



REPORT OF INDEPENDENT AUDITORS  
AND FINANCIAL STATEMENTS

**CENTRAL WASHINGTON HEALTH  
SERVICES ASSOCIATION**  
dba **CENTRAL WASHINGTON HOSPITAL**

December 31, 2017 and 2016

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## **Report of Independent Auditors**

The Board of Directors  
Central Washington Health Services Association  
dba Central Washington Hospital

### **Report on the Financial Statements**

We have audited the accompanying financial statements of Central Washington Health Services Association, dba Central Washington Hospital (the Association), which comprise the balance sheets as of December 31, 2017 and 2016, and the related statements of operations, changes in net assets, 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 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 the Association, as of December 31, 2017 and 2016, and the changes in its net assets and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

*Aras Odeno LLP*

Everett, Washington  
April 30, 2018

**Central Washington Health Services Association  
dba Central Washington Hospital  
Balance Sheets**

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**ASSETS**

	December 31,	
	<u>2017</u>	<u>2016</u>
<b>CURRENT ASSETS</b>		
Cash and cash equivalents	\$ 59,267,519	\$ 62,106,699
Receivables		
Patient accounts, net of allowance for doubtful accounts of \$8,778,000 in 2017 and \$7,602,000 in 2016	50,139,803	44,891,159
Estimated third-party payor settlements	-	375,000
Other	8,054,716	11,686,302
Medical supplies	5,615,227	5,648,904
Prepaid expenses	1,166,215	1,186,012
Assets limited as to use that are required for current liabilities	<u>4,163,356</u>	<u>4,162,363</u>
Total current assets	<u>128,406,836</u>	<u>130,056,439</u>
<b>ASSETS LIMITED AS TO USE</b>		
By board for malpractice costs	2,315,000	2,315,000
By board for workers' compensation deposit	1,453,000	1,531,394
By board for capital improvements and other purposes	116,782,819	87,528,351
Held by trustee under Series 2009 and 2015 Revenue Bond financing indenture agreements, net of amounts required for current liabilities	<u>3,220,718</u>	<u>3,121,271</u>
	<u>123,771,537</u>	<u>94,496,016</u>
<b>TEMPORARILY RESTRICTED RECEIVABLE</b>	<u>248,624</u>	<u>248,624</u>
<b>PROPERTY AND EQUIPMENT, net</b>	<u>139,547,637</u>	<u>137,005,330</u>
<b>OTHER ASSETS</b>		
Note receivable from affiliate	16,393,114	15,428,419
Other	<u>722,068</u>	<u>1,029,462</u>
	<u>17,115,182</u>	<u>16,457,881</u>
Total assets	<u>\$ 409,089,816</u>	<u>\$ 378,264,290</u>

**Central Washington Health Services Association  
dba Central Washington Hospital  
Balance Sheets**

**LIABILITIES AND NET ASSETS**

	December 31,	
	2017	2016
<b>CURRENT LIABILITIES</b>		
Accounts payable	\$ 5,352,076	\$ 2,584,465
Accrued liabilities		
Payroll and related liabilities	7,412,779	7,546,197
Paid leave	4,846,553	4,696,532
Interest	2,705,856	2,784,863
Other	290,657	301,046
Estimated third-party payor settlements	510,000	-
Due to affiliate	3,784,193	2,719,533
Current portion of long-term debt	2,929,516	2,769,516
Total current liabilities	27,831,630	23,402,152
ESTIMATED MEDICAL MALPRACTICE COSTS	3,238,777	4,900,517
LONG-TERM DEBT, net of current portion	114,626,806	117,742,513
Total liabilities	145,697,213	146,045,182
<b>NET ASSETS</b>		
Unrestricted	263,143,979	231,970,484
Temporarily restricted	248,624	248,624
Total net assets	263,392,603	232,219,108
Total liabilities and net assets	\$ 409,089,816	\$ 378,264,290

**Central Washington Health Services Association  
dba Central Washington Hospital  
Statements of Operations**

	Years Ended December 31,	
	2017	2016
<b>UNRESTRICTED REVENUE AND OTHER SUPPORT</b>		
Net patient service revenue (net of contractual allowances and discounts)	\$ 343,225,644	\$ 321,636,005
Provision for bad debts	(7,347,428)	(6,740,125)
Net patient service revenue less provision for bad debts	335,878,216	314,895,880
Other revenue	6,304,423	3,877,720
Total revenue and other support	342,182,639	318,773,600
<b>EXPENSES</b>		
Salaries and wages	96,797,828	91,327,905
Employee benefits	25,890,135	25,390,556
Professional fees	77,261,996	58,214,904
Supplies	83,087,661	77,769,236
Purchased services	12,514,928	11,971,327
Insurance	(705,991)	2,977,396
Rent	1,046,691	1,178,070
Other	9,547,177	8,448,576
Depreciation and amortization	10,830,505	11,303,929
Interest	5,249,305	5,392,035
Total expenses	321,520,235	293,973,934
<b>INCOME FROM OPERATIONS</b>	20,662,404	24,799,666
<b>OTHER INCOME</b>		
Investment income	3,277,150	2,344,476
Other	1,395,148	1,308,530
	4,672,298	3,653,006
<b>EXCESS OF REVENUE OVER EXPENSES</b>	25,334,702	28,452,672
<b>NET UNREALIZED GAIN ON INVESTMENTS</b>	5,838,793	3,197,390
<b>CHANGE IN UNRESTRICTED NET ASSETS</b>	\$ 31,173,495	\$ 31,650,062

**Central Washington Health Services Association  
dba Central Washington Hospital  
Statements of Changes in Net Assets**

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	Years Ended December 31,	
	<u>2017</u>	<u>2016</u>
UNRESTRICTED NET ASSETS		
Excess of revenue over expenses	\$ 25,334,702	\$ 28,452,672
Net unrealized gain on investments	<u>5,838,793</u>	<u>3,197,390</u>
Change in unrestricted net assets	<u>31,173,495</u>	<u>31,650,062</u>
CHANGE IN NET ASSETS	31,173,495	31,650,062
NET ASSETS, beginning of year	<u>232,219,108</u>	<u>200,569,046</u>
NET ASSETS, end of year	<u><u>\$ 263,392,603</u></u>	<u><u>\$ 232,219,108</u></u>

**Central Washington Health Services Association  
dba Central Washington Hospital  
Statements of Cash Flows**

	Years Ended December 31,	
	2017	2016
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Change in unrestricted net assets	\$ 31,173,495	\$ 31,650,062
Adjustments to reconcile change in unrestricted net assets to net cash from operating activities		
Depreciation	11,150,772	11,621,135
Amortization	60,797	62,708
Amortization of bond premium	(246,987)	(246,987)
(Gain) loss on sale of property and equipment	(9,000)	176,693
Provision for bad debts	7,347,428	6,740,125
Change in estimated medical malpractice costs	(1,661,740)	1,435,197
Net unrealized gain on investments	(5,838,793)	(3,197,390)
Increase (decrease) in cash due to changes in assets and liabilities		
Patient accounts receivable	(12,596,072)	(6,034,210)
Estimated third-party payor settlements	885,000	793,887
Other receivables	3,631,586	(2,594,335)
Medical supplies	33,677	1,031,189
Prepaid expenses	19,797	1,158,547
Other assets	307,394	475,428
Accounts payable and due to affiliates	4,984,929	(2,277,754)
Accrued liabilities	(72,793)	1,117,136
Net cash from operating activities	<u>39,169,490</u>	<u>41,911,431</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Purchase of property and equipment	(14,836,737)	(2,422,130)
Proceeds from sale of assets limited as to use	84,503,602	59,437,847
Purchase of assets limited as to use	(107,941,323)	(61,658,253)
Note receivable from affiliate	(964,695)	(822,348)
Net cash from investing activities	<u>(39,239,153)</u>	<u>(5,464,884)</u>
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Repayment of long-term debt	(2,769,517)	(2,645,438)
Net cash from financing activities	<u>(2,769,517)</u>	<u>(2,645,438)</u>
<b>CHANGE IN CASH AND CASH EQUIVALENTS</b>	(2,839,180)	33,801,109
<b>CASH AND CASH EQUIVALENTS, beginning of year</b>	<u>62,106,699</u>	<u>28,305,590</u>
<b>CASH AND CASH EQUIVALENTS, end of year</b>	<u>\$ 59,267,519</u>	<u>\$ 62,106,699</u>

**Supplemental Schedule of Investing and Financing Activities**

The Association paid interest of \$5,328,312 and \$5,455,238 during the years ended December 31, 2017 and 2016, respectively.

**Supplemental Disclosure of Noncash Investing Activities**

During 2017, the Association transferred approximately \$1,153,000 in fixed assets to an affiliate in exchange for a reduction in due to affiliate.

# Central Washington Health Services Association dba Central Washington Hospital

## Notes to Financial Statements

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### Note 1 – Organization

Central Washington Health Services Association, dba Central Washington Hospital (the Association), is accredited by DNV GL Healthcare and operates a licensed 198-bed acute care hospital delivering a full range of health care services in Wenatchee, Washington, and the North Central Washington area. The Association is a not-for-profit institution governed by a Board of Directors, providing general inpatient services including medical, surgical, home infusion services, intensive care and coronary care, neonatal intensive care, pediatrics, obstetrics, gynecology, and oncology. The Association is a Federal Regional Referral center, and is designated by the State as a Level III General Trauma center and Level III Pediatric Trauma center, supported by a comprehensive range of surgical procedures in orthopedic, neurosurgery, vascular surgery, interventional cardiac catheterization, and open-heart surgery.

The Association is a not-for-profit integrated health care delivery system with a skilled nursing facility, orthopedic clinic, home health services, hospice services, and participation in a physician-hospital-community health organization.

Confluence Health was formed in 2012 as a health system that represents an affiliation between Central Washington Hospital (a not-for-profit organization) and Wenatchee Valley Medical Group (WVMG) (a for-profit organization). Effective January 1, 2013, the Association affiliated with Confluence Health, and Confluence Health became the sole member of the Association. The Board of Directors of Confluence Health consists of 9 community members and 6 physicians of Wenatchee Valley Medical Group.

Confluence Health, a separate 501(c)(3) organization, provides the administrative and shared functions for the health system. Confluence Health began operations on January 1, 2013.

The mission statement of Confluence Health is:

*We are dedicated to improving our patients' health by providing safe, high-quality care in a compassionate and cost-effective manner.*

The affiliation was completed in 2013, at which time WVMG transferred its remaining nonphysician employees and its operations to Wenatchee Valley Hospital (a not-for-profit organization). Confluence Health is the sole member of Wenatchee Valley Hospital. The three affiliated entities, the Association, Wenatchee Valley Hospital, and Confluence Health, are referred to collectively as Confluence Health. The three entities have contracted with WVMG for physician services.

### Note 2 – Summary of Significant Accounting Policies

**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.

# Central Washington Health Services Association dba Central Washington Hospital

## Notes to Financial Statements

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### Note 2 – Summary of Significant Accounting Policies (continued)

**Cash and cash equivalents** – Cash and cash equivalents include certain investments in highly liquid debt instruments with original maturities of three months or less.

**Patient accounts receivable** – Accounts receivable are reduced by an allowance for doubtful accounts. In evaluating the collectability of accounts receivable, the Association 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 Association 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 (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 Association 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.

The Association's self-pay write-offs were \$7,347,000 and \$6,740,000 for the years ended December 31, 2017 and 2016, respectively.

**Medical supplies** – Medical supplies, composed primarily of medical and surgical inventories, are stated at the lower of replacement or market.

**Assets limited as to use** – Assets limited as to use primarily include assets held by trustees under indenture agreements and designated assets set aside by the board of trustees for future capital improvements, over which the board retains control and may, at its discretion, subsequently use for other purposes. Amounts required to meet current liabilities of the Association have been reclassified from assets limited as to use to current liabilities in the balance sheets at December 31, 2017 and 2016.

Investments in equity securities with readily determinable fair values and all investments in debt securities are measured at fair value in the balance sheets. Investment income or loss (including realized gains and losses on investments, interest, and dividends) is included in the excess of revenue over expenses unless the income or loss is restricted by donor or law. Unrealized gains and losses on investments are excluded from the excess of revenue over expenses unless the investments are trading securities.

**Central Washington Health Services Association  
dba Central Washington Hospital  
Notes to Financial Statements**

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**Note 2 – Summary of Significant Accounting Policies (continued)**

**Property and equipment** – Property and equipment acquisitions are recorded at cost. Depreciation is provided over the estimated useful life of each class of depreciable asset, which ranges from 3 to 40 years, and is computed on the straight-line method. Interest cost incurred on borrowed funds during the period of construction of capital assets is capitalized as a component of the cost of acquiring those assets.

Gifts of long-lived assets such as property and equipment are reported as unrestricted donations, unless explicit donor stipulations specify how the donated assets must be used. Gifts of long-lived assets with explicit restrictions that specify how the assets are to be used and gifts of cash or other assets that must be used to acquire long-lived assets are reported as temporarily or permanently restricted donations. Absent explicit donor stipulations about how long those long-lived assets must be maintained, expirations of donor restrictions are reported when the donated or acquired long-lived assets are placed in service.

**Estimated malpractice costs** – The provision for estimated medical malpractice claims includes estimates of the ultimate costs for both reported claims and claims incurred but not reported.

**Federal income tax** – The Association is a not-for-profit corporation and has been recognized as tax-exempt pursuant to Section 501(c)(3) of the Internal Revenue Code.

The Association is exempt from federal income tax under Section 501(c)(3) of the Internal Revenue Code except to the extent of unrelated business taxable income as defined under IRC Sections 511 through 515. Any unrelated business income generated is not significant; therefore, no provision for income taxes has been recorded. The Association adopted accounting for uncertain tax positions. The accounting standard prescribes a recognition threshold and measurement process for uncertain tax positions. As of December 31, 2017 and 2016, the Association had no uncertain tax positions requiring accrual.

**Net patient service revenue** – The Association has agreements with third-party payors that provide for payments to the Association at amounts different from its established rates. Payment arrangements include prospectively determined rates per discharge, reimbursed costs, discounted charges, and per diem payments. Net patient service revenue is reported at estimated net realizable amounts from patients, third-party payors, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined.

**Charity care** – The Association provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. Because the Association does not pursue collection of amounts determined to qualify as charity care, they are not reported as revenue.

**Contributions received** – Contributions received, including property or investments, are recorded as unrestricted, temporarily restricted, or permanently restricted support and net assets depending on the existence and/or nature of any donor restrictions.

# Central Washington Health Services Association dba Central Washington Hospital

## Notes to Financial Statements

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### Note 2 – Summary of Significant Accounting Policies (continued)

**Net assets** – Net assets of the Association and changes therein are classified and reported as follows:

**Unrestricted net assets** – Net assets that are not subject to donor-imposed stipulations but can be designated by the Board of Directors.

**Temporarily restricted net assets** – Net assets subject to donor-imposed stipulations that may or will be met by actions of the Association and/or the passage of time. When a restriction expires, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the statements of operations as net assets released from donor restrictions. Temporarily restricted net assets include assets restricted for a completed construction project. The associated receivable due from Confluence Health Foundation was \$248,624 for the years ended December 31, 2017 and 2016, and is expected to be received within five years.

**Permanently restricted net assets** – Net assets subject to donor-imposed stipulations that they be maintained permanently by the Association. Donors of these assets may permit the Association to use all or part of the income earned on any related investments for general or specific purposes. The Association has no permanently restricted net assets.

**Donor-restricted gifts** – Unconditional promises to give cash and other assets to the Association are reported at fair value at the date the promise is received. Conditional promises to give and indications of intentions to give are reported at fair value at the date the gift is received. The gifts are reported as either temporarily or permanently restricted support if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified as unrestricted net assets and reported in the statements of operations and changes in net assets as assets released from restrictions. Donor-restricted contributions whose restrictions are met within the same year as received are reported as unrestricted contributions in the accompanying financial statements.

**Excess of revenue over expenses** – The statements of operations include excess of revenue over expenses. Changes in unrestricted net assets that are excluded from excess of revenue over expenses, consistent with industry practice, include unrealized gains and losses on investments other than trading securities, permanent transfers of assets to and from affiliates for other than goods and services, contributions of long-lived assets (including assets acquired using contributions that by donor restriction were to be used for the purpose of acquiring such assets), management services, and other similar items.

**Donated services** – A substantial number of volunteers donate significant amounts of their time for the Association's program activities. These donated hours are a necessary part of the Association's activities because its services could not be sustained without such support and because these activities enhance the financial assets of the Association. No dollar amounts have been reflected in the accompanying statements for these services because the services do not require specialized skills.

**Central Washington Health Services Association  
dba Central Washington Hospital  
Notes to Financial Statements**

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**Note 2 – Summary of Significant Accounting Policies (continued)**

**Reclassifications** – Certain amounts in the 2016 financial statements have been reclassified to be comparable with current year presentation. Such reclassifications have no effect on previously reported operating results.

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

The Association has evaluated subsequent events through April 30, 2018, which is the date the financial statements are issued, and concluded that there were no events or transactions that need to be disclosed.

**Note 3 – Net Patient Service Revenue**

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

**Medicare** – Inpatient acute care services rendered to Medicare program beneficiaries are paid at prospectively determined rates. These rates vary according to a patient classification system that is based on clinical, diagnostic, and other factors. The Association qualifies for disproportionate share (DSH) payments from Medicare. The DSH payment rate is added to the prospective rate for each inpatient discharge. The Association is eligible for a higher disproportionate share payment rate estimated at 16.04% in 2017 and 15.22% in 2016. The Association met the criteria for this additional payment as a result of the high number of low-income patients served exceeding the eligibility threshold of qualified patient days as a percentage of total patient days. Section 3133 of the Affordable Care Act amended DSH payments effective October 1, 2013. With this change, the Association receives 25 percent of the previous payment method along with payments for uncompensated care based on changes in the percentage of individuals that are uninsured. The uncompensated care payments are set annually by Medicare. Each hospital eligible for DSH will receive uncompensated care payments. The majority of outpatient services are reimbursed on a prospective payment system or fee schedule. The Association's Medicare cost reports have been audited by the Medicare Administrative Contractor fiscal intermediary through 2014. Net revenue billed under the Medicare program totaled approximately \$148,282,000 and \$131,290,000 for 2017 and 2016, respectively.

**Central Washington Health Services Association  
dba Central Washington Hospital  
Notes to Financial Statements**

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**Note 3 – Net Patient Service Revenue (continued)**

**Medicaid** – Inpatient acute care services rendered to Medicaid program beneficiaries are paid on a prospective payment system similar to Medicare. Outpatient services to Medicaid beneficiaries are paid prospectively based on ambulatory payment classifications. Net revenue billed under the Medicaid program totaled approximately \$44,373,000 and \$42,765,000 for 2017 and 2016, respectively.

The Association has also entered into payment agreements with certain commercial insurance carriers and preferred provider organizations. The basis for payment to the Association under these agreements varies from established charges.

The Association recognizes patient service revenue associated with services provided to patients who have third-party payor coverage on the basis of contractual rates for the services rendered. For uninsured patients who do not qualify for charity care, the Association recognizes revenue on the basis of its standard rates for services provided (or on the basis of discounted rates, if negotiated or provided by policy). On the basis of historical experience, a significant portion of the Association’s uninsured patients will be unable or unwilling to pay for the services provided. Thus, the Association records a significant provision for bad debts related to uninsured patients in the period the services are provided. Patient service revenue, net of contractual allowances and discounts (but before the provision for bad debts), recognized in the period from these major payor sources is as follows.

	<u>Third-Party Payors</u>	<u>Self-Pay (Uninsured Only)</u>	<u>Total All Payors</u>
Patient service revenue (net of contractual allowances and discounts) for the year ended December 31, 2017	<u>\$ 336,472,030</u>	<u>\$ 6,753,614</u>	<u>\$ 343,225,644</u>
Patient service revenue (net of contractual allowances and discounts) for the year ended December 31, 2016	<u>\$ 318,119,387</u>	<u>\$ 3,516,618</u>	<u>\$ 321,636,005</u>

**Central Washington Health Services Association  
dba Central Washington Hospital  
Notes to Financial Statements**

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**Note 4 – Charity Care**

The Association maintains records to identify and monitor the level of charity care it provides. These records include the amount of charges forgone for services and supplies furnished under its charity care policy and the estimated cost of those services and supplies. The following information measures the level of charity care provided for the years ended December 31:

	2017	2016
Charges forgone, based on established rates	\$ 5,207,842	\$ 5,074,041

Management estimates charity care costs by calculating a ratio of cost to gross charges, and then multiplying that ratio by the gross uncompensated charges associated with providing care to charity patients. Charity care costs were \$2,005,000 and \$1,979,000 for the years ended December 31, 2017 and 2016, respectively.

**Note 5 – Assets Limited as to Use**

The composition of assets limited as to use at December 31 is set forth in the following table. Investments are stated at fair value.

	2017	2016
By board designated for malpractice costs		
Pooled funds and mutual funds	\$ 2,315,000	\$ 2,315,000
By board for workers' compensation deposit		
Cash and cash equivalents and treasury notes	\$ 1,453,000	\$ 1,531,394
By board for capital improvements and other purposes, net of amounts required for current liabilities		
Cash and cash equivalents	\$ 12,813,594	\$ 12,036,242
Pooled funds and mutual funds	103,969,225	75,492,109
	\$ 116,782,819	\$ 87,528,351
Under indenture agreement held by trustee		
Cash and cash equivalents	\$ 4,171,967	\$ 4,163,828
Guaranteed investment contracts	3,212,107	3,119,806
	7,384,074	7,283,634
Less current portion of indenture agreement held by trustee required for current liabilities	4,163,356	4,162,363
Noncurrent portion	\$ 3,220,718	\$ 3,121,271

**Central Washington Health Services Association  
dba Central Washington Hospital  
Notes to Financial Statements**

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**Note 5 – Assets Limited as to Use (continued)**

Investment income and gains for assets limited as to use, cash equivalents, and other investments are composed of the following for the years ending December 31:

	<u>2017</u>	<u>2016</u>
Investment income		
Interest and dividend income	\$ 2,742,372	\$ 2,185,953
Investment fees	(206,261)	(190,936)
Realized net gain on sales of securities	741,039	349,459
	<u>\$ 3,277,150</u>	<u>\$ 2,344,476</u>

**Note 6 – Property and Equipment**

A summary of property and equipment at December 31 follows:

	<u>2017</u>	<u>2016</u>
Land and land improvements	\$ 12,343,029	\$ 12,574,676
Buildings and building improvements	119,518,185	116,035,513
Fixed equipment	75,073,031	75,332,246
Major movable and minor equipment	108,396,823	103,379,760
	315,331,068	307,322,195
Less accumulated depreciation and amortization	<u>183,159,251</u>	<u>178,654,309</u>
	132,171,817	128,667,886
Construction in progress	<u>7,375,820</u>	<u>8,337,444</u>
	<u>\$ 139,547,637</u>	<u>\$ 137,005,330</u>

As of December 31, 2017, the Association had remaining commitments in the amount of approximately \$4,300,000 related to the termination of their prior electronic medical record system and approximately \$7,100,000 related to a lab consolidation project.

**Central Washington Health Services Association  
dba Central Washington Hospital  
Notes to Financial Statements**

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**Note 7 – Long-Term Debt**

A summary of long-term debt at December 31 follows:

	<u>2017</u>	<u>2016</u>
Series 2015 - Washington Health Care Facilities Authority Revenue Bonds, net of unamortized premium of \$5,310,227 due through July 1, 2039, in principal payments ranging from \$655,000 to \$7,930,000 annually and interest ranging from 4% to 5%.	\$ 107,965,227	\$ 108,842,214
Series 2009 - Washington Health Care Facilities Authority Revenue Bonds, due through July 1, 2023, in principal payments ranging from \$1,390,000 to \$2,390,000 annually and interest ranging from 5.88% to 6.25%.	10,725,000	12,850,000
Utility Local Improvement District No. 2 - loan payable due in 2028, payable in annual installments of principal with interest. The interest rate is fixed at 2.9%.	<u>174,195</u>	<u>188,712</u>
Long-term debt	118,864,422	121,880,926
Less current portion	(2,929,516)	(2,769,516)
Less net unamortized issuance costs	<u>(1,308,100)</u>	<u>(1,368,897)</u>
	<u>\$ 114,626,806</u>	<u>\$ 117,742,513</u>

The Washington Health Care Facilities Authority (the Authority) issued special-obligation \$103,895,000 par value Series 2015 Revenue Bonds for the advanced refunding. The Series 2015 Revenue Bonds are payable solely from payments made by the Association and are collateralized by an interest in the Association's gross receivables, gross receipts, equipment, a deed of trust in certain property, and funds held by the trustee under the bond indenture agreement (Note 5).

The Authority issued special-obligation Series 2009 Revenue Bonds and loaned the proceeds to the Association. The Series 2009 Revenue Bonds are payable solely from payments made by the Association and are collateralized by an interest in the Association's gross receivables, gross receipts, equipment, a deed of trust in certain property, and funds held by the trustee under the bond indenture agreement (Note 5).

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### Note 7 – Long-Term Debt (continued)

The Bond Loan and Security Agreement and the Trust Indenture contain restrictive covenants that require, among other matters, that the Association maintain minimum debt service coverage, excess margin, and cushion ratios. The Association is in compliance with these financial covenants at December 31, 2017 and 2016.

Principal maturities of long-term debt are as follows:

2018	\$	2,929,516
2019		3,094,516
2020		3,269,516
2021		3,449,516
2022		3,639,516
Thereafter		<u>97,171,615</u>
		113,554,195
Net unamortized premiums		<u>5,310,227</u>
	\$	<u><u>118,864,422</u></u>

### Note 8 – Estimated Medical Malpractice Costs

The Association is insured as a part of Confluence Health through a contract with an insurance company that provides coverage on a claims-made basis. There is a self-insured retention limit of \$2,000,000 per incident with \$4,000,000 in aggregate for hospital and insured physician claims combined for Confluence Health. In addition, as a part of Confluence Health, the Association maintains excess malpractice insurance coverage on a claims-made basis up to \$40,000,000 per incident and in aggregate on both hospital and insured physician claims.

The Association recognizes expenses associated with unasserted medical malpractice claims in the period in which the incidents are expected to have occurred rather than when a claim is asserted. Expenses associated with these incidents are estimated and based on actuarial assumptions of current settlement costs. In calculating the 2017 estimated malpractice liability, the Association's actuaries used an undiscounted 70% confidence level for determining the present value of future claims.

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**Note 9 – Retirement Plan**

The Association has two defined contribution retirement plans for qualified employees. The Association contributes an amount equal to a specified percentage of the employees' effective compensation as defined by the plans. One plan is a 403(b) plan for employees of the Association who are part of a collective bargaining unit. These employees are qualified to participate in the plan after two years of continuous service. Plan benefits are fully vested to the employee upon entry into the plan. In 2013, the Association's defined contribution retirement plan for qualified employees changed, for those employees not part of a collective bargaining unit, to a 401(k) plan under Confluence Health. The plan is a safe harbor plan in which the Association contributes a specified percentage of the employees' effective contribution based on the contribution made by the employee. Employees are eligible to participate in the plan after one year of continuous service. Plan benefits are fully vested to employees upon entry into the plan. The Association, as part of Confluence Health, may also make a discretionary contribution to the plan. There is a six-year vesting schedule for the discretionary contributions to the plan. The Association made a discretionary contribution in 2017 and 2016. Retirement plan costs charged to operations were approximately \$4,740,000 and \$5,187,000 in 2017 and 2016, respectively. It is the Association's policy to fund retirement plan costs accrued.

**Note 10 – Self-Insured Plans**

Liabilities related to self-insured plans in the amount of \$469,000 and \$448,000 at December 31, 2017 and 2016, respectively, were included in the accrued liabilities on the balance sheets.

**Health** – The Association has self-funded employee health care plans. The plans are funded from the Association's unrestricted cash and cash equivalents. The Association has stop-loss coverage through an insurance company that provides coverage for employee claims in excess of \$400,000 for individual claims. Payments by the Association for health insurance expense were approximately \$11,944,000 and \$10,885,000 in 2017 and 2016, respectively.

**Workers' compensation** – The Association has a self-insured workers' compensation plan for its employees. The Association pays its share of actual injury claims, maintenance of reserves, administrative expenses, and reimbursement premiums. Costs of the Association for workers' compensation expenses were approximately \$843,000 and \$904,000 in 2017 and 2016, respectively.

**Unemployment** – The Association has a self-insured unemployment plan for its employees. The Association pays its share of actual unemployment claims and administrative expenses. Payments by the Association for unemployment expense were approximately \$108,000 and \$90,000 in 2017 and 2016, respectively.

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**Note 11 – Concentrations of Credit Risk**

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

	<u>2017</u>	<u>2016</u>
Medicare	40%	36%
Medicaid	19%	21%
Commercial	14%	16%
Premera	12%	15%
Other payors	9%	7%
Patient self-pay	<u>6%</u>	<u>5%</u>
	<u>100%</u>	<u>100%</u>

**Note 12 – Commitments and Contingencies**

**Operating leases** – The Association leases various equipment and facilities under operating leases. These operating leases are not long-term commitments. Total rental expense in 2017 and 2016 for all operating leases was \$1,046,691 and \$1,178,070, respectively.

**Regulation and litigation** – The Association 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 Association’s future financial position or results from operations.

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 continues with respect to investigations and allegations concerning possible violations of fraud and abuse statutes and regulations by health care providers. 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 Association 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.

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**Note 13 – Confluence Health Foundation**

Confluence Health Foundation (the Foundation) is a separate not-for-profit corporation whose articles of incorporation identified the Association as the Foundation's primary beneficiary. Effective September 2014, the articles of incorporation were amended to identify not only the Association, but also Confluence Health and Wenatchee Valley Hospital as the Foundation's primary beneficiaries.

The Foundation is authorized by the primary beneficiaries to solicit contributions on their behalf. In the absence of donor restrictions, the Foundation has discretionary control over the amounts, timing, and use of its distributions.

Summarized financial information as of and for the years ended December 31, relating to the Foundation, is as follows:

	<u>2017</u>	<u>2016</u>
Assets, primarily cash and investments	<u>\$ 13,975,000</u>	<u>\$ 12,409,000</u>
Payable to Central Washington Hospital	\$ 249,000	\$ 249,000
Other liabilities	<u>1,377,000</u>	<u>1,307,000</u>
	<u>1,626,000</u>	<u>1,556,000</u>
Net assets	<u>12,349,000</u>	<u>10,853,000</u>
	<u>\$ 13,975,000</u>	<u>\$ 12,409,000</u>
Increase (decrease) in net assets	<u>\$ 1,496,000</u>	<u>\$ 2,617,000</u>

**Note 14 – Fair Value of Assets**

The Association adopted fair value accounting, which establishes a framework for measuring fair value and expands disclosures about fair value measurements.

Fair value is defined as the price that would be received to sell an asset in an orderly transaction between market participants at the measurement date. Fair value accounting also establishes a hierarchy that requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. There are three levels of inputs that may be used to measure fair value:

**Level 1** – Quoted prices in active markets for identical assets.

**Level 2** – Quoted prices in markets that are not considered to be active or financial instruments without quoted market prices, but for which all significant inputs are observable, either directly or indirectly.

**Level 3** – Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets.

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**Note 14 – Fair Value of Assets (continued)**

The following is a description of the valuation methodologies used for instruments measured at fair value on a recurring basis and recognized in the accompanying balance sheets, as well as the general classification of such instruments pursuant to the valuation hierarchy.

**Certificates of deposit** – Certificates of deposit are valued at fair value by discounting the related cash flows based on current yields of similar instruments with comparable durations considering the creditworthiness of the issuer.

**Guaranteed investment contract** – The guaranteed investment contract (GIC) is valued at fair value by discounting the related cash flows based on current yields of similar instruments with comparable durations considering the creditworthiness of the issuer.

**Bonds** – Valued using pricing models maximizing the use of observable inputs for similar securities, which includes basing value on yields currently available on comparable securities of issuers with similar credit ratings.

**Available-for-sale securities** – Where quoted market prices are available in an active market, securities are classified within Level 1 of the valuation hierarchy. If quoted market prices are not available, the fair values are estimated by using pricing models, quoted prices of securities with identical characteristics, or discounted cash flows. In certain cases where Level 1 or Level 2 inputs are not available, securities would be classified within Level 3 of the hierarchy.

	Fair Value	Fair Value Measurements Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
<b>December 31, 2017</b>				
Cash and cash equivalents	\$ 4,171,967	\$ 4,171,967	\$ -	\$ -
Money market accounts	11,453,516	11,453,516	-	-
Treasury bills	2,813,078	2,813,078	-	-
Fixed income				
Corporate bonds	46,040,968	-	46,040,968	-
U.S. governmental bonds	16,788,853	-	16,788,853	-
Agency bonds	1,212,749	-	1,212,749	-
Mutual funds	40,458,895	40,458,895	-	-
Certificates of deposit	1,453,000	-	1,453,000	-
Preferred stock	329,760	329,760	-	-
Guaranteed investment contracts	3,212,107	-	3,212,107	-
	<u>\$ 127,934,893</u>	<u>\$ 59,227,216</u>	<u>\$ 68,707,677</u>	<u>\$ -</u>

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**Note 14 – Fair Value of Assets (continued)**

<b>December 31, 2016</b>	Fair Value	Fair Value Measurements Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Cash and cash equivalents	\$ 4,163,828	\$ 4,163,828	\$ -	\$ -
Money market accounts	13,257,796	13,257,796	-	-
Treasury bills	309,840	309,840	-	-
Fixed income				
Corporate bonds	31,153,127	-	31,153,127	-
U.S. governmental bonds	15,990,730	-	15,990,730	-
Agency bonds	723,147	-	723,147	-
Mutual funds	28,408,711	28,408,711	-	-
Certificates of deposit	1,531,394	-	1,531,394	-
Guaranteed investment contracts	3,119,806	-	3,119,806	-
	<b>\$ 98,658,379</b>	<b>\$ 46,140,175</b>	<b>\$ 52,518,204</b>	<b>\$ -</b>

Total gains and losses are included in the statements of operations in investment income and unrealized loss on investments.

**Note 15 – Fair Value of Financial Instruments**

The following methods and assumptions were used by the Association in estimating the fair value of its financial instruments.

**Cash and cash equivalents** – The Association maintains its cash and cash equivalent accounts, which at times may exceed federally insured limits, at financial institutions. The carrying amount reported in the balance sheets for cash and cash equivalents approximates its fair value.

**Assets limited as to use** – These assets consist primarily of cash and short-term investments and interest receivable. The carrying amount reported in the balance sheets is fair value.

**Accounts payable and accrued expenses** – The carrying amount reported in the balance sheets for accounts payable and accrued expenses approximates its fair value.

**Estimated third-party payor settlements** – The carrying amount reported in the balance sheets for estimated third-party payor settlements approximates its fair value.

**Long-term debt** – Fair values of the Association’s revenue bonds are based on current traded value. The fair value of the Association’s remaining long-term debt is estimated using discounted cash flow analyses, based on the Association’s current incremental borrowing rates for similar types of borrowing arrangements. These instruments are categorized as Level 2 in the fair value hierarchy (Note 14).

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**Note 15 – Fair Value of Financial Instruments (continued)**

The carrying amounts and fair values of the Association's financial instruments, excluding instruments that have carrying amounts that approximate fair value, are as follows:

	2017		2016	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Long-term debt	<u>\$ 117,556,322</u>	<u>\$ 123,585,496</u>	<u>\$ 120,512,029</u>	<u>\$ 121,348,760</u>

The amortized cost and estimated fair values of the available-for-sale investment securities are as follows:

	Historical Cost	Gross Unrealized Gains	Gross Unrealized Losses		Fair Value
			Less Than 12 Months	Greater Than 12 Months	
Investments in marketable securities					
December 31, 2017					
Corporate bonds	\$ 46,072,464	\$ 590,671	\$ (272,475)	\$ (349,692)	\$ 46,040,968
Agency bonds	1,221,079	3,701	(8,596)	(3,435)	1,212,749
U.S. governmental bonds	16,898,506	27,532	(85,349)	(51,836)	16,788,853
	<u>\$ 64,192,049</u>	<u>\$ 621,904</u>	<u>\$ (366,420)</u>	<u>\$ (404,963)</u>	<u>\$ 64,042,570</u>
Investments in marketable securities					
December 31, 2016					
Corporate bonds	\$ 31,467,767	\$ 322,578	\$ (104,740)	\$ (532,478)	\$ 31,153,127
Agency bonds	16,182,853	4,277	(15,198)	(181,202)	15,990,730
U.S. governmental bonds	729,376	2,133		(8,362)	723,147
	<u>\$ 48,379,996</u>	<u>\$ 328,988</u>	<u>\$ (119,938)</u>	<u>\$ (722,042)</u>	<u>\$ 47,867,004</u>

Proceeds from sales of available-for-sale securities were \$84,503,602 and \$59,437,847 in 2017 and 2016, respectively.

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**Note 15 – Fair Value of Financial Instruments (continued)**

Contractual maturities of investment securities as of December 31, 2017, are shown below. Expected maturities will differ from contractual maturities because issuers may have the right to call or prepay obligations with or without prepayment penalties.

	Fair Value of Investments in Marketable Securities
Contractual maturities	
Due within one year	\$ 2,119,137
Due after one year through five years	26,205,275
Due after five years through ten years	20,384,734
Due after ten years	15,333,424
	\$ 64,042,570

**Note 16 – Affiliation Transactions**

**Professional services** – As part of the affiliation described in Note 1 between Confluence Health, Wenatchee Valley Medical Group, and the Association, the Association reimburses Wenatchee Valley Medical Group for professional services rendered. Expenses incurred under this arrangement totaled \$3,759,201 and \$3,386,354 for the years ended December 31, 2017 and 2016, respectively. There was an amount payable of \$3,433,235 and \$2,719,533 at December 31, 2017 and 2016, respectively.

**Note receivable from affiliate** – The Association and Confluence Health entered into a note in 2013 for a maximum amount of \$30,000,000. The note bears interest at prime plus 2% (4.5% at December 31, 2017). The terms of the note payable provide for quarterly principal payments due in 20 installments with 19 installments of \$500,000 commencing in September 2021 and the remaining unpaid aggregate balance paid in July 2026. Interest accrued on the note is payable quarterly. The amount outstanding as due, including accrued interest to the Association under this agreement, is \$16,393,114 and \$15,428,419 at December 31, 2017 and 2016, respectively.

**Management services** – The employees of Confluence Health provide administrative services to the Association beginning in 2013. In connection with services provided, the Association reimbursed Confluence Health in the amount of \$52,460,770 and \$41,417,248 for the years ended December 31, 2017 and 2016, respectively.

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**Note 17 – Functional Expenses**

The Association provides health care, education, and social services to patients and residents within its geographic location. Expenses related to providing these services by functional class for the years ended December 31 are as follows:

	<u>2017</u>	<u>2016</u>
Patient health care and other program services	\$ 266,861,795	\$ 246,214,322
General and administrative	<u>54,658,440</u>	<u>47,759,612</u>
	<u>\$ 321,520,235</u>	<u>\$ 293,973,934</u>

