



Report of Independent Auditors  
and Financial Statements for

**Public Hospital District No. 2,  
Snohomish County, Washington dba  
Verdant Health Commission**

December 31, 2012 and 2011

**MOSS ADAMS** LLP

Certified Public Accountants | Business Consultants

*Acumen. Agility. Answers.*

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## REPORT OF INDEPENDENT AUDITORS

To the Board of Commissioners  
Public Hospital District No. 2,  
Snohomish County, Washington dba  
Verdant Health Commission

### **Report on Financial Statements**

We have audited the accompanying financial statements of Public Hospital District No. 2, Snohomish County, Washington dba Verdant Health Commission (the District), which comprise the statements of net position as of December 31, 2012 and 2011, and the related statements of revenues, expenses, and changes in net position and cash flows for the years then ended, and the related notes to the financial statements.

### ***Management's Responsibility for the Financial Statements***

Management is responsible for the preparation and fair presentation of these financial statements in accordance with 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. Those standards require that we plan and perform the audits 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 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. 2, Snohomish County, Washington dba Verdant Health Commission as of December 31, 2012 and 2011, 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.

***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 8 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.

A handwritten signature in black ink that reads "Moss Adams LLP". The signature is written in a cursive, flowing style.

Everett, Washington  
April 22, 2013

**PUBLIC HOSPITAL DISTRICT NO. 2, SNOHOMISH COUNTY, WASHINGTON dba  
VERDANT HEALTH COMMISSION  
MANAGEMENT'S DISCUSSION AND ANALYSIS**

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The following discussion and analysis for Public Hospital District No. 2, Snohomish County, Washington dba Verdant Health Commission (the District), provides an overview of the District's financial activities for the years ended December 31, 2012 and 2011. Please read it in conjunction with the District's financial statements, which follow this analysis.

**Using These Basic Financial Statements**

The District's financial statements consist of three statements: a statement of net position; a statement of revenues, expenses, and changes in net position; and a statement of cash flows. These financial statements and related notes provide information about the financial activities of the District.

**The Statement of Net Position and Statement of Revenues, Expenses, and Changes in Net Position**

These two 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 when the underlying transactions occur, regardless of when cash is received or paid. These statements report the District's net assets and the changes therein. When assessing the overall health of the District, other nonfinancial factors also need to be considered, such as changes in services offered, measures of the quality of service offered, and local economic factors.

**The Statement of Cash Flows**

This statement reports cash receipts, cash payments, and net changes in cash resulting from operations, investing, and capital and noncapital financing activities. It provides information about sources and uses of cash and the change in cash balances during the reporting periods.

**The Transition of Operations, Effective September 1, 2010**

Until September 1, 2010, Public Hospital District No. 2, Snohomish County, Washington, owned and operated Stevens Hospital. Through a lease and operating agreement, on September 1, 2010, Swedish Health Services, a nonprofit corporation, took over operation of the hospital and renamed it Swedish/Edmonds. This transition significantly changed the role of the District. The District retained ownership of the hospital but will no longer manage its operations and will instead be a landlord to Swedish Health Services. As of December 31, 2012, Swedish Health Services had paid \$17.2 million in total lease payments to the District for the use of real property and personal assets owned by the District.

**PUBLIC HOSPITAL DISTRICT NO. 2, SNOHOMISH COUNTY, WASHINGTON dba  
VERDANT HEALTH COMMISSION  
MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)**

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**The Transition of Operations, Effective September 1, 2010 (continued)**

The negotiated agreement terms for use of the hospital by Swedish Health Services are for 30 years, with options to renew, wherein the District will receive monthly lease payments that increase 3.0% per year for the first 15 years, after which time the monthly payments will be steady for the remainder of the agreement. Additionally, Swedish Health Services agrees to invest a minimum of \$90.0 million into hospital capital improvements over the course of the first 10 years, with no less than \$6.0 million per year in each of those 10 years.

The District will maintain investments sufficient to take back the operation of the hospital in the event of default by Swedish Health Services or some other extraordinary event. This transition significantly impacted many of the statement of net position accounts for the year ending December 31, 2010, and along with the long-term agreement with Swedish Health Systems, significantly improves the short- and long-term financial viability of the District.

**The Verdant Health Commission**

As of September 1, 2010, the District began doing business as South Snohomish County Commission for Health (SSCCFH). The SSCCFH name was changed in 2011 by a vote of the commissioners to the Verdant Health Commission (Verdant). Verdant is governed by the board of five elected commissioners. The mission of Verdant is to improve the health and well-being of our community. This mission will be completed by contracting for services with local organizations, businesses, and government agencies, and the establishment of Verdant-operated initiatives. Long-term financial stability will be established by investing available revenues received from Swedish Health Systems, as well as ongoing tax levy revenues, into allowable government funds, thus building adequate reserves over the next 10 years.

Verdant began accepting funding proposals in June of 2011 in four health priority areas: Education and Empowerment, Prevention, Access to Healthcare Services, and Policy and Advocacy. Funds are available for one-time uses like events and short-term needs in the community, as well as for ongoing health and wellness programs. Verdant paid out nearly \$1.9 million in community program investments during 2012. Each program is managed through a cooperative agreement with partners, and is being monitored for performance and compliance by Verdant staff.

Some of the programs approved in 2012 include a mobile medical clinic that provides free medical care for uninsured individuals with the goal of helping them to overcome chronic health conditions, a back-to-school health fair that provided immunizations and health screenings for children and youth, and a mobile dental clinic that provides free dental care at five South Snohomish County locations. Recipients of services include seniors, youth, and uninsured members of our community. In all, programs funded in 2012 were expected to serve 13,000 South Snohomish County residents.

Additionally, Verdant took the lead on two health and wellness initiatives during 2012, including 6 Weeks to a Healthier You, which was a community health and wellness program that provided information, motivation, and biometric screenings designed to help community residents improve their health. The event ran for six consecutive weeks and attracted 480 participants and led to measurable improvements in participants' health measures. Verdant also led an effort to encourage South Snohomish County residents to get vaccinated against whooping cough. The whooping cough campaign included meetings with community leaders, outreach to businesses and community organizations, a printed newsletter, and phone outreach to area households.

**PUBLIC HOSPITAL DISTRICT NO. 2, SNOHOMISH COUNTY, WASHINGTON dba  
VERDANT HEALTH COMMISSION  
MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)**

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**The Verdant Health Commission (continued)**

Looking to the future, Verdant will continue funding effective and sustainable community health programs, as well as convening stakeholders to develop new initiatives that address key community health and wellness needs. Verdant will also continue partnerships and support community providers and employers to improve the health and well-being of South Snohomish County residents.

**Statement of Net Position**

The District's net position is the difference between its assets and liabilities as reported in the statement of net position (in thousands).

	<u>2012</u>	<u>2011</u>	<u>2010</u>
Assets			
Current assets	\$ 44,093	\$ 38,132	\$ 31,009
Capital assets, net	26,154	31,219	37,012
Other noncurrent assets	<u>6,099</u>	<u>4,129</u>	<u>2,716</u>
Total assets	<u>\$ 76,346</u>	<u>\$ 73,480</u>	<u>\$ 70,737</u>
Liabilities			
Current liabilities	\$ 1,198	\$ 5,349	\$ 5,639
Long-term debt, net	6,330	7,000	9,030
Other long-term liabilities	<u>203</u>	<u>566</u>	<u>4,042</u>
Total liabilities	<u>7,731</u>	<u>12,915</u>	<u>18,711</u>
Net position			
Net investment in capital assets	19,104	22,214	24,553
Restricted for debt service	95	238	323
Unrestricted	<u>49,416</u>	<u>38,114</u>	<u>27,150</u>
Total net position	<u>68,615</u>	<u>60,566</u>	<u>52,026</u>
Total liabilities and net position	<u>\$ 76,346</u>	<u>\$ 73,481</u>	<u>\$ 70,737</u>

**Current Assets**

Total current assets of \$44.1 million at year-end 2012 reflect an increase of \$6.0 million (15.6%), compared to the balance of \$38.1 million at the end of 2011. Cash and short-term investments increased by \$5.6 million (15.2%) in 2012, compared to an increase of \$23.3 million (173.7%) in 2011.

**PUBLIC HOSPITAL DISTRICT NO. 2, SNOHOMISH COUNTY, WASHINGTON dba  
VERDANT HEALTH COMMISSION  
MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)**

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**Statement of Net Position (continued)**

**Capital Assets**

The District's net capital assets decreased \$5.1 million (16.2%) in 2012, compared to a net decrease of \$5.8 million (15.7%) in 2011. This decrease is primarily a result of depreciation. No major additions were acquired in 2012.

**Other Noncurrent Assets**

Other noncurrent assets totaled \$6.1 million at year-end 2012, an increase of \$2.0 million (47.7%) from \$4.1 million in 2011. This total includes nearly \$6.0 million in deferred rent, up from \$4.1 million in 2011. The deferred rent results from straight-line recognition of the 30-year lease of the hospital to Swedish Health Services.

**Current Liabilities**

Current liabilities decreased \$4.2 million (77.6%) from \$5.3 million in 2011 to \$1.2 million in 2012. Accrued salaries and benefits decreased by \$1.2 million due to payment in full of deferred compensation of former Stevens Hospital CEO, Stephen McCary. In 2011, estimated third-party payor settlements equaled a net liability of \$1.2 million due to an unexpected Washington State fiscal-year 2010 interim CPE settlement payment. In 2012, estimated third-party payor settlements equaled a net receivable of \$1.0 million.

**Long-Term Debt**

As of December 31, 2012, the District had \$6.3 million in long-term debt and obligations under capital leases, net of current portion, which is a \$0.7 million (9.6%) decrease from 2011. Outstanding 1999 LTGO refunding bonds were paid in full during 2012 by the issuance of \$6.6 million of 2012 LTGO refunding bonds. Principal payments during 2012, in excess of the 1999 LTGO refunding bond payments, totaled \$1.0 million. Outstanding 2003 UTGO refunding bonds were paid in full during 2011.

**Other Long-Term Liabilities**

Other noncurrent liabilities of \$0.2 million decreased by \$0.4 million (64.1%) in 2012 from \$0.6 million in 2011.

**PUBLIC HOSPITAL DISTRICT NO. 2, SNOHOMISH COUNTY, WASHINGTON dba  
VERDANT HEALTH COMMISSION  
MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)**

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**Operating Results and Changes in the District's Net Position**

In 2012, the District's net assets increased \$8.0 million (13.3%), compared to an increase of \$8.5 million (16.4%) in 2011.

	<u>2012</u>	<u>2011</u>	<u>2010</u>
Operating revenues			
Lease revenue	\$ 10,398	\$ 10,390	\$ 3,462
Other operating revenues	17	-	-
Total operating revenues	<u>10,415</u>	<u>10,390</u>	<u>3,462</u>
Operating expenses			
Salaries and benefits	714	462	80
Program expenditures	1,866	298	-
Other	481	834	512
Depreciation	5,004	5,786	2,097
Total operating expenses	<u>8,065</u>	<u>7,380</u>	<u>2,689</u>
Operating income	<u>2,350</u>	<u>3,010</u>	<u>773</u>
Nonoperating revenues (expenses)			
Tax levies	2,037	3,196	4,193
Investment income	1,126	1,934	674
Interest expense and amortization	(192)	(345)	(1,001)
Noncapital grants and contributions	-	-	63
Income from operating hospital	-	-	1,927
Other income	2,728	745	3,212
Net nonoperating revenues	<u>5,699</u>	<u>5,530</u>	<u>9,068</u>
Excess of revenues over expenses before capital grants and contributions	8,049	8,540	9,841
Capital grants and contributions	<u>-</u>	<u>-</u>	<u>57</u>
Increase in net assets	8,049	8,540	9,898
Net assets, beginning of year	<u>60,566</u>	<u>52,026</u>	<u>42,128</u>
Net assets, end of year	<u>\$ 68,615</u>	<u>\$ 60,566</u>	<u>\$ 52,026</u>

**PUBLIC HOSPITAL DISTRICT NO. 2, SNOHOMISH COUNTY, WASHINGTON dba  
VERDANT HEALTH COMMISSION  
MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)**

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**Operating Results and Changes in the District's Net Position (continued)**

Operating revenues in 2012 totaling \$10.4 million were attributed to lease payments. Of that, \$10.1 million was attributable to the Swedish Health Services lease. Additional lease revenues were received from other lease agreements including Value Village and Healthcare Reality.

Overall operating costs of \$8.1 million at year-end 2012 reflect an increase of \$0.7 million (9.3%) compared to the balance of \$7.4 million at the end of 2011. Salaries and benefits totaled \$0.7 million compared to \$0.5 million in 2011. Program investment expenditures totaled \$1.9 million in 2012 compared to only \$0.3 million in 2011. Depreciation made the largest impact on operating expenses in 2012 totaling \$5.0 million as compared to \$5.8 million in 2011, a decrease of 13.5%.

Net nonoperating revenues for 2012 were \$5.7 million, compared to \$5.5 million in 2011. Investment income at year-end 2012 was \$1.1 million, a decrease of \$0.8 million (41.8%) over 2011.

**Contacting the District's Financial Management**

This financial report is designed to provide our taxpayers, suppliers, and creditors with a general overview of the District's finances and to show the District's accountability for the money it receives. If you have any questions about this report or need additional financial information, contact the District's finance office at PO Box 2606, Lynnwood, Washington 98036.

**PUBLIC HOSPITAL DISTRICT NO. 2, SNOHOMISH COUNTY, WASHINGTON dba  
VERDANT HEALTH COMMISSION  
STATEMENTS OF NET POSITION**

**ASSETS**

	December 31,	
	<u>2012</u>	<u>2011</u>
<b>CURRENT ASSETS</b>		
Cash and cash equivalents	\$ 2,088,169	\$ 1,593,972
Investments	40,128,375	35,054,113
Receivables	776,813	1,098
Estimated third-party payor settlements	975,760	-
Prepaid expenses and other	29,282	1,243,971
Assets whose use is limited	<u>94,818</u>	<u>238,455</u>
Total current assets	<u>44,093,217</u>	<u>38,131,609</u>
<b>CAPITAL ASSETS</b>		
Nondepreciable capital assets	3,996,406	3,996,406
Depreciable capital assets, net of accumulated depreciation	<u>22,157,998</u>	<u>27,222,344</u>
Capital assets, net of accumulated depreciation	<u>26,154,404</u>	<u>31,218,750</u>
DEFERRED FINANCING COSTS, net of accumulated amortization	<u>105,544</u>	<u>79,816</u>
DEFERRED RENT	<u>5,992,490</u>	<u>4,050,062</u>
Total assets	<u>\$ 76,345,655</u>	<u>\$ 73,480,237</u>

**LIABILITIES AND NET POSITION**

<b>CURRENT LIABILITIES</b>		
Current portion of long-term debt	\$ 720,000	\$ 2,005,037
Accounts and warrants payable	184,067	342,127
Accrued interest	15,001	-
Accrued salaries and benefits	34,215	1,240,384
Estimated self-insured liabilities	244,556	565,648
Estimated third-party payor settlements	<u>-</u>	<u>1,195,473</u>
Total current liabilities	1,197,839	5,348,669
LONG-TERM DEBT, net of current portion	6,329,914	7,000,000
OTHER LONG-TERM LIABILITIES	<u>202,870</u>	<u>565,649</u>
Total liabilities	<u>7,730,623</u>	<u>12,914,318</u>
<b>NET POSITION</b>		
Net investment in capital assets	19,104,490	22,213,713
Restricted for debt service	94,818	238,455
Unrestricted	<u>49,415,724</u>	<u>38,113,751</u>
Total net position	<u>68,615,032</u>	<u>60,565,919</u>
Total liabilities and net position	<u>\$ 76,345,655</u>	<u>\$ 73,480,237</u>

**PUBLIC HOSPITAL DISTRICT NO. 2, SNOHOMISH COUNTY, WASHINGTON dba  
VERDANT HEALTH COMMISSION  
STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION**

	Years Ended December 31,	
	<u>2012</u>	<u>2011</u>
OPERATING REVENUES		
Lease revenue	\$ 10,397,997	\$ 10,389,975
Other operating revenue	17,493	-
Total operating revenues	<u>10,415,490</u>	<u>10,389,975</u>
OPERATING EXPENSES		
Salaries and wages	560,621	354,137
Employee benefits	153,343	108,153
Program expenditures	1,866,239	297,736
Professional services	271,869	588,811
Other	209,079	244,802
Depreciation	<u>5,004,001</u>	<u>5,786,321</u>
Total operating expenses	<u>8,065,152</u>	<u>7,379,960</u>
Operating income	<u>2,350,338</u>	<u>3,010,015</u>
NONOPERATING REVENUES (EXPENSES)		
General obligation tax levy	-	1,164,262
Maintenance and operations tax levy	2,037,301	2,031,611
Investment income	1,125,643	1,934,442
General obligation interest expense and amortization	-	(31,921)
Other interest expense and amortization	(192,469)	(313,302)
Other income	<u>2,728,300</u>	<u>744,912</u>
Net nonoperating revenues	<u>5,698,775</u>	<u>5,530,004</u>
Increase in net position	8,049,113	8,540,019
NET POSITION, beginning of year	<u>60,565,919</u>	<u>52,025,900</u>
NET POSITION, end of year	<u>\$ 68,615,032</u>	<u>\$ 60,565,919</u>

**PUBLIC HOSPITAL DISTRICT NO. 2, SNOHOMISH COUNTY, WASHINGTON dba  
VERDANT HEALTH COMMISSION  
STATEMENTS OF CASH FLOWS**

**Increase (Decrease) in Cash and Cash Equivalents**

	Years Ended December 31,	
	2012	2011
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Cash received for leasing and other operations	\$ 8,533,994	\$ 7,674,011
Cash paid to employees	(707,370)	(295,484)
Cash paid on community programs	(1,866,239)	(297,736)
Cash paid to suppliers for goods and services	(1,858,739)	(2,269,078)
Net cash from operating activities	4,101,646	4,811,713
<b>CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES</b>		
Cash received from maintenance and operations tax levy for noncapital purposes	1,067,570	1,015,632
Principal payments on noncapital long-term debt	(320,000)	(40,000)
Interest paid on noncapital long-term debt	(1,201)	(1,395)
Cash received from Swedish Health Services	379,385	17,024,702
Other, net	(60,834)	(7,372)
Net cash from noncapital financing activities	1,064,920	17,991,567
<b>CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES</b>		
Principal payments on long-term debt	(8,685,037)	(3,394,046)
Interest paid on long-term debt	(165,186)	(348,082)
Proceeds from issuance of 2012 bonds	6,625,000	-
Proceeds from bond premium	496,236	-
Payments of bond issuance costs	(108,131)	-
Cash received from maintenance and operations tax levy for capital	1,030,035	1,034,876
Cash received from general obligation tax levy for capital	-	1,210,860
Acquisition and construction of capital assets	-	(3,982)
Net cash from capital and related financing activities	(807,083)	(1,500,374)
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Purchase of investments, net	(5,542,227)	(22,606,195)
Investment income	1,676,784	1,087,324
Net cash from investing activities	(3,865,443)	(21,518,871)
<b>NET INCREASE IN CASH AND CASH EQUIVALENTS</b>	494,040	(215,965)
<b>CASH AND CASH EQUIVALENTS, beginning of year</b>	1,594,129	1,810,094
<b>CASH AND CASH EQUIVALENTS, end of year</b>	\$ 2,088,169	\$ 1,594,129
<b>RECONCILIATION OF CASH AND CASH EQUIVALENTS TO THE STATEMENTS OF NET POSITION</b>		
Cash and cash equivalents	\$ 2,088,169	\$ 1,593,972
Cash and cash equivalents in assets whose use is limited	-	157
	\$ 2,088,169	\$ 1,594,129

**PUBLIC HOSPITAL DISTRICT NO. 2, SNOHOMISH COUNTY, WASHINGTON dba  
VERDANT HEALTH COMMISSION  
STATEMENTS OF CASH FLOWS (continued)**

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**Increase (Decrease) in Cash and Cash Equivalents**

	Years Ended December 31,	
	<u>2012</u>	<u>2011</u>
RECONCILIATION OF OPERATING INCOME TO NET CASH FROM OPERATING ACTIVITIES		
Operating income	\$ 2,350,338	\$ 3,010,015
Adjustments to reconcile operating income to net cash from operating activities		
Depreciation	5,004,001	5,786,321
Loss on disposal of capital assets	60,345	10,512
Changes in operating assets and liabilities		
Receivables	587	70,653
Estimated third-party payor settlements	(1,004,983)	-
Prepaid expenses and other	1,214,689	318,286
Deferred rent	(1,942,428)	(2,797,129)
Accounts and warrants payable	77,455	(207,675)
Accrued salaries and benefits	(1,206,169)	880,247
Self-insured liabilities	(452,189)	(2,259,517)
	<u>\$ 4,101,646</u>	<u>\$ 4,811,713</u>
Net cash from operating activities		

**PUBLIC HOSPITAL DISTRICT NO. 2, SNOHOMISH COUNTY, WASHINGTON dba  
VERDANT HEALTH COMMISSION  
NOTES TO FINANCIAL STATEMENTS**

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**Note 1 - Organization and Summary of Accounting Policies**

**Organization** - Until September 1, 2010, Public Hospital District No. 2 of Snohomish County, Washington dba Verdant Health Commission (the District), a Washington municipal corporation, owned and operated Stevens Hospital (the Hospital), located in Edmonds, Washington. The Hospital is an acute care community hospital with 156 set-up beds. As of September 1, 2010, the District continued doing business as Verdant Health Commission. The District is governed by the board of five elected commissioners. The mission of the District is to improve the health and well-being of the community. This mission will be completed by contracting for services with local partners, businesses, and government agencies. Long-term financial stability will be established by investing available revenues received from Swedish Health Systems, as well as tax levy revenues, into allowable government funds, thus building adequate reserves over the next 10 years.

On March 4, 2010, the District entered into an agreement to lease and operate the Hospital (the Agreement) with Swedish Health Services (SHS), a nonprofit corporation that calls for a long-term lease of all the facilities and operations of the Hospital that were previously operated by the District. SHS renamed the Hospital Swedish/Edmonds. As part of this agreement, the District transferred and assigned certain assets and liabilities to Swedish/Edmonds on September 1, 2010, in exchange for cash considerations of \$17,024,702, which were paid on March 28, 2011. This includes transfer of control of Stevens Foundation (the Foundation), which was organized and formally incorporated as a 501(c)(3) tax-exempt organization.

In conjunction with the Agreement between the District and SHS, a lease and operating agreement (the Lease) was executed between the District and Swedish/Edmonds, which was dated and effective September 1, 2010. This agreement represents a lease of the District's hospital facility, equipment, and health care delivery system. The leased assets are included in the statements of net position under the following headings and in the following amounts at December 31:

	<u>2012</u>	<u>2011</u>
Capital assets		
Nondepreciable capital assets	\$ 1,574,076	\$ 1,574,076
Depreciable capital assets, net of accumulated depreciation	<u>22,154,016</u>	<u>27,218,362</u>
	<u>\$ 23,728,092</u>	<u>\$ 28,792,438</u>

**PUBLIC HOSPITAL DISTRICT NO. 2, SNOHOMISH COUNTY, WASHINGTON dba  
VERDANT HEALTH COMMISSION  
NOTES TO FINANCIAL STATEMENTS**

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**Note 1 - Organization and Summary of Accounting Policies (continued)**

The terms of the Lease specify an initial 30-year term, with two 10-year renewal options. Rental payments to be made by SHS will be \$600,000 per month, with annual escalation of 3% per year on each anniversary date for the first 15 years. The rent is on an absolute net basis, with SHS being responsible for all operating costs associated with the facilities. The Lease calls for certain approvals by the District that affect the operation of the facility for the following: change in license, major service line changes, union contract representation, and maintenance of an independent medical staff. SHS has committed to an initial capital investment of \$90 million over the first 10 years of the Lease, including the installation of the Epic electronic medical record system at the facility. An additional capital investment by SHS is committed each year based on 25% of the defined profitability of the facility. In addition, a potential commitment of a major expansion project of up to \$60 million will be undertaken, provided there is adequate return on investment and demand criteria are met, and the SHS board of trustees approves such a project. The District and SHS will form a strategic collaboration committee to provide oversight for the Lease and strategic planning activities for the facility.

The County Treasurer acts as an agent to collect property taxes levied in the county for all taxing authorities. Taxes are levied annually on assessed values as established by the County Assessor. Tax collections are distributed monthly to the District by the County Treasurer. Property taxes are recorded as receivables and revenue when levied. Because state law allows for the sale of property for failure to pay taxes, no estimate of uncollectible taxes is made.

In September 1997, the voters of the District approved a maintenance and operations (M&O) tax levy upon the taxable property within the District; the M&O tax provided approximately \$2,037,000 of funding in 2012 and \$2,032,000 of funding in 2011. The levy is ongoing in future years. The M&O tax levy funds are reported in the accompanying statements of revenues, expenses, and changes in net position as nonoperating revenues.

**Basis of presentation** - The financial statements reflect the operations of the District using enterprise fund accounting. Revenues and expenses are recognized on the accrual basis using the economic resources measurement focus.

The District reports its financial information in a form that complies with the pronouncements of the Governmental Accounting Standards Board (GASB) and the Audit and Accounting Guide for Health Care Organizations of the American Institute of Certified Public Accountants.

**Use of estimates** - The preparation of financial statements in conformity 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. Key estimates include useful lives of capital assets, third-party cost report settlements, and self-insured liabilities. Changes in estimates resulted in an increase to other nonoperating income of \$2,790,000 and \$750,000 for the years ended December 31, 2012 and 2011, respectively. The change in estimate for 2012 is due primarily to the impact of the change in estimated third-party settlements directly and through Swedish/Edmonds due to the change in supplemental security income ratios, which impact the outstanding Medicare cost reports.

**PUBLIC HOSPITAL DISTRICT NO. 2, SNOHOMISH COUNTY, WASHINGTON dba  
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NOTES TO FINANCIAL STATEMENTS**

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**Note 1 - Organization and Summary of Accounting Policies (continued)**

**Cash and cash equivalents** - For purposes of the statements of cash flows, the District considers all highly liquid investments (excluding cash and short-term investments included in restricted assets) with a maturity of three months or less when purchased to be cash equivalents.

**Restricted assets** - As described further in Note 7, the District receives tax levy funds that are used solely for debt service associated with the general obligation bonds. Taxes and interest receivable and scheduled debt service payments temporarily invested prior to becoming due are recorded as restricted assets. All receipts and earnings generated on such investments are reported as nonoperating revenues and expenses.

**Capital assets** - Capital assets are stated at cost. Improvements and replacement of capital assets are capitalized. The District's capitalization threshold is \$1,000 per item and a useful life of at least two years. Maintenance and repairs are expensed. The cost of capital assets sold or retired and the related accumulated depreciation are removed from the accounts, and any resulting gain or loss is recorded.

Depreciation is computed using the straight-line method over the estimated useful lives of the related assets. Assets under capital leases are amortized over the shorter of the lease term or useful life. Amortization attributable to assets acquired under capital leases is included with depreciation as shown in the statements of revenues, expenses, and changes in net position.

The following is a summary of asset lives used:

Buildings and building improvements	2 - 50 years
Equipment	2 - 50 years
Land improvements	2 - 25 years

**Financing costs** - The cost of obtaining debt is deferred and amortized on the straight-line method over the term of the related debt, which approximates the result of using the effective interest method.

**Deferred rent** - Deferred rent represents lease revenue on a straight-line basis in excess of lease payments received. Lease revenue is recorded evenly throughout the lease term. Differences between the actual lease payments owed during the year and the amount of lease payments recorded evenly throughout the lease term represent deferred rent income.

**Self-insurance liabilities** - The District accrues an estimate of losses and related expenses for its self-insured workers' compensation claims. The District maintains stop-loss insurance for workers' compensation claims in excess of specified amounts. This estimated liability is recorded in the accompanying statements of net position within accrued salaries and benefits. The amount is approximately \$245,000 and \$566,000 as of December 31, 2012 and 2011, respectively. The District also records a liability for estimated professional liabilities (Note 6).

**PUBLIC HOSPITAL DISTRICT NO. 2, SNOHOMISH COUNTY, WASHINGTON dba  
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NOTES TO FINANCIAL STATEMENTS**

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**Note 1 - Organization and Summary of Accounting Policies (continued)**

**Estimated third-party payor settlements** - Under a contractual agreement with Medicare, the Hospital is paid at an interim rate during the year for certain services and programs. The difference between interim payments and estimated final reimbursement for the cost report year results in a settlement receivable or payable, which may be adjusted in future periods as final settlements are determined. The Medicare program's administrative procedures preclude final determination of settlement amounts until after the annual cost reports have been audited or otherwise reviewed and settled by Medicare. The District's cost reports have been audited by the Medicare fiscal intermediary through December 31, 2007. The estimated settlement amounts for the 2008, 2009, and 2010 cost reports are included in the accompanying financial statements.

While operating Stevens Hospital, the District participated in the Medicaid Certified Public Expenditures (CPE) program for inpatient reimbursement, which provides for interim payments for certain services and programs. The difference between interim payments and estimated final reimbursement for the Washington State fiscal year results in a settlement receivable or payable, which may be adjusted in future periods as final settlements are determined.

**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.

**Statements of revenues, expenses, and changes in net assets** - For purposes of presentation, transactions deemed by management to be ongoing, major, or central to the provision of District services are reported as operating revenues and expenses. All levy income, interest expense, investment income, and other peripheral or incidental transactions are reported as nonoperating revenues and expenses.

**Income taxes** - As a political subdivision of the state of Washington, the District is not subject to federal income tax, as its income is excluded from gross income for federal income tax purposes under Section 115 of the Internal Revenue Code.

**Reclassifications** - Certain reclassifications have been made to prior-year amounts to conform to the current-year presentation to more consistently present financial information between years.

**Subsequent events** - Subsequent events are events or transactions that occur after the statements of net position date but before financial statements are available to be 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 22, 2013, which is the date the financial statements are available to be issued.

**PUBLIC HOSPITAL DISTRICT NO. 2, SNOHOMISH COUNTY, WASHINGTON dba  
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NOTES TO FINANCIAL STATEMENTS**

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**Note 2 - Cash, Cash Equivalents, Investments, and Deposits**

The composition of cash, cash equivalents, investments, and deposits at December 31 is as follows:

	2012	2011
Assets whose use is not restricted		
Cash in banks - interest-bearing	\$ 2,088,169	\$ 1,527,548
Short-term Treasury Investment Fund	-	66,424
Governmental Mutual Fund	40,128,375	35,054,113
	42,216,544	36,648,085
Restricted investments		
Short-term Treasury Investment Fund	-	157
Governmental Mutual Fund	-	83,176
	-	83,333
Total cash, cash equivalents, investments, and deposits	\$ 42,216,544	\$ 36,731,418

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, eligible bankers' acceptances, and repurchase agreements (up to 30 days).

Because the District is a political subdivision of the state, deposits and investments are categorized to give an indication of the risk assumed at year-end. Category 1 includes deposits and investments that are insured, registered, or held in the District's name. Category 2 includes uninsured and unregistered investments that are held by a 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. At December 31, 2012 and 2011, all deposits and investments of the District are categorized as Category 1.

**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.

**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. Collateral protection is provided by the Washington Public Deposit Protection Commission.

**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. The District is not exposed to custodial credit risk.

**PUBLIC HOSPITAL DISTRICT NO. 2, SNOHOMISH COUNTY, WASHINGTON dba  
VERDANT HEALTH COMMISSION  
NOTES TO FINANCIAL STATEMENTS**

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**Note 2 - Cash, Cash Equivalents, Investments, and Deposits (continued)**

**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 is not exposed to concentration of credit risk because all deposits and investments are insured or collateralized.

**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 is not exposed to interest rate risk because all deposits and investments are extremely liquid.

**Note 3 - Capital Assets**

Capital asset additions, retirements, and balances for the years ended December 31, 2012 and 2011, were as follows:

	Beginning Balance January 1, 2012	Additions	Retirements	Account Transfers	Ending Balance December 31, 2012
<b>ASSETS AT COST</b>					
<b>NONDEPRECIABLE CAPITAL ASSETS</b>					
Land	\$ 3,996,406	\$ -	\$ -	\$ -	\$ 3,996,406
<b>DEPRECIABLE CAPITAL ASSETS</b>					
Land improvements	2,285,382	-	-	-	2,285,382
Buildings and building improvements	39,487,921	-	-	-	39,487,921
Equipment	48,443,319	-	(352,243)	-	48,091,076
<b>LESS ACCUMULATED DEPRECIATION</b>					
Land improvements	1,812,973	81,616	-	-	1,894,589
Buildings and building improvements	25,815,269	1,347,089	-	-	27,162,358
Equipment	35,366,036	3,575,296	(291,898)	-	38,649,434
DEPRECIABLE CAPITAL ASSETS, net	27,222,344	(5,004,001)	(60,345)	-	22,157,998
CAPITAL ASSETS, net	\$ 31,218,750	\$ (5,004,001)	\$ (60,345)	\$ -	\$ 26,154,404
	Beginning Balance January 1, 2011	Additions	Retirements	Account Transfers	Ending Balance December 31, 2011
<b>ASSETS AT COST</b>					
<b>NONDEPRECIABLE CAPITAL ASSETS</b>					
Land	\$ 3,996,406	\$ -	\$ -	\$ -	\$ 3,996,406
<b>DEPRECIABLE CAPITAL ASSETS</b>					
Land improvements	2,285,382	-	-	-	2,285,382
Buildings and building improvements	39,487,921	-	-	-	39,487,921
Equipment	49,078,130	3,982	(638,793)	-	48,443,319
<b>LESS ACCUMULATED DEPRECIATION</b>					
Land improvements	1,730,987	81,986	-	-	1,812,973
Buildings and building improvements	24,306,365	1,508,904	-	-	25,815,269
Equipment	31,798,886	4,195,431	(628,281)	-	35,366,036
DEPRECIABLE CAPITAL ASSETS, net	33,015,195	(5,782,339)	(10,512)	-	27,222,344
CAPITAL ASSETS, net	\$ 37,011,601	\$ (5,782,339)	\$ (10,512)	\$ -	\$ 31,218,750

**PUBLIC HOSPITAL DISTRICT NO. 2, SNOHOMISH COUNTY, WASHINGTON dba  
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NOTES TO FINANCIAL STATEMENTS**

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**Note 4 - Deferred Rent**

As referenced in Note 1, the District entered into a lease and operating agreement (the Lease) with SHS that was dated and effective September 1, 2010. The terms of the Lease specify an initial 30-year term, with two 10-year renewal options. Rental payments to be made by SHS will be \$600,000 per month, with annual escalation of 3% per year on each anniversary date for the first 15 years. The rental payments will freeze at the rate set during year 15 for the duration of the Lease.

Rental payments to be received under this agreement are as follows:

	<u>Rental Payments</u>
2013	\$ 7,714,865
2014	7,946,311
2015	8,184,700
2016	8,430,241
2017	8,683,148
2018 - 2022	47,483,014
2023 - 2027	54,481,594
2028 - 2032	56,086,827
2033 - 2037	56,086,827
2038 - 2040	<u>29,912,974</u>
	<u><u>\$ 285,010,501</u></u>

**Note 5 - Long-Term Debt**

The balances of the District's long-term debt at December 31 are set forth below:

	<u>2012</u>	<u>2011</u>
LTGO Bonds, 1999, refunded in 2012.	\$ -	\$ 8,000,000
LTGO Refunding Bonds, 2012, 2.00% to 3.00%, principal due serially on December 1 in amounts from \$720,000 in 2013 to \$955,000 in 2020, including unamortized premium of \$491,067, net of unamortized loss on refunding of \$66,153 in 2012.	7,049,914	-
Master equipment sales agreement, paid in full in 2012.	-	<u>1,005,037</u>
Total long-term debt and obligations under capital leases	7,049,914	9,005,037
Less current portion	<u>(720,000)</u>	<u>(2,005,037)</u>
Long-term debt and obligations under capital leases, net of current portion	<u><u>\$ 6,329,914</u></u>	<u><u>\$ 7,000,000</u></u>

**PUBLIC HOSPITAL DISTRICT NO. 2, SNOHOMISH COUNTY, WASHINGTON dba  
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NOTES TO FINANCIAL STATEMENTS**

**Note 5 - Long-Term Debt (continued)**

Long-term debt and capital lease obligations' activity summary for 2012 and 2011 is as follows:

	January 1, 2012	Additions	Reductions	December 31, 2012	Amounts Due Within One Year
LONG-TERM DEBT					
1999 LTGO Bond	\$ 8,000,000	\$ -	\$ (8,000,000)	\$ -	\$ -
2012 LTGO Bond	-	7,054,151	(4,237)	7,049,914	(720,000)
Master equipment sales agreement	1,005,037	-	(1,005,037)	-	-
Total long-term debt	9,005,037	7,054,151	(9,009,274)	7,049,914	(720,000)
OTHER LONG-TERM LIABILITIES	565,649	-	(362,779)	202,870	-
	<u>\$ 9,570,686</u>	<u>\$ 7,054,151</u>	<u>\$ (9,372,053)</u>	<u>\$ 7,252,784</u>	<u>\$ (720,000)</u>
	January 1, 2011	Additions	Reductions	December 31, 2011	Amounts Due Within One Year
LONG-TERM DEBT					
1999 LTGO Bond	\$ 9,000,000	\$ -	\$ (1,000,000)	\$ 8,000,000	\$ 1,000,000
2003 UTGO Bond	1,174,361	-	(1,174,361)	-	-
Master equipment sales agreement	2,284,083	-	(1,279,046)	1,005,037	1,005,037
Total long-term debt	12,458,444	-	(3,453,407)	9,005,037	2,005,037
OTHER LONG-TERM LIABILITIES	4,041,974	-	(3,476,325)	565,649	-
	<u>\$ 16,500,418</u>	<u>\$ -</u>	<u>\$ (6,929,732)</u>	<u>\$ 9,570,686</u>	<u>\$ 2,005,037</u>

Scheduled principal and interest repayments on long-term debt are as follows as of December 31, 2012:

	Long-Term Debt	
	Principal	Interest
2013	\$ 720,000	\$ 182,054
2014	745,000	169,700
2015	770,000	154,800
2016	805,000	131,700
2017	840,000	107,550
2018 - 2020	2,745,000	167,100
	6,625,000	<u>\$ 912,904</u>
Amounts representing net unamortized premium and deferred loss	<u>424,914</u>	
	<u>\$ 7,049,914</u>	

**PUBLIC HOSPITAL DISTRICT NO. 2, SNOHOMISH COUNTY, WASHINGTON dba  
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NOTES TO FINANCIAL STATEMENTS**

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**Note 5 - Long-Term Debt (continued)**

In November 2012, the District issued the Limited Tax General Obligation Refunding Bonds, 2012 (2012 LTGO Refunding Bonds) for a par value of \$6,625,000 with a premium of \$49,236. The District has designated its M&O tax levy, approved by the voters of the District in September 1997, to the payment of principal and interest on the 2012 LTGO Refunding Bonds. The proceeds from the bonds were used to refund the remaining balance of the 1999 Series LTGO Bonds, which totaled approximately \$7,000,000. The refunding resulted in the recognition of an accounting loss of \$67,085, which will be deferred and amortized over the life of the 2012 LTGO Refunding Bonds. The refunding decreased the District's aggregate debt service payments by \$358,000 over the next eight years and resulted in an economic gain (difference between the present values of the old and new debt service payments) of \$440,000.

**Note 6 - Professional Liability Insurance**

Prior to September 1, 2010, The District maintained a claims-made professional liability insurance policy through a commercial carrier with a self-insured retention per claim. Effective September 1, 2010, the District purchased a tail policy to cover all claims incurred prior to that date. Under this policy, there is a deductible amount of \$100,000 per claim. The policy was purchased to provide maximum coverage for the exposure to the deductible for all claims. At December 31, 2010, the District had estimated a liability for amounts to be paid under the deductible of this policy. This liability is included in the accompanying statements of net position at \$202,000 and \$566,000 at December 31, 2012 and 2011.

**Note 7 - 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. 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 2012 and 2011, the District's regular tax levy was \$0.11 and \$0.10 per \$1,000 on a total assessed valuation of \$18,922,089,875 and \$21,166,181,462, for a total regular levy of \$2,037,301 and \$2,031,611, respectively. There was a voter-approved tax levy through 2011 for service of the UTGO bonds. For 2011, the tax levy for bond service was \$0.06 per \$1,000 on the total assessed valuation, for a total additional levy of \$1,109,800.

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.

**PUBLIC HOSPITAL DISTRICT NO. 2, SNOHOMISH COUNTY, WASHINGTON dba  
VERDANT HEALTH COMMISSION  
NOTES TO FINANCIAL STATEMENTS**

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**Note 8 - Retirement Plan**

Effective July 1, 2010, the District sponsored a 401(a) plan and a 457 plan that are available to all benefit-eligible employees working over 20 hours per week. Employees are eligible to contribute at their hire date. Employees contribute to the 457 plan at their discretion. Employee contributions were approximately \$19,000 and \$7,000 during the years ended December 31, 2012 and 2011, respectively. The District contributes to the 401(a) plan at 3% of employee wages with an additional matching contribution of up to 3% of the amount contributed by the employee to the 457 plan. The District's policy is to fully fund the contributions. The District contributed approximately \$28,000 and \$12,000 during the years ended December 31, 2012 and 2011, respectively.

**Note 9 - Commitments and Contingencies**

**Litigation and compliance with laws and regulations** - The District is involved in litigation 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.

The hospital industry is subject to numerous laws and regulations of federal, state, and local governments. These laws and regulations include, but are not necessarily limited to, matters such as licensure, accreditation, government hospital program participation requirements, reimbursement for patient services, and Medicare and Medicaid fraud and abuse. Government agencies are actively conducting investigations concerning possible violations of fraud and abuse statutes and regulations by hospital providers. Violations of these laws and regulations could result in expulsion from government hospital 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.