue billed under the Medicaid program totaled approximately $64,791,000 and $58,028,000 for 2018 and 2017, respectively. Unsecured net patient accounts receivable due from Medicaid at December 31, 2018 and 2017, were approximately $4,911,000 and $7,116,000, respectively.

The District's estimates of final settlements to or from Medicare and Medicaid through 2018 have been recorded in the accompanying statements of net position. Laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term. Differences between the net amounts accrued and subsequent settlements are recorded in operations at the time of settlement.

Other third-party payors – The District has also entered into various payment arrangements with certain commercial insurance carriers, health maintenance organizations, and preferred provider organizations, which provide for payment or reimbursement at amounts different from published rates. Contractual adjustments represent the difference between published rates for services and amounts paid or reimbursed by these third-party payors.

Note 3 – Net Patient Service Revenue (continued)

The following are the components of net patient service revenue for the District for the years ended December 31, 2018 and 2017:

	2018	2017
Gross patient service revenue	$ 1,372,603,213	$ 1,221,719,792
Less adjustments to gross patient service revenue		
Contractual adjustments	967,918,779	846,833,733
Provision for bad debts	21,677,341	21,720,708
Charity care	8,171,661	4,141,519
Total adjustments to gross patient service charges	997,767,781	872,695,960
Net patient service revenue	$ 374,835,432	$ 349,023,832

Note 4 – Deposits, Investments, and Assets Limited as to Use

The District makes investments in accordance with Washington State law. Eligible investments include obligations secured by the U.S. Treasury, other obligations of the United States or its agencies, certificates of deposit with approved institutions, insured money market funds, commercial paper, registered warrants of local municipalities, the Washington State Local Government Investment Pool (LGIP), eligible bankers' acceptances, and repurchase agreements.

As a political subdivision of the state, the District categorizes deposits and investments to give an indication of the risk assumed at year-end. Category 1 includes deposits and investments that are insured, registered, or held by the District's agent in the District's name. Category 2 includes uninsured and unregistered investments that are held by the broker's or dealer's trust department or agent in the District's name. Category 3 includes uninsured and unregistered deposits and investments for which the securities are held by the broker or dealer, or its trust department or agent, but not in the District's name.

Note 4 – Deposits, Investments, and Assets Limited as to Use (continued)

At December 31, 2018 and 2017, all deposits and investments of the District are categorized as Category 1 and consist of the following:

	2018	2017
Unrestricted cash	$ 873,722	$ 1,142,196
Short-term investments		
Investment in State Treasurer's Investment Pool	39,371,984	17,970,128
Assets limited as to use		
Cash and cash equivalents	2,184,034	11,055,035
Certificates of deposit	-	677,886
Government agency securities	68,938,429	44,848,373
Investment in State Treasurer's Investment Pool	64,026,701	76,643,521
	135,149,164	133,224,815
Total deposits and investments	$ 175,394,870	$ 152,337,139

The composition of investments, reported at fair value by investment type at December 31, 2018, and excluding unrestricted cash, short-term investments, and other assets limited as to use balances of $106,456,441, is as follows:

Investment Type	Quoted Prices in Active Markets for Identical Assets (Level 1)	Percentage of Totals
Government agency securities	$ 68,938,429	100%

The composition of investments, reported at fair value by investment type at December 31, 2017, and excluding unrestricted cash, short-term investments, and other assets limited as to use balances of $107,588,766, is as follows:

Investment Type	Quoted Prices in Active Markets for Identical Assets (Level 1)	Percentage of Totals
Government agency securities	$ 44,848,373	100%

Note 4 – Deposits, Investments, and Assets Limited as to Use (continued)

The District's deposits and investments had the following maturities as of December 31, 2018:

Deposit/Investment Type	Fair Value	Investment Maturities (in Years) Less Than 1	1–5
Demand deposit	$ 873,722	$ -	$ -
Money market	2,184,034	-	-
Government agency securities	68,938,429	68,938,429	-
Investment in State Treasurer's Investment Pool	103,398,685	-	-
	$ 175,394,870	$ 68,938,429	$ -

The District participates in the LGIP. The Office of the State Treasurer of Washington (OST) manages and operates the LGIP. Participation by local governments is voluntary. The investment policies of the LGIP are the responsibility of the OST and any proposed changes are reviewed by the LGIP Advisory Committee. The LGIP is comparable to a Rule 2a-7 money market fund recognized by the Securities and Exchange Commission (17 CFR 270.2a-7). Rule 2a-7 funds are limited to high-quality obligations with limited maximum and average maturities, the effect of which is to minimize both market and credit risk. The objectives of the State Treasurer's investment practices for the LGIP, in priority order, will be safety, liquidity, and return on investment. Separate financial statements for the LGIP are available from the OST. The LGIP is not subject to risk evaluation.

Credit risk – Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. The District's investment policy limits the types of securities to those authorized by statute; therefore, credit risk is very limited. Obligations of the U.S. government and agencies are not considered to have credit risk.

Deposits – All of the District's deposits are either insured or collateralized. The District's insured deposits are covered by the Federal Deposit Insurance Corporation (FDIC). Collateral protection is provided by the Washington Public Deposit Protection Commission (WPDPC).

Custodial credit risk – Custodial credit risk is the risk that in the event of a failure of the counterparty, the District will not be able to recover the value of the investment or collateral securities that are in the possession of an outside party. All U.S. government securities are held by the District's safekeeping custodian acting as an independent third party and carry no custodial credit risk.

Concentration of credit risk – Concentration of credit risk is the risk of loss attributed to the magnitude of the District's investment in a single issuer. The District mitigates credit risk by limiting the percentage of the portfolio invested with any one issuer.

Note 4 – Deposits, Investments, and Assets Limited as to Use (continued)

Interest rate risk – Interest rate risk is the risk that changes in interest rates of debt instruments will adversely affect the fair value of an investment. The District manages interest rate risk by having policy limitations on the maximum maturity of any one security to less than 36 months from settlement date to maturity date unless matched to a specific cash flow requirement.

In addition to interest and investment income included in nonoperating income, interest income included in other operating revenues totaled $679,287 and $160,291 for the years ended December 31, 2018 and 2017, respectively.

Note 5 – Capital Assets

Capital asset additions, retirements, and balances for the years ended December 31, 2018 and 2017, were as follows:

	Beginning Balance January 1, 2018	Additions	Retirements	Account Transfers	Ending Balance December 31, 2018
NONDEPRECIABLE CAPITAL ASSETS					
Land	$ 10,066,771	$ 1,645,559	$ -	$ -	$ 11,712,330
Construction in progress	108,520	3,634,068	-	(1,464,072)	2,278,516
Total nondepreciable capital assets	10,175,291	5,279,627	-	(1,464,072)	13,990,846
DEPRECIABLE CAPITAL ASSETS					
Land improvements	7,340,456	-	-	-	7,340,456
Buildings and leasehold improvements	139,327,221	568,287	(4,999)	117,433	140,007,942
Fixed equipment	22,957,049	172,235	(37,142)	50,875	23,143,017
Movable equipment	135,683,676	8,786,106	(542,440)	1,295,764	145,223,106
LESS ACCUMULATED DEPRECIATION AND AMORTIZATION					
Land improvements	(3,451,122)	(264,587)	-	-	(3,715,709)
Buildings and leasehold improvements	(61,539,887)	(5,323,301)	4,999	-	(66,858,189)
Fixed equipment	(18,557,315)	(600,419)	37,142	-	(19,120,592)
Movable equipment	(78,192,912)	(10,369,059)	542,440	-	(88,019,531)
Depreciable capital assets, net	143,567,166	(7,030,738)	-	1,464,072	138,000,500
	$ 153,742,457	$ (1,751,111)	$ -	$ -	$ 151,991,346

Note 5 – Capital Assets (continued)

	Beginning Balance January 1, 2017	Additions	Retirements	Account Transfers	Ending Balance December 31, 2017
NONDEPRECIABLE CAPITAL ASSETS					
Land	$ 10,066,771	$ -	$ -	$ -	$ 10,066,771
Construction in progress	11,790,900	210,426	-	(11,892,806)	108,520
Total nondepreciable capital assets	21,857,671	210,426	-	(11,892,806)	10,175,291
DEPRECIABLE CAPITAL ASSETS					
Land improvements	7,340,456	-	-	-	7,340,456
Buildings and leasehold improvements	138,510,996	816,225	-	-	139,327,221
Fixed equipment	22,749,345	105,162	(7,883)	110,425	22,957,049
Movable equipment	92,376,908	32,581,891	(1,057,504)	11,782,381	135,683,676
LESS ACCUMULATED DEPRECIATION AND AMORTIZATION					
Land improvements	(3,142,150)	(308,972)	-	-	(3,451,122)
Buildings and leasehold improvements	(56,207,642)	(5,332,245)	-	-	(61,539,887)
Fixed equipment	(17,966,962)	(598,236)	7,883	-	(18,557,315)
Movable equipment	(71,201,259)	(8,049,157)	1,057,504	-	(78,192,912)
Depreciable capital assets, net	112,459,692	19,214,668	-	11,892,806	143,567,166
	$ 134,317,363	$ 19,425,094	$ -	$ -	$ 153,742,457

The District has included equipment under capital lease obligations with a cost of $8,326,467 and $6,848,819 in capital assets at December 31, 2018 and 2017. Amortization expense of $2,266,436 and $495,619 related to this equipment was recorded in depreciation and amortization expense for 2018 and 2017, respectively. Accumulated amortization for equipment under capital lease was $2,992,793 and $726,357 at December 31, 2018 and 2017, respectively.

Depreciation and amortization expense of operating assets for the years ended December 31, 2018 and 2017, was $16,557,366 and $14,288,610, respectively.

Note 6 – Investments in Joint Ventures

Cascade Imaging Associates, LLC – Together with a local radiology group, the District formed Cascade Imaging Associates, LLC (CIA), a limited liability company, to provide magnetic resonance imaging and computer-assisted tomography services to the residents of the community. The District has a 50% interest in CIA at December 31, 2018. During the years ended December 31, 2018 and 2017, the District recognized operating income of $2,450,235 and $1,889,141, respectively, for its share of the net income realized by CIA. The District's recorded investment in CIA was $418,134 and $532,899 at December 31, 2018 and 2017, respectively.

Medical Information Network – North Sound, Inc. – Together with area hospitals, the District joined Medical Information Network – North Sound, Inc. (MIN – NS), a Washington nonprofit corporation, to electronically connect patients, providers, and others to a regional electronic health record to improve quality and efficiency of health care services in North Sound communities. The District has a 50% interest in MIN – NS at December 31, 2018. During the years ended December 31, 2018 and 2017, the District recognized operating loss of $26,888 and $154,405, respectively, for its share of net loss realized by MIN – NS. The District's recorded investment in MIN – NS was $51,124 and $78,012 at December 31, 2018 and 2017, respectively.

Skagit Digital Imaging, LLC – Together with a local radiology group, the District formed Skagit Digital Imaging, LLC (SDI), a limited liability company, to provide mammography and stereotactic biopsy services to the residents of the community. The District has a 50% interest in SDI at December 31, 2018. During the years ended December 31, 2018 and 2017, the District recognized operating income of $21,632 and operating loss of $92,783, respectively, for its share of the net income or loss realized by SDI. The District's recorded investment in SDI was $186,451 and $164,819 at December 31, 2018 and 2017, respectively.

Skagit Hospice Services, LLC – Together with Public Hospital District No. 304 of Skagit County, Washington, the District formed Skagit Hospice Services, LLC, dba Hospice of the Northwest (Hospice), a limited liability company, to provide hospice services to the residents of the community. The District has a 50% interest in Hospice at December 31, 2018. During the years ended December 31, 2018 and 2017, the District recognized operating income of $211,662 and operating loss of $48,749, respectively, for its share of the net income or loss realized by Hospice. The District's recorded investment in Hospice was $1,570,893 and $1,359,231 at December 31, 2018 and 2017, respectively.

Skagit Valley Real Estate Partnership – As part of the closing of the integration with SRC in 2013, the District purchased a membership interest in Skagit Valley Real Estate Partnership (SVREP), a partnership that invests in and develops real property located mainly in Skagit and Snohomish Counties, Washington. The District has a 30% interest in SVREP at December 31, 2018. During the years ended December 31, 2018 and 2017, the District recognized operating income of $275,000 and $347,100, respectively, for its share of the net income realized by SVREP. The District's recorded investment in SVREP was $4,848,478 and $5,009,979 at December 31, 2018 and 2017, respectively.

Smokey Point Medical Center, LLC – Together with PHD No. 3, the District formed Smokey Point Medical Center, LLC (SPMC), a limited liability company, which owns the building, land, and equipment leased to the District and PHD no. 3 to operate the Smokey Point clinics. The District has a 50% interest in SPMC at December 31, 2018. During the years ended December 31, 2018 and 2017, the District recognized operating income of $375,072 and $341,436, respectively, for its share of the net income realized by SPMC. The District's recorded investment in SPMC was $5,136,770 and $5,561,698 at December 31, 2018 and 2017, respectively.

Note 6 – Investments in Joint Ventures (continued)

Aggregated financial information for all of the District's joint ventures is summarized below:

	2018	2017
Current assets	$ 7,462,071	$ 7,403,206
Noncurrent assets, net	25,178,315	26,257,925
	$ 32,640,386	$ 33,661,131
Current liabilities	$ 1,996,367	$ 1,974,916
Long-term liabilities	11,279,552	11,770,231
Equity	19,364,467	19,915,984
	$ 32,640,386	$ 33,661,131
Revenue	$ 29,714,151	$ 27,156,951
Expenses	21,991,864	21,764,051
Net income	$ 7,722,287	$ 5,392,900

For more information on these joint ventures, including financial statements for the individual joint ventures, please contact the Business Services office of the District.

Note 7 – Long-Term Debt and Other Noncurrent Liabilities

Interest rates and maturities of long-term debt at December 31, 2018 and 2017, for the District consisted of the following:

	2018	2017
Revenue and refunding bonds, 2016 series, 4.00% to 5.00%, due serially on December 1, in amounts from $1,635,000 in 2019 to $5,875,000 in 2032, maturing in 2037, net of unamortized premium of $5,945,069 and $6,260,736 in 2018 and 2017, respectively.	$ 65,535,069	$ 67,425,736
Revenue bonds, 2010 series, 4.25% to 6.00%, due serially on December 1, in amounts from $525,000 in 2019 to $7,425,000 in 2035, net of unamortized discount of $279,531 and $296,137 in 2018 and 2017, respectively.	31,250,469	31,733,863
General obligation and refunding bonds, 2012 series, 3.13% to 5.00%, due serially on December 1, in amounts from $2,845,000 in 2019 to $6,225,000 in 2028, net of unamortized premium of $4,202,115 and $4,625,857 in 2018 and 2017, respectively.	48,227,115	51,240,857
Revenue and refunding bonds, 2013A series, 4.00% to 5.00%, due serially on December 1, in amounts from $1,665,000 in 2019 to $7,895,000 in 2036, maturing in 2037, net of unamortized premium of $1,853,959 and $1,957,920 in 2018 and 2017, respectively.	24,468,959	26,157,920
Notes payable to individuals, due in monthly installments from $15,700 to $23,200, including interest from 4.50% to 5.00% with various maturities through July 2024.	954,316	1,362,926
Note payable to bank, due in monthly installments of $9,900, including interest at 4.25% through January 2021.	223,554	330,399
Note payable paid in full during 2018.	-	1,136,739
Capital lease obligations, stated at present value of future minimum lease payments.	5,584,564	6,296,008
	176,244,046	185,684,448
Less current portion	(9,290,692)	(9,956,836)
	$ 166,953,354	$ 175,727,612

Note 7 – Long-Term Debt and Other Noncurrent Liabilities (continued)

Under the terms of the revenue and refunding bonds, the District has agreed to maintain certain financial ratios and meet certain covenants. Management is not aware of any violations with its debt covenants.

During 2016, the District issued the 2016 revenue bonds to carry out a tax-exempt refunding of the 2005 and 2007 revenue and refunding bonds. The refunding resulted in the recognition of an accounting loss of $703,391, which will be deferred and amortized over the life of the 2007 bond, which was set to mature in 2032 and is classified as a deferred outflow of resources on the statement of net position. The refunding decreased the District's aggregate debt service payments by $8,527,000 over the next 16 years and resulted in an economic gain (difference between the present values of the old and new debt service payments) of $6,663,000.

Changes in the District's noncurrent liabilities during the years ended December 31, 2018 and 2017, are summarized below:

	Beginning Balance January 1, 2018	Additions	Reductions	Ending Balance December 31, 2018	Amounts Due Within One Year
LONG-TERM DEBT					
2010 Revenue bonds	$ 31,733,863	$ -	$ 483,394	$ 31,250,469	$ 525,000
2012 GO and refunding bonds	51,240,857	-	3,013,742	48,227,115	2,845,000
2013 Revenue and refunding bonds	26,157,920	-	1,688,961	24,468,959	1,665,000
2016 Revenue and refunding bonds	67,425,736	-	1,890,667	65,535,069	1,635,000
Notes payable to individuals	1,362,926	-	408,610	954,316	157,394
Note payable to bank	330,399	-	106,845	223,554	111,088
Note payable to Epic	1,136,739	-	1,136,739	-	-
Capital lease obligations	6,296,008	1,477,648	2,189,092	5,584,564	2,352,210
Total long-term debt	185,684,448	1,477,648	10,918,050	176,244,046	9,290,692
ESTIMATED PROFESSIONAL LIABILITY	4,036,788	946,616	-	4,983,404	-
Total noncurrent liabilities	$ 189,721,236	$ 2,424,264	$ 10,918,050	$ 181,227,450	$ 9,290,692

Note 7 – Long-Term Debt and Other Noncurrent Liabilities (continued)

	Beginning Balance January 1, 2017	Additions	Reductions	Ending Balance December 31, 2017	Amounts Due Within One Year
LONG-TERM DEBT					
2010 Revenue bonds	$ 32,197,258	$ -	$ 463,395	$ 31,733,863	$ 500,000
2012 GO and refunding bonds	54,009,600	-	2,768,743	51,240,857	2,590,000
2013 Revenue and refunding bonds	27,786,880	-	1,628,960	26,157,920	1,585,000
2016 Revenue and refunding bonds	69,276,403	-	1,850,667	67,425,736	1,575,000
Notes payable to individuals	1,754,859	-	391,933	1,362,926	413,010
Note payable to bank	433,212	-	102,813	330,399	90,115
Note payable to Epic	-	1,804,739	668,000	1,136,739	1,136,739
Capital lease obligations	666,649	6,154,087	524,728	6,296,008	2,066,972
Total long-term debt	186,124,861	7,958,826	8,399,239	185,684,448	9,956,836
ESTIMATED PROFESSIONAL LIABILITY	4,003,245	33,543	-	4,036,788	-
Total noncurrent liabilities	$ 190,128,106	$ 7,992,369	$ 8,399,239	$ 189,721,236	$ 9,956,836

Annual debt service requirements to maturity for long-term debt are as follows:

Year Ending December 31,	Bonds and Notes Payable			Capital Leases Payable		
	Principal	Interest	Total	Principal	Interest	Total
2019	$ 6,938,482	$ 7,849,807	$ 14,788,289	$ 2,352,210	$ 75,607	$ 2,427,817
2020	7,406,312	7,524,910	14,931,222	2,295,000	51,628	2,346,628
2021	7,798,430	7,175,025	14,973,455	457,468	30,979	488,447
2022	8,335,952	6,802,078	15,138,030	314,002	15,086	329,088
2023	8,903,820	6,402,845	15,306,665	165,884	3,554	169,438
2024-2028	52,812,468	25,618,106	78,430,574	-	-	-
2029-2033	33,155,000	14,401,495	47,556,495	-	-	-
2034-2038	33,587,406	4,472,563	38,059,969	-	-	-
Total	158,937,870	$ 80,246,829	$ 239,184,699	$ 5,584,564	$ 176,854	$ 5,761,418
Net unamortized premiums and discounts	11,721,612					
	$ 170,659,482					

Note 8 – Deferred Compensation and Pension Plans

The District has a deferred compensation plan and pension plans created in accordance with Internal Revenue Code §457(b), §401(a), and §414(h). The plans are available to eligible employees and collectively provide for District matching contributions of a maximum of 9% of the employee's gross compensation earned in the prior year. Current District policy is to fund contributions. Plan provisions and contribution requirements are established by the District and may be amended by the District's Board of Commissioners.

Under the §401(a) plan, the District makes contributions on behalf of eligible employees based upon funding levels ranging from 4% to 9% of an employee's gross earnings plus an additional 1/10 of 1% for each year of the first 10 years of credited service. The District contributes up to 9% not to exceed the maximum federal amount for the year. Employees are not allowed to contribute to the §401(a) plan. All employee contributions are made to the §457(b) plan.

The §457(b) plan is available to eligible employees and permits them to defer a portion of their salary until withdrawn in future years. The deferred compensation is not available to employees until termination, retirement, death, or an unforeseeable emergency.

The §414(h) plan allows a limited group of employees to make an irrevocable election prior to the beginning of the plan year. The maximum contribution is the §415 limit minus any employer §401(a) contributions. These pick-up contributions are completely voluntary and are in addition to any District contributions made to the §401(a) plan and any contributions that are made to the §457(b) deferred compensation plan. Generally, the benefits may only be distributed at termination of employment or death.

The District has limited administrative involvement and does not perform the investing function for the plans. The District does not hold the assets of the plans in a trustee capacity and does not perform fiduciary accountability for the plans. Therefore, the District employees' deferred compensation plans are not reported on the financial statements of the District.

The District's contributions to the employee benefit plans totaled approximately $7,872,000 and $7,259,000 in 2018 and 2017, respectively. Contributions made by employees to the benefit plans totaled approximately $9,402,000 and $8,351,000 in 2018 and 2017, respectively. For more information on the retirement plans, contact the District's director of human resources.

Note 9 – Property Taxes

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

Taxes are due in two equal installments on April 30 and October 31. Collections are distributed monthly to the District by the county treasurer.

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

For 2018 and 2017, the District did not have a regular tax levy. There is a voter-approved tax levy for service of the unlimited tax general obligation bonds. For 2018 and 2017, the tax levy for bond service was $0.86 and $0.88 per $1,000 on a total assessed valuation of $4,724,722,380 and $4,291,075,086, for a total levy of $4,076,981 and $3,771,898, respectively. The District also receives revenue from timber taxes. Timber tax revenue in 2018 and 2017 was $436,000 and $402,640, respectively.

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

Note 10 – Postemployment Benefits Other Than Pensions (OPEB)

General information about the OPEB Plan

Plan description – Eligible retirees and spouses are entitled to subsidies associated with postemployment medical benefits provided through the Public Employee Benefits Board (PEBB), which is an agent multiple-employer defined benefit plan. The PEBB was created within the Washington State Health Care Authority to administer medical, dental, and life insurance plans for public employees and retirees. No assets are accumulated in a trust that meets the criteria in paragraph 4 of GASB 75.

Benefits provided – The subsidies provided by PEBB and valued in this report 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.

Note 10 – Postemployment Benefits Other Than Pensions (OPEB) (continued)

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. Active employees will tend to be younger and healthier than retirees on average, and therefore can be expected to have lower average health costs. For post-65 retirees and spouses, the retiree does not pay the full premium due to the subsidy discussed above.

Employees covered by benefit terms – At December 31, 2018 and 2017, the following employees were covered by the benefit terms:

Inactive employees or beneficiaries currently receiving benefit payments	77
Active plan members	1,681
	1,758

Contributions – PEBB administrative costs as well as implicit and explicit subsidies are funded by required contributions from participating employers. Contributions are set each biennium as part of the Washington State's budget process. The benefits are funded on a pay-as you-go basis.

Other information – PEBB does issue a stand-alone financial report, but information about PEBB can be found at http://leg.wa.gov/osa/additionalservices/Pages/OPEB.aspx.

Total OPEB liability

The District's total OPEB liability was $23,464,988 and $18,991,781 as of the reporting date of December 31, 2018 and 2017, respectively. The corresponding measurement date was December 31, 2017 and 2017, respectively, and the actuarial valuation date was January 1, 2017. GASB 75 allows a lag of up to one year between the measurement date and the reporting date. No adjustment is required between the measurement date and the reporting date.

Actuarial assumptions and other inputs – The total OPEB liability in the December 31, 2018 actuarial valuation was determined using the following actuarial assumptions and other inputs, applied to all periods included in the measurement, unless otherwise specified:

Inflation	3.0%
Salary increases	3.75% = 0.75% real wage growth above inflation. The individual's salary growth is used for use in the actuarial cost method.
Healthcare cost trend rates	Pre-65 ranging from 7.0% to 4.8% and Post-65 ranging from 7.4% to 4.9%
Discount Rate (Liabilities)	3.44% and 3.78% as of December 31, 2018 and 2017, respectively

The discount rate was based on the Bond Buyer General Obligation 20-bond municipal bond index for bonds that mature in 20 years. GASB 75 requires that the discount rate be based on a 20-year high quality (AA/Aa or higher) municipal bond rate.

Note 10 – Postemployment Benefits Other Than Pensions (OPEB) (continued)

Demographic assumptions regarding retirement, mortality, turnover, and marriage are based on assumptions used in the 2018 actuarial valuation for Washington State Public Employees' Retirement System (PERS), and modified for the District.

- The assumed rates of disability under PERS tier 2 and 3 from the 2018 actuarial valuation are less than 0.1% for ages 50 and below and continue to be low after that. An assumption of a 0% disability rate for all ages was used.

- For service retirement, the post-2013, plans 2 and 3, with less than 30 years of service assumptions from the 2018 actuarial valuation for Washington State PERS was used.

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

The actuarial assumptions used for the December 31, 2018 reporting were based on a census date of January 1, 2017.

Changes in the total OPEB liability

Balance at January 1, 2017	$ 17,045,593
Service cost	2,377,362
Interest	688,677
Changes of benefit terms	-
Differences between expected and actual experience	-
Changes of assumptions or other inputs	(852,947)
Benefit payments	(266,904)
Net Changes	1,946,188
Balance at December 31, 2017	$ 18,991,781
Service cost	2,322,431
Interest	800,469
Changes of benefit terms	-
Differences between expected and actual experience	-
Changes of assumptions or other inputs	1,628,431
Benefit payments	(278,124)
Net Changes	4,473,207
Balance at December 31, 2018	$ 23,464,988

Changes of assumptions and other inputs reflect a change in the discount rate from 3.57% in 2016 to 3.78% in 2017 and 3.44% in 2018.

Note 10 – Postemployment Benefits Other Than Pensions (OPEB) (continued)

Sensitivity of the total OPEB liability to changes in the discount rate – The following presents the total OPEB liability of the County, as well as what the County'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 discount rate:

2018	1% Decrease (2.44%)	Discount Rate (3.44%)	1% Increase (4.44%)
Total OPEB liability	$ 29,229,663	$ 23,464,988	$ 19,067,110

2017	1% Decrease (2.78%)	Discount Rate (3.78%)	1% Increase (4.78%)
Total OPEB liability	$ 23,532,391	$ 18,991,781	$ 15,519,808

Sensitivity of the total OPEB liability to changes in the healthcare cost trend rates – The following presents the total OPEB liability of the District, as well as what the District's total OPEB liability would be if it were calculated using healthcare cost trend rates that are 1-percentage-point lower or 1-percentage-point higher than the current healthcare cost trend rates:

2018	1% Decrease	Healthcare Cost Trend Rates	1% Increase
Total OPEB liability	$ 18,276,510	$ 23,464,988	$ 30,675,901
2017			
Total OPEB liability	$ 15,057,789	$ 18,991,781	$ 24,381,072

The health cost trend assumptions apply to both current and future retirees and generally decrease over time from a high of 7.0% to 4.8% for pre-65 retirees and from a high of 7.4% to 4.9% for post-65 retirees. The dental cost trend assumptions generally increase over time and range from 3.48% to 4.0%.

Note 10 – Postemployment Benefits Other Than Pensions (OPEB) (continued)

OPEB expense and deferred outflows of resources and deferred inflows of resources related to OPEB

For the year ended December 31, 2018 and 2017, the District recognized OPEB expense of $2,918,632 and $2,717,902, respectively, which was included in Employee Benefits in the Statement of Revenues, Expenses, and Changes in Net Position. The District reported deferred outflows of resources and deferred inflows of resources related to OPEB from the following sources as of December 31:

2018	Deferred Outflows of Resources	Deferred Inflows of Resources
Differences between expected and actual experience	$ -	$ -
Changes of assumptions or other inputs	1,473,342	690,481
	$ 1,473,342	$ 690,481
2017		
Differences between expected and actual experience	$ -	$ -
Changes of assumptions or other inputs	-	771,714
	$ -	$ 771,714

Amounts reported as deferred outflows of resources and deferred inflows of resources related to OPEB will be recognized in OPEB expense as follows:

2019	$ 73,856
2020	73,856
2021	73,856
2022	73,856
2023	73,856
Thereafter	413,581

Note 11 – Professional Liability Insurance

The District has purchased professional liability insurance from Physicians Insurance (PI) on a claims-made basis in the amount of $1 million per occurrence, with a $5 million annual aggregate limit. The District has a retention of $100,000 per claim with an aggregate retention of $300,000. PI, together with MedPro and AIG, also provides excess coverage on a claims-made basis in the amount of $45 million per occurrence, with a $49 million annual aggregate limit. The District accrues an actuarial estimate of the expected value of losses and related expenses for unreported incidents and claims on an occurrence basis, discounted at 4%, which was $4,983,000 and $4,037,000 at December 31, 2018 and 2017, respectively.

Note 12 – Joint Venture Transactions

The District provides services, including accounting, management, and ancillary services, to the joint ventures (Note 6). The District was reimbursed approximately $12,278,000 and $11,964,000 in expenses related to these services for the years ended December 31, 2018 and 2017, respectively.

As of December 31, 2018 and 2017, the District had a total of approximately $677,000 and $694,000, respectively, in accounts receivable from joint ventures.

The joint ventures provide various services to the District (Note 6). The District paid approximately $16,584,000 and $15,930,000 to the joint ventures for providing these services for the years ended December 31, 2018 and 2017, respectively.

As of December 31, 2018 and 2017, the District had a total of approximately $922,000 and $982,000, respectively, in accounts payable to joint ventures.

Note 13 – Concentrations of Credit Risk

The District grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payor agreements. The mix of net receivables from patients and third-party payors at December 31, 2018 and 2017, was as follows:

	2018	2017
Medicare	33%	35%
Medicaid	10%	15%
Group Health	9%	8%
Patient and self-pay	1%	1%
Commercial	36%	30%
Other third-party payors	11%	11%
	100%	100%

Note 14 – Commitments and Contingencies

Operating leases – The District leases certain facilities and equipment under operating lease arrangements. The following is a schedule by year of future minimum lease payments as of December 31, 2018:

2019	$ 7,377,789
2020	6,945,796
2021	6,947,661
2022	5,245,694
2023	5,283,499
2024-2028	9,031,687
2029-2032	3,995,017
	$ 44,827,143

Rent expense on operating leases for 2018 and 2017 was $8,945,000 and $9,784,000, respectively.

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

Compliance with laws and regulations – The health care industry is subject to numerous laws and regulations from 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 Medicare and Medicaid fraud and abuse. Government activity with respect to investigations and allegations regarding possible violations of these laws and regulations by health care providers, including those related to medical necessity, coding, and billing for services, has increased substantially. Violations of these laws and regulations could result in expulsion from government health care programs, together with the imposition of significant fines and penalties, as well as significant repayments for patient services previously billed. Management believes that the District is in compliance with the fraud and abuse regulations, as well as other applicable government laws and regulations. Compliance with such laws and regulations can be subject to future government review and interpretation, as well as regulatory actions unknown or unasserted at this time.

Note 15 – Collective Bargaining Agreements

At December 31, 2018, the District had a total of approximately 2,437 employees. Of this total, 1,746 employees are covered by collective bargaining agreements. There are 1,248 employees under agreements that expire during 2019 and 498 employees under agreements that expired during 2018 and is under negotiation. The District does not anticipate any significant interruptions as a result of negotiations surrounding the collective bargaining agreement.

MOSSADAMS

Report of Independent Auditors on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*

To the Board of Commissioners
Public Hospital District No. 1 of Skagit County, Washington

We have audited, in accordance with the auditing standards generally accepted in the United States of America 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 the District as of and for the year ended December 31, 2018, and the related notes to the financial statements, which collectively comprise the District's basic financial statements, and have issued our report thereon dated April 18, 2019.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the District'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 opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the District's internal control. Accordingly, we do not express an opinion on the effectiveness of the District'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 District'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 entity'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 entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Moss Adams LLP

Everett, Washington
April 18, 2019

Required Supplementary Information

Public Hospital District No. 1 of Skagit County, Washington
Schedule of Changes in Total Other Post-Employment Benefits and Related Ratios

	2018	2017
Total OPEB liability		
Service cost	$ 2,322,431	$ 2,377,362
Interest	800,469	688,677
Changes of benefit terms	-	-
Differences between expected and actual experience	-	-
Changes of assumptions or other inputs	1,628,431	(852,947)
Benefit payments	(278,124)	(266,904)
Net change in total OPEB liability	4,473,207	1,946,188
Total OPEB liability - beginning	18,991,781	17,045,593
Total OPEB liability - ending	$ 23,464,988	$ 18,991,781
Plan fiduciary net position	$ -	$ -
Net OPEB liability	$ 23,464,988	$ 18,991,781
Plan fiduciary net position as a percentage of total OPEB liability	0%	0%
Covered-employee payroll	$ 170,215,023	$ 150,792,481
Total OPEB liability as a percentage of covered-employee payroll	13.79%	12.59%

*This schedule is presented to illustrate the requirement to show information for 10 years.
However, until a full 10-year trend is compiled, the District will present information for available years.

Changes in benefit terms – There were no applicable changes during the period.

Changes of assumptions – Changes of assumptions and other inputs reflect the effects of changes in the discount rate each period. The discount rate changed from 3.57% in 2016 to 3.78% in 2017 and 3.44% in 2018. As this is a newly adopted standard, a full 10-year trend is not available.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