



**INDEPENDENT AUDITOR'S REPORT
AND FINANCIAL STATEMENTS
DECEMBER 31, 2006 AND 2005**

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INDEPENDENT AUDITOR'S REPORT

To the Commissioners of
Public Hospital District No. 1,
Snohomish County, Washington
dba Valley General Hospital

We have audited the balance sheet of Public Hospital District No. 1, Snohomish County, Washington (a municipal corporation), dba Valley General Hospital, as of December 31, 2006 and 2005, and the related statements of revenues, expenses, and changes in net assets, and cash flows for the years then ended. These financial statements are the responsibility of the District's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Public Hospital District No. 1, Snohomish County, Washington, dba Valley General Hospital, as of December 31, 2006 and 2005, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The accompanying management's discussion and analysis on pages 2 through 10 is not a required part of the financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.



Everett, Washington
May 24, 2007

**PUBLIC HOSPITAL DISTRICT NO. 1,
SNOHOMISH COUNTY, WASHINGTON
MANAGEMENT’S DISCUSSION AND ANALYSIS**

Our discussion and analysis of Public Hospital District No.1, Snohomish County, WA (District), doing business as Valley General Hospital (Hospital) financial performance provides an overview of the District’s financial activities for the fiscal years ended December 31, 2006 and 2005. Please read it in conjunction with the District’s financial statements, which follow this analysis. Unless otherwise indicated, dollar amounts are in thousands.

Financial Highlights

- The District’s net assets increased in 2006 after posting a decrease in both 2005 and 2004. Net assets increased \$1,353 or 7.8 percent in 2006 and decreased \$1,027 or 5.6 percent and \$686 or 3.6 percent in 2005 and 2004, respectively.
- The District reported an operating gain of \$155 in 2006 and operating losses of \$1,877 and \$1,502 in 2005 and 2004, respectively. Operating gains in 2006 increased by \$2,032 from the 2005 operating loss. The 2005 loss increased \$375 or 25.0 percent and the 2004 loss increased \$1,171 or 354.3 percent each from the prior year. Total gains in 2006 increased by \$2,380 or 231.8 percent.
- Nonoperating income increased by \$348 or 40.9 percent in 2006 compared to 2005, \$35 or 4.2 percent in 2005 compared to 2004, and a decrease of \$146 or 15.2 percent in 2004 compared to 2003.

The District’s financial statements consist of three statements—a Balance Sheet; a Statement of Revenues, Expenses, and Changes in Fund Net Assets; and a Statement of Cash Flows. These financial statements and related notes provide information about the activities of the District, including resources held by the Hospital but restricted for specific purposes by enabling legislation.

The Balance Sheet and Statement of Revenues, Expenses, and Changes in Net Assets

In analysis of its finances, one of the most important questions asked about the District is, “Is the District as a whole better or worse off as a result of the year’s activities?” The Balance Sheet and the Statement of Revenues, Expenses, and Changes in Net Assets report information about the District’s resources and its activities in a way that helps answer this question. These statements include all restricted and unrestricted assets and liabilities using the accrual basis of accounting. All of the current year’s revenues and expenses are taken into account regardless of when cash is received or paid.

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

**PUBLIC HOSPITAL DISTRICT NO. 1,
SNOHOMISH COUNTY, WASHINGTON
MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)**

The Statement of Cash Flows

The final required statement is the Statement of Cash Flows. This statement reports cash receipts, cash payments, and net changes in cash resulting from operating, investing, and financing activities. It provides answers to such questions as "Where did cash come from?" "What was cash used for?" and "What was the change in cash balance during the reporting period?"

The Hospital District's Balance Sheet

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

	2006	2005	2004
ASSETS			
Current assets	\$ 9,864	\$ 9,270	\$ 9,598
Capital assets, net	20,098	19,817	17,905
Other noncurrent assets	10,344	6,009	8,677
Total assets	<u>\$ 40,306</u>	<u>\$ 35,096</u>	<u>\$ 36,180</u>
LIABILITIES			
Long-term debt outstanding	\$ 16,556	\$ 12,920	\$ 13,669
Other current and noncurrent liabilities	5,103	4,882	4,190
Total liabilities	<u>21,659</u>	<u>17,802</u>	<u>17,859</u>
NET ASSETS			
Invested in capital, net	3,542	6,897	4,236
Restricted for debt service	1,446	1,434	1,409
Unrestricted	13,659	8,963	12,676
Total net assets	<u>18,647</u>	<u>17,294</u>	<u>18,321</u>
Total liabilities and net assets	<u>\$ 40,306</u>	<u>\$ 35,096</u>	<u>\$ 36,180</u>

**PUBLIC HOSPITAL DISTRICT NO. 1,
SNOHOMISH COUNTY, WASHINGTON
MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)**

The Hospital District's Balance Sheet (continued)

In 2006, the net capital assets increased by \$281 (1.4 percent). In addition to routine capital equipment replacement, the District began the multi-year installation of a hospital-wide information technology update in late 2006. Construction also began for a new Cat Scan, which was completed in early 2007. The hospital also replaced the cardiac monitoring system with the assistance of restricted donations from the Valley General Hospital Foundation.

A funded escrow account was set up near the end of 2006, with funds designated to the Information Technology project and the purchase and installation of the Cat Scan.

In 2005, the net capital assets increased significantly, \$1,912 (10.7 percent). Two major construction projects were completed, tenant improvements in a new physician owned medical office building and a parking lot expansion. In addition, major investments of \$1,500 were made in new imaging equipment, which was purchased using noncurrent assets.

In 2004, net capital assets changed only moderately, increasing \$43. The transactions included purchases of new capital and projects of \$2,481 and the sale of property resulting in a \$763 net decrease in land.

In 2004, a significant increase in total liabilities came from a February 2004 issue of Limited General Obligation Bonds totaling \$7,425, increasing long-term debt.

**PUBLIC HOSPITAL DISTRICT NO. 1,
SNOHOMISH COUNTY, WASHINGTON
MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)**

Operating Results and Changes in the Hospital's Net Assets

The District reported operating income of \$155 during 2006, which followed reported financial losses of \$1,877 during 2005 and \$1,502 during 2004. The following is a presentation of certain financial information derived from the District's Statement of Revenues, Expenses, and Changes in Net Assets (in thousands):

	<u>2006</u>	<u>2005</u>	<u>2004</u>
OPERATING REVENUES			
Net patient service revenue	\$ 40,281	\$ 34,968	\$ 32,116
Revenue from tax levies for maintenance and operations	373	388	385
Other operating revenues	<u>524</u>	<u>446</u>	<u>645</u>
Total operating revenues	<u>41,178</u>	<u>35,802</u>	<u>33,146</u>
OPERATING EXPENSES			
Salaries and benefits	25,109	23,030	21,382
Supplies and other	8,513	7,858	7,276
Purchased services	5,274	5,077	4,357
Depreciation	<u>2,127</u>	<u>1,714</u>	<u>1,633</u>
Total operating expenses	<u>41,023</u>	<u>37,679</u>	<u>34,648</u>
Operating income (loss)	155	(1,877)	(1,502)
NONOPERATING INCOME (EXPENSE)			
Revenue from tax levies for debt service	1,627	1,673	1,563
Sky Valley Family Medicine Clinic			(98)
Interest expense	(646)	(629)	(624)
Interest income	387	129	78
Loss on sale of capital assets	(52)	(293)	(101)
Other expense, net	<u>(118)</u>	<u>(30)</u>	<u>(2)</u>
INCREASE (DECREASE) IN NET ASSETS	<u>\$ 1,353</u>	<u>\$ (1,027)</u>	<u>\$ (686)</u>
NET ASSETS, end of year	<u>\$ 18,647</u>	<u>\$ 17,294</u>	<u>\$ 18,321</u>

**PUBLIC HOSPITAL DISTRICT NO. 1,
SNOHOMISH COUNTY, WASHINGTON
MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)**

Operating Gains and Losses

A major component of the overall change in the District's net assets is its operating income or loss, which is, generally, the difference between net patient service revenues and the expenses incurred to perform those services. The District reported operating income of \$155 during 2006, which followed three years of reporting losses of \$1,877, \$1,502, and \$331 in 2005, 2004, and 2003 respectively, after reporting income for the previous five years. The District's operations were begun in 1960 as a municipal hospital, when it was agreed that a portion of its costs would be subsidized by property tax revenues, making the facility more affordable for the County's lower income residents.

The primary components of the increases or decreases in operating expenses are:

- Increases in salary and benefit costs for the hospital's employees of \$2,079 or 9.0 percent in 2006, \$1,649 or 7.7 percent in 2005, and \$1,679 or 8.5 percent in 2004.
- Increases in medical supply and drug costs of \$151 or 2.8% in 2006, \$164 or 3.2 percent in 2005, and \$528 or 11.4 percent in 2004.
- Increases in professional liability costs of \$141 or 20.2 percent in 2006, \$52 or 8.1 percent in 2005, and \$390 or 153.2 percent in 2004.
- Increases in the level of uncompensated care. These are services provided for which there is no expectation of payment.
- Increases in rents and leases of \$276 or 47.3 percent in 2006, \$230 or 65.0 percent in 2005, and \$72 or 25.9 percent in 2004.
- Increases in depreciation expenses of \$413 or 24.1 percent in 2006, \$81 or 5.0 percent in 2005, and a decrease of \$37 or 2 percent decline in 2004.
- Decreases in agency and consulting costs of \$258 or 14.9 percent in 2006, \$16 or .9 percent in 2005, and \$186 or 9.6 percent in 2004.

Employee salary and benefits costs increased each year since 2004 based on rates established in labor contracts negotiated in 2004, 2005, and 2006. Current labor contracts for the District's unionized employees extend until 2008 and 2009. In August 2005, the District added an outpatient Internal Medicine Clinic, including one full-time internal medicine physician. In 2004, a Hospitalist Program was added, including four full-time internal medicine physicians.

Significant supply costs include the cost of pharmaceuticals, which were up \$41 or 4.4 percent between 2005 and 2006, and were up \$61 or 6.9 percent between 2004 and 2005. Patient chargeable supplies and implants were down \$82 or 3.4 percent between 2005 and 2006, and were also down \$70 or 2.8 percent between 2004 and 2005. The cost of reagents used in our lab increased by \$68 or 16.3 percent between 2005 and 2006, and increased by \$36 or 9.4 percent between 2004 and 2005.

In August 2005, the hospital completed tenant improvements in a physician-owned building and began leasing space. The hospital leased space for the full year of 2006, resulting in an increase of \$276 or 47.3 percent between 2005 and 2006. The increase to leases and rentals totaled \$230 or 65 percent between 2004 and 2005.

**PUBLIC HOSPITAL DISTRICT NO. 1,
SNOHOMISH COUNTY, WASHINGTON
MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)**

Operating Gains and Losses (continued)

The District provides care for patients who have little or no health insurance or other means of repayment. As discussed, this service to the community is consistent with the goals established for the District when it was established in 1960. The level of services provided to these patients increased by \$1,094 or 45.0 percent between 2005 and 2006, and by \$1,579 or 185.7 percent in 2005 from 2004. Because there is no expectation of repayment, charity care is not reported as patient service revenues of the District.

Other uncompensated care, bad debts, decreased by \$889 or 52.3 percent between 2005 and 2006, and decreased by \$557 or 24.7 percent between 2004 and 2005.

Other operating expenses include decreases in agency and other professional costs of \$258 or 14.9 percent between 2005 and 2006, and a decrease of \$16 or 0.9 percent between 2004 and 2005. Purchased services in both the billing office and medical records increased \$315 or 98.6 percent, and plant maintenance costs increased \$131 or 75.7 percent from 2005 to 2006. In 2004, purchased services related to direct patient care increased by \$160 or 40 percent, and marketing and strategic planning services of \$81 or 103 percent. In addition, two other significant changes increased other operating expenses during 2004: replacement of a CT tube for \$81 or 129 percent, and a change to outside linen services of \$199. Neither of these occurred in either of the previous two years. The linen services will continue in the future.

Nonoperating Revenues and Expenses

Nonoperating revenues consist primarily of property taxes levied by the District, interest revenue and investment earnings, and, in 2003, income or loss from the operation of the Sky Valley Family Medicine Clinic in Sultan. In February 2004, the District's Commissioners approved the purchase of the clinic in Sultan rather than have the clinic close or consolidate outside the Sultan community as proposed by the previous owner. The Commissioners did not intend to permanently acquire the clinic. Rather, their intent was to provide a bridge or transition period for the physicians to prepare their clinic to become independent. Initially, the Commissioners planned on a one-year transition period. However, due to the difficulty experienced by the physicians in obtaining medical liability insurance, the Board extended the ownership period to October 1, 2004. The voters of the hospital district approved no changes to the standing levy or additional bonds during 2006 and 2005. The current regular levy rate is \$.12 per \$1,000 of property valuation.

Grants, Contributions, and Endowments

The District receives both capital and operating grants from various state and federal agencies for specific programs. During 2006, the District received \$101 in trauma and emergency preparedness grants. During 2005, the District received public hospital grants totaling \$302 and trauma and emergency preparedness grants totaling \$52, for a total of \$354. In 2004, the District received public hospital grants totaling \$197, trauma grants totaling \$71, and other grants totaling \$6, for total grants of \$282.

**PUBLIC HOSPITAL DISTRICT NO. 1,
SNOHOMISH COUNTY, WASHINGTON
MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)**

Grants, Contributions, and Endowments (continued)

The District received a net of \$108 from the Valley General Hospital Foundation and the Valley General Hospital Guild, with the majority of the funding being used to replace the cardiac monitoring system in the Emergency Department. The District received \$20 from the Valley General Hospital Foundation and the Hospital Guild during 2005, and \$83 was received and used primarily to fund facility improvements and to purchase surgical and critical care capital equipment. The Valley General Foundation is a 501(c)(3) organization with its own Board of Directors, which functions independently of the District Board of Commissioners and Hospital Administration. Grants, contributions, and endowments are reported as nonoperating income.

The District's Cash Flows

Changes in the District's cash flows are consistent with changes in operating incomes/losses and nonoperating revenues and expenses, discussed earlier, with few exceptions. In September 2006, the District entered into a financing arrangement to fund a new CT scanner and to fund a multi-year hospital-wide information technology upgrade. The total debt commitment is \$5,164, with \$1,497 being distributed during 2006 as progress billings for information technology upgrade. A new bond issuance in 2004 increased cash flows as discussed below. Cash flows used by operating activities decreased more than operating losses in 2003 due to increases in the District's patient accounts receivable.

	<u>2006</u>	<u>2005</u>	<u>2004</u>
Net cash from operating activities	\$ 1,984	\$ 651	\$ (889)
Net cash from noncapital financing activities	256	368	285
Net cash from capital and related financing activities	2,165	(3,865)	5,646
Net cash from investing activities	<u>387</u>	<u>129</u>	<u>77</u>
Net change in cash and cash equivalents	<u>\$ 4,792</u>	<u>\$ (2,717)</u>	<u>\$ 5,119</u>

**PUBLIC HOSPITAL DISTRICT NO. 1,
SNOHOMISH COUNTY, WASHINGTON
MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)**

Capital Asset and Debt Administration

Capital Assets

At the end of 2006, the District had \$20.1 million invested in capital assets, net of accumulated depreciation, a \$281 thousand increase from the \$19.8 million that was invested in capital assets for 2005. In 2006, the District began two major projects, the replacement of the Cat Scan, and a multi-year hospital-wide information technology upgrade.

At the end of 2005, the District had \$19.8 million invested in capital assets, net of accumulated depreciation, a 1.9 million increase from the \$17.9 million that was invested in capital assets for 2004. In 2005, the District completed two major construction projects, tenant improvements and a parking lot expansion, costing an additional \$1,145 and \$47, respectively. In addition, major movable equipment purchases totaled \$2,688, the largest piece of equipment being the replacement of an MRI unit.

In 2004, the District purchased new equipment costing \$2,481, including major movable equipment purchases of \$564, additional parking lot development of \$1,004, and investments in Medical Office Building rental space tenant improvements of \$482. We entered into a capital lease with LA Barrington for approximately \$37. The District has found it more economical to lease some of its equipment. This allows the District to avoid some of the costs of obsolescence caused by technological changes.

The Hospital Board of Commissioners approved dedicating a portion of the proceeds from the regular levy to debt repayment. On February 1, 2004, the District issued bonds totaling \$7,425 for the purpose of constructing additional clinical space and paying for equipment and improvement upgrades in imaging, rehabilitation services, pharmacy, medical/surgical equipment, and information technology. At December 31, 2005, the District has spent \$5,034 for parking, additional clinical space, and equipment. During 2006, an additional \$57 was spent for internal remodeling projects. The bonds will be repaid over a 15-year period.

Debt

At year-end, the District had \$2,815 in Unlimited Tax General Obligation and \$8,495 in Limited Tax General Obligation Bonds outstanding. The District entered into a five-year equipment financing arrangement with Key Government Finance totaling \$5,164. Proceeds were deposited into an interest-bearing escrow account, which will be drawn down as the new equipment, a Cat Scan and a hospital-wide information technology upgrade, are received and installed. In 2005, the District entered into four capital lease agreements totaling \$415. In 2004, the District issued Limited Tax Obligation Bonds totaling \$7,425, a note payable for \$116,000, capital leases of \$56, and net line of credit borrowings of \$24. The District's formal debt issuances—government bonds—cannot be issued without approval of the Board of Commissioners. The amount of debt issued is subject to limitations that apply to the Hospital District. The District received a rating of "A" from Fitch during the issuance of the new bond debt in 2004.

**PUBLIC HOSPITAL DISTRICT NO. 1,
SNOHOMISH COUNTY, WASHINGTON
MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)**

Economic Factors

The District is primarily a residential community. The local economy is based on health care, agriculture, government employment associated with State correctional facilities and several school districts, and growing retail and light manufacturing sectors. Monroe is the largest city in the District and is an agricultural supply and service center, as well as trade, business, and professional service center. Small, diverse industries play a role in the local Monroe economy, while growth has been primarily attributable to increasing population and employment opportunities in the adjacent areas of Lynnwood, Everett, Woodinville, and the “technology corridor” of north King County and south Snohomish County, including the Everett Boeing plant.

Contacting the District's Financial Management

This financial report provides our patients, suppliers, taxpayers, and creditors with a general overview of Snohomish County Public Hospital District Number One's finances and shows the District's accountability for the money it receives. If you have questions about this report or need additional financial information, contact the District's Administrative Office at Valley General Hospital, 14701 179th Street S.E., Monroe, WA 98272-0646.

**PUBLIC HOSPITAL DISTRICT NO. 1,
SNOHOMISH COUNTY, WASHINGTON
dba VALLEY GENERAL HOSPITAL
BALANCE SHEET**

ASSETS

	DECEMBER 31,	
	<u>2006</u>	<u>2005</u>
CURRENT ASSETS		
Cash	\$ 1,132,006	\$ 711,236
Patient accounts receivable, net of estimated uncollectibles of \$1,029,000 in 2006 and \$1,337,000 in 2005	6,905,848	6,693,405
Inventory	810,587	808,416
Prepaid expenses	353,065	417,528
Assets limited as to use required for current liabilities	<u>662,832</u>	<u>639,510</u>
Total current assets	<u>9,864,338</u>	<u>9,270,095</u>
ASSETS LIMITED AS TO USE, net of current portion	<u>10,209,397</u>	<u>5,871,850</u>
CAPITAL ASSETS		
Land	2,317,877	2,317,877
Construction in progress	2,632,428	1,158,353
Depreciable capital assets, net of accumulated depreciation	<u>15,147,453</u>	<u>16,340,805</u>
	<u>20,097,758</u>	<u>19,817,035</u>
DEFERRED FINANCING COSTS	<u>134,352</u>	<u>137,184</u>
Total assets	<u><u>\$ 40,305,845</u></u>	<u><u>\$ 35,096,164</u></u>

**PUBLIC HOSPITAL DISTRICT NO. 1,
SNOHOMISH COUNTY, WASHINGTON
dba VALLEY GENERAL HOSPITAL
BALANCE SHEET**

LIABILITIES AND NET ASSETS

	DECEMBER 31,	
	<u>2006</u>	<u>2005</u>
CURRENT LIABILITIES		
Accounts payable	\$ 2,027,402	\$ 2,006,031
Accrued salaries and benefits	2,263,166	1,845,901
Accrued interest	42,427	47,106
Deferred revenue	208,416	320,317
Estimated third-party payor settlements	314,385	430,819
Other accrued liabilities	77,145	62,525
Current portion of long-term debt	<u>2,356,746</u>	<u>1,347,630</u>
Total current liabilities	7,289,687	6,060,329
ESTIMATED MEDICAL MALPRACTICE COSTS	169,819	169,819
LONG-TERM DEBT, net of current portion	<u>14,199,409</u>	<u>11,572,025</u>
Total liabilities	21,658,915	17,802,173
NET ASSETS		
Invested in capital assets, net of related debt	3,541,603	6,897,380
Restricted for debt service	1,446,291	1,433,772
Unrestricted	<u>13,659,036</u>	<u>8,962,839</u>
TOTAL NET ASSETS	<u>18,646,930</u>	<u>17,293,991</u>
Total liabilities and net assets	<u>\$ 40,305,845</u>	<u>\$ 35,096,164</u>

**PUBLIC HOSPITAL DISTRICT NO. 1,
SNOHOMISH COUNTY, WASHINGTON
dba VALLEY GENERAL HOSPITAL
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS**

	YEAR ENDED DECEMBER 31,	
	2006	2005
OPERATING REVENUES		
Net patient service revenue (net of provision for bad debts of \$812,393 in 2006 and \$1,701,222 in 2005)	\$ 40,280,753	\$ 34,967,567
Revenue from tax levies for maintenance and operations	372,751	388,451
Other revenue	524,522	446,321
Total operating revenues	<u>41,178,026</u>	<u>35,802,339</u>
OPERATING EXPENSES		
Salaries and benefits	25,109,386	23,030,235
Supplies and other	8,512,955	7,858,287
Purchased services	5,274,031	5,077,227
Depreciation	2,126,651	1,713,619
Total operating expenses	<u>41,023,023</u>	<u>37,679,368</u>
Operating income (loss)	<u>155,003</u>	<u>(1,877,029)</u>
NONOPERATING INCOME (EXPENSE)		
Revenue from tax levies for general obligation bonds	1,627,365	1,673,169
Interest expense	(646,127)	(629,348)
Interest income	386,781	129,502
Loss on sale of capital assets	(52,164)	(293,007)
Other expense, net	(117,919)	(30,035)
Net nonoperating income	<u>1,197,936</u>	<u>850,281</u>
INCREASE (DECREASE) IN NET ASSETS	1,352,939	(1,026,748)
NET ASSETS, beginning of year	<u>17,293,991</u>	<u>18,320,739</u>
NET ASSETS, end of year	<u>\$ 18,646,930</u>	<u>\$ 17,293,991</u>

**PUBLIC HOSPITAL DISTRICT NO. 1,
SNOHOMISH COUNTY, WASHINGTON
dba VALLEY GENERAL HOSPITAL
STATEMENT OF CASH FLOWS**

Increase (Decrease) in Cash and Cash Equivalents

	YEAR ENDED DECEMBER 31,	
	2006	2005
CASH FLOWS FROM OPERATING ACTIVITIES		
Receipts from and on behalf of patients	\$ 39,839,975	\$ 35,945,762
Payments to suppliers and contractors	(13,688,703)	(12,798,704)
Payments to employees	(24,692,121)	(22,941,905)
Other cash receipts	524,522	446,321
Net cash from operating activities	<u>1,983,673</u>	<u>651,474</u>
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Cash from tax levies considered financing activity	374,050	397,876
Other	(117,919)	(30,035)
Net cash from noncapital financing activities	<u>256,131</u>	<u>367,841</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Cash from tax levies for general obligation bonds	1,636,565	1,675,676
Proceeds from long-term debt	5,163,906	
Principal paid on long-term debt	(1,580,230)	(1,217,523)
Interest payments	(595,150)	(561,791)
Purchase of capital assets	(2,459,538)	(3,506,804)
Decrease in line of credit		(258,456)
Proceeds received from sale of capital assets		3,600
Net cash from capital and related financing activities	<u>2,165,553</u>	<u>(3,865,298)</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Interest income	386,781	129,502
NET CHANGE IN CASH AND CASH EQUIVALENTS	4,792,138	(2,716,481)
CASH AND CASH EQUIVALENTS, beginning of year	7,111,988	9,828,469
CASH AND CASH EQUIVALENTS, end of year	<u>\$ 11,904,126</u>	<u>\$ 7,111,988</u>
RECONCILIATION OF CASH AND CASH EQUIVALENTS TO THE STATEMENT OF NET ASSETS		
Cash	\$ 1,132,006	\$ 711,236
Cash and cash equivalents in assets whose use is limited	10,772,120	6,400,752
	<u>\$ 11,904,126</u>	<u>\$ 7,111,988</u>

See accompanying notes.

**PUBLIC HOSPITAL DISTRICT NO. 1,
SNOHOMISH COUNTY, WASHINGTON
dba VALLEY GENERAL HOSPITAL
STATEMENT OF CASH FLOWS (continued)**

Increase (Decrease) in Cash and Cash Equivalents

	YEAR ENDED	
	DECEMBER 31,	
	2006	2005
RECONCILIATION OF OPERATING INCOME TO NET CASH FROM OPERATING ACTIVITIES		
Operating income (loss)	\$ 155,003	\$ (1,877,029)
Revenue from tax levies considered noncapital financing activity	(372,751)	(388,451)
Noncash expenses included in operating income		
Depreciation	2,126,651	1,713,619
Decrease in estimated medical malpractice costs		(6,080)
Provision for bad debts	812,393	1,701,222
Change in operating assets and liabilities		
Patient accounts receivable	(1,024,836)	(1,536,457)
Inventory and prepaid expenses	62,292	21,106
Accounts payable	21,371	155,336
Accrued liabilities	431,885	54,778
Deferred revenue	(111,901)	320,317
Estimated third-party payor settlements	(116,434)	493,113
Net cash from operating activities	<u>\$ 1,983,673</u>	<u>\$ 651,474</u>
SUPPLEMENTAL DISCLOSURES OF NONCASH TRANSACTIONS		
Capital assets financed with capital lease obligations		<u>\$ 415,417</u>

**PUBLIC HOSPITAL DISTRICT NO. 1,
SNOHOMISH COUNTY, WASHINGTON
dba VALLEY GENERAL HOSPITAL
NOTES TO FINANCIAL STATEMENTS**

Note 1 - Organization and Summary of Significant Accounting Policies

Organization - Public Hospital District No. 1, Snohomish County, Washington (the District or the Hospital) is organized as a municipal corporation pursuant to the laws of the state of Washington. The purpose of the District is to own and operate the hospital and other health care facilities and provide health care services to the residents of Monroe, Washington and the surrounding communities. The District's primary operations include Valley General Hospital, an acute care hospital, and Valley General Behavioral Health Programs. The hospital and behavioral health programs are licensed for 72 beds. The financial statements of the District include the health care and financing activities of the District.

Fund accounting - The District utilizes the proprietary fund method of accounting, whereby revenue and expenses are recognized on the accrual basis. Pursuant to Governmental Accounting Standards Board (GASB) Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, the District has elected to apply the provisions of all relevant pronouncements of the Financial Accounting Standards Board (FASB), including those issued after November 30, 1989, that do not conflict with or contradict GASB pronouncements.

Cash and cash equivalents - The District defines cash on deposit, investments in the local government investment pool, and other highly liquid investments with initial maturities of three months or less to be cash and cash equivalents for purposes of the statement of cash flows.

Patient accounts receivable - Receivables arising from revenue for services to patients are reduced by an allowance for estimated uncollectible accounts based on past experience and other circumstances that may affect the ability of patients to meet their obligations. Accounts deemed uncollectible are charged against this allowance.

Inventory - Inventory consists of pharmaceutical, medical-surgical, dietary, and other hospital supplies valued at cost.

Assets limited as to use - Assets limited as to use include assets set aside by the Board of Commissioners to fund future capital improvements over which the Board retains control, and assets set aside under debt agreements. Investments are recorded at fair value. Amounts required to meet current liabilities have been classified as current assets in the accompanying balance sheet.

During 2005, the District implemented GASB 40, *Deposit and Investment Risk Disclosures*. Statement 40 amends GASB Statement 3 and addresses common deposit and investment risks: credit risk, custodial credit risk, concentration of credit risk, and interest rate risk. These risks are disclosed in conjunction with other deposit and investment disclosures (Note 3).

**PUBLIC HOSPITAL DISTRICT NO. 1,
SNOHOMISH COUNTY, WASHINGTON
dba VALLEY GENERAL HOSPITAL
NOTES TO FINANCIAL STATEMENTS**

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

Capital assets - Capital assets are stated at cost. Depreciation of property and equipment is determined using the straight-line method over the assets' estimated useful lives as follows:

Land improvements	5 - 40 years
Buildings and improvements	5 - 40 years
Fixed equipment	5 - 20 years
Movable equipment	4 - 15 years

Maintenance and repairs are charged to operations when they occur. Donated items are recorded at fair market value at the date of the contribution. The District's capitalization policy is \$500 and a minimum useful life of two years.

Deferred financing costs - The cost of issuing long-term debt is capitalized and amortized using the straight-line method over the life of the related debt issue.

Loss on bond defeasance - In accordance with GASB 23, a loss on bond defeasance was recognized in 1995, which represented the difference between the reacquisition price and net carrying amount of the old debt. This loss was deferred and is shown as a reduction of the related long-term debt, and is being amortized using the effective interest method over the remaining life of the defeased debt. Amortization of \$49,000 and \$45,000 was included in interest expense for the years ended December 31, 2006 and 2005, respectively.

Restricted resources - When the District has both restricted and unrestricted resources available to finance a particular program, it is the District's policy to use restricted resources before unrestricted resources. There were no restricted resources other than those restricted for debt service at December 31, 2006 or 2005.

Net assets - Net assets of the District are classified in four components. *Net assets invested in capital assets net of related debt* consist of capital assets net of accumulated depreciation and reduced by the current balances of any outstanding borrowings used to finance the purchase or construction of those assets. *Restricted expendable net assets* are noncapital net assets that must be used for a particular purpose, as specified by creditors, grantors, or contributors external to the District, including amounts deposited with the County Treasurer as required by bond indentures. *Restricted nonexpendable net assets* equal the principal portion of permanent endowments. *Unrestricted net assets* are remaining net assets that do not meet the definition of *invested in capital assets net of related debt* or *restricted*.

Operating revenues and expenses - The District's statement of revenues, expenses, and changes in net assets distinguishes between operating and nonoperating revenues and expenses. Operating revenues result from exchange transactions associated with providing health care services—the District's principal activity. Nonexchange revenues, including taxes, grants, and contributions received for purposes other than capital asset acquisition or debt service, are reported as other operating revenues. Operating expenses are all expenses incurred to provide health care services, other than financing costs paid by specific tax proceeds.

**PUBLIC HOSPITAL DISTRICT NO. 1,
SNOHOMISH COUNTY, WASHINGTON
dba VALLEY GENERAL HOSPITAL
NOTES TO FINANCIAL STATEMENTS**

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

Net patient service revenue - Net patient service revenue is reported in the period in which services are provided at established rates, net of contractual adjustments for Medicare, Medicaid and other third-party payors. Contractual adjustments include differences between established billing rates and amounts estimated by management as reimbursable under various cost reimbursement formulas or contractual relationships in effect.

When reimbursement settlements are received, or when information becomes available regarding changes in recorded reimbursement, variations from amounts previously established as preliminary settlements are accounted for as a contractual adjustment in the period the settlements are received, or when information regarding reimbursement changes becomes available.

Charity care - The District provides care to patients who meet certain criteria under charity care policies. Amounts representing charity are not reported as net patient service revenue because the District does not pursue collection. Forgone revenue for charity care measured by the standard charges was \$3,523,518 in 2006 and \$2,429,860 in 2005.

Tax levy revenue - The District is permitted to levy an annual maintenance and operations tax on certain property within the hospital district without a vote of the taxpayers. Tax levy proceeds used to fund operating costs of the District are reported as other revenue. Tax levy proceeds pledged for repayment of general obligation bonds are reported as nonoperating income.

Estimated medical malpractice costs - The District has purchased claims-based liability insurance coverage that covers only asserted malpractice claims. The District recognizes expenses associated with reported claims and estimated claims incurred but not reported in the period in which the incidents are estimated to have occurred, rather than when a claim is asserted. Accrued malpractice losses, in management's opinion, provide an adequate reserve for loss contingencies. Expenses associated with these incidents are based on actuarial assumptions of settlement costs.

Federal income tax - No provision has been made for federal income taxes, as the District is a municipal corporation and is exempt from federal taxation.

Use of estimates - 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 revenue and expenses during the reporting period. Actual results could differ from those estimates.

**PUBLIC HOSPITAL DISTRICT NO. 1,
SNOHOMISH COUNTY, WASHINGTON
dba VALLEY GENERAL HOSPITAL
NOTES TO FINANCIAL STATEMENTS**

Note 2 - Patient Service Revenues

The District has arrangements with third-party payors that reimburse the District for patient services at amounts different from standard charges. A summary of the payment arrangements with major third-party payors follows:

Medicare - Inpatient acute care services rendered to Medicare program beneficiaries are paid at predetermined, specific rates for each hospital discharge. Discharges are classified according to a list of diagnosis related groups (DRGs). Each DRG has a payment weight assigned to it, based on the average resources used to treat Medicare patients in that DRG. The District's classification of DRGs and the appropriateness of their admission are subject to an independent review by a peer review organization.

Most outpatient services to Medicare beneficiaries are paid prospectively based on ambulatory payment classifications (APCs). The District's cost reports have been reviewed and/or audited by the Medicare fiscal intermediary through 2004. Net revenue billed under Medicare totaled approximately \$11,755,000 and \$12,024,000 for 2006 and 2005, respectively. Unsecured net patient accounts receivable due from Medicare at December 31, 2006 and 2005 were approximately \$1,016,000 and \$1,803,000, respectively.

Medicaid - Prior to July 1, 2005, inpatient acute-care services rendered to Medicaid program beneficiaries were paid on a prospective payment system similar to Medicare. After July 1, 2005, a new inpatient Medicaid reimbursement methodology for all noncritical access Washington State governmental hospitals was implemented, called "Certified Public Expenditures." Under this program, the Hospital is paid for inpatient Medicaid services based on costs including certain costs of uncompensated care. The estimated costs for inpatient care are calculated as a ratio of cost to charges from a base year (two years before the service year). Under the program, the Hospital will be reimbursed the higher of the full cost of service or "baseline" reimbursement that would have been received based on the pre-July 1 inpatient payment system. Outpatient services are paid on a percentage of allowed charges based on a ratio of the Hospital's operating expenses to total revenue for outpatient services. Net revenue billed under the Medicaid program totaled approximately \$4,521,000 and \$3,562,000 for 2006 and 2005, respectively. Unsecured net patient accounts receivable due from Medicaid at December 31, 2006 and 2005 were approximately \$592,000 and \$550,000, respectively.

Other third-party payor arrangements - The District has entered into payment agreements with certain commercial insurance companies. Payment under these agreements includes prospectively determined rates and discounts from standard charges.

Patient accounts receivable, including amounts due from third-party payors, are unsecured and arise from services provided to individuals geographically concentrated in Monroe, Washington and the surrounding communities.

**PUBLIC HOSPITAL DISTRICT NO. 1,
SNOHOMISH COUNTY, WASHINGTON
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NOTES TO FINANCIAL STATEMENTS**

Note 2 - Patient Service Revenues (continued)

The following are the components of net patient service revenue for the years ended December 31:

	<u>2006</u>	<u>2005</u>
Gross patient service charges	\$ 74,589,981	\$ 60,440,319
Adjustments to patient service charges		
Contractual discounts	29,973,317	21,341,670
Provision for bad debts	812,393	1,701,222
Charity care	3,523,518	2,429,860
	<u>34,309,228</u>	<u>25,472,752</u>
	<u>\$ 40,280,753</u>	<u>\$ 34,967,567</u>

Note 3 - Deposits and Investments

Deposits and investments are made up of the following:

Cash and cash equivalents		
Deposits in banks	\$ 1,132,006	\$ 711,236
Assets limited as to use		
Deposits in banks	7,096,596	2,904,047
Local government investment pool	3,675,524	3,496,705
Property taxes receivable	100,109	110,608
	<u>10,872,229</u>	<u>6,511,360</u>
	<u>\$ 12,004,235</u>	<u>\$ 7,222,596</u>

**PUBLIC HOSPITAL DISTRICT NO. 1,
SNOHOMISH COUNTY, WASHINGTON
dba VALLEY GENERAL HOSPITAL
NOTES TO FINANCIAL STATEMENTS**

Note 3 - Deposits and Investments (continued)

Assets whose use is limited are subject to the following restrictions and designations:

	<u>2006</u>	<u>2005</u>
Bond funds	\$ 1,446,291	\$ 1,433,772
Designated by the Board of Commissioners		
For capital improvements	7,819,434	3,540,853
ProShare SWAP Program	347,178	332,100
Rural Hospital Assistance	<u>1,259,326</u>	<u>1,204,635</u>
	10,872,229	6,511,360
Less assets limited as to use that are required for current liabilities	<u>662,832</u>	<u>639,510</u>
	<u><u>\$ 10,209,397</u></u>	<u><u>\$ 5,871,850</u></u>

The District has established bond funds required under its bond resolutions. These funds are to be used to service the District's tax general bonds obligation.

Rural Hospital Assistance funds include cash received from third parties designated by the Board of Commissioners to be used to augment health care services and improve access to care in the Hospital's service area.

The Hospital 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).

As 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, 2006 and 2005, all deposits and investments of the District are categorized as Category 1.

**PUBLIC HOSPITAL DISTRICT NO. 1,
SNOHOMISH COUNTY, WASHINGTON
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NOTES TO FINANCIAL STATEMENTS**

Note 3 - Deposits and Investments (continued)

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

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

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

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.

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, as 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, as all deposits and investments are extremely liquid.

**PUBLIC HOSPITAL DISTRICT NO. 1,
SNOHOMISH COUNTY, WASHINGTON
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NOTES TO FINANCIAL STATEMENTS**

Note 4 - Capital Assets

The schedule of capital asset activity for the years ended December 31, 2006 and 2005 is as follows:

	Beginning Balance January 1, 2006	Additions	Retirements	Account Transfers	Ending Balance December 31, 2006
NONDEPRECIABLE					
CAPITAL ASSETS					
Land	\$ 2,317,877				\$ 2,317,877
Construction in progress	1,158,353	\$ 1,709,847		\$ (235,772)	2,632,428
Total nondepreciable capital assets	<u>3,476,230</u>	<u>1,709,847</u>		<u>(235,772)</u>	<u>4,950,305</u>
DEPRECIABLE CAPITAL ASSETS					
Land improvements	1,175,340			8,979	1,184,319
Buildings and improvements	17,790,954		\$ (61,634)	107,250	17,836,570
Fixed equipment	2,239,537	87,741		87,277	2,414,555
Movable equipment	11,958,788	661,950	(369,981)	32,266	12,283,023
LESS ACCUMULATED DEPRECIATION					
Land improvements	(157,407)	(56,376)			(213,783)
Buildings and improvements	(7,026,359)	(758,410)	35,953		(7,748,816)
Fixed equipment	(2,023,455)	(43,084)			(2,066,539)
Movable equipment	(7,616,593)	(1,268,781)	343,498		(8,541,876)
Depreciable capital assets, net	<u>16,340,805</u>	<u>(1,376,960)</u>	<u>(52,164)</u>	<u>235,772</u>	<u>15,147,453</u>
	<u>\$ 19,817,035</u>	<u>\$ 332,887</u>	<u>\$ (52,164)</u>	<u>\$ -</u>	<u>\$ 20,097,758</u>

**PUBLIC HOSPITAL DISTRICT NO. 1,
SNOHOMISH COUNTY, WASHINGTON
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NOTES TO FINANCIAL STATEMENTS**

Note 4 - Capital Assets (continued)

	Beginning Balance <u>January 1, 2005</u>	Additions	Retirements	Account Transfers	Ending Balance <u>December 31, 2005</u>
NONDEPRECIABLE					
CAPITAL ASSETS					
Land	\$ 2,317,877				\$ 2,317,877
Construction in progress	<u>2,957,849</u>	<u>\$ 3,075,927</u>		<u>\$ (4,875,423)</u>	<u>1,158,353</u>
Total nondepreciable capital assets	<u>5,275,726</u>	<u>3,075,927</u>		<u>(4,875,423)</u>	<u>3,476,230</u>
DEPRECIABLE CAPITAL ASSETS					
Land improvements	192,355			982,985	1,175,340
Buildings and improvements	15,803,700	13,495	\$ (57,504)	2,031,263	17,790,954
Fixed equipment	2,261,537	6,305	(28,305)		2,239,537
Movable equipment	10,905,923	826,494	(1,634,804)	1,861,175	11,958,788
LESS ACCUMULATED DEPRECIATION					
Land improvements	(108,473)	(48,934)			(157,407)
Buildings and improvements	(6,428,032)	(648,247)	49,920		(7,026,359)
Fixed equipment	(2,006,067)	(41,710)	24,322		(2,023,455)
Movable equipment	<u>(7,991,629)</u>	<u>(974,728)</u>	<u>1,349,764</u>		<u>(7,616,593)</u>
Depreciable capital assets, net	<u>12,629,314</u>	<u>(867,325)</u>	<u>(296,607)</u>	<u>4,875,423</u>	<u>16,340,805</u>
	<u>\$ 17,905,040</u>	<u>\$ 2,208,602</u>	<u>\$ (296,607)</u>	<u>\$ -</u>	<u>\$ 19,817,035</u>

Depreciation expense of operating assets for the years ended December 31, 2006 and 2005 was \$2,126,651 and \$1,713,619, respectively.

The District has included equipment under capital lease obligations in capital assets with a cost of \$904,392 and \$975,671 at December 31, 2006 and 2005, respectively. Amortization expense of \$231,364 and \$138,069 related to this equipment was recorded in depreciation expense for 2006 and 2005, respectively. Accumulated amortization for equipment under capital lease obligations was \$195,820 and \$257,040 at December 31, 2006 and 2005, respectively.

The District estimates the cost to complete construction in progress is \$1.4 million at December 31, 2006.

**PUBLIC HOSPITAL DISTRICT NO. 1,
SNOHOMISH COUNTY, WASHINGTON
dba VALLEY GENERAL HOSPITAL
NOTES TO FINANCIAL STATEMENTS**

Note 5 - Employee Benefit Plans

Defined contribution plan - The District sponsors a defined contribution plan in accordance with Internal Revenue Code Section 401(a) covering substantially all qualified employees. Plan provisions and contribution requirements are established by the District and may be amended by the District's Board of Commissioners. Active participants meeting hourly and employee contribution criteria receive an employer matching contribution based on a percentage of the employees' base salary, subject to certain limitations. The employer contribution fully vests upon completion of five qualified years, or upon the occurrence of death, disability, or attainment of age 65 for qualified employees. Vesting retroactively accelerates 20% per qualified year for individuals involved in a reduction in force. Forfeited contributions, if any, are applied against future employer obligations.

The District's liability under the plan is limited to its annual contribution. It is the District's policy to fund current pension costs accrued under the plan. Contributions to the plan charged to operations amounted to approximately \$1,117,000 in 2006 and \$924,000 in 2005. Contributions made by employees to the benefit plan totaled approximately \$1,437,000 in 2006 and \$1,049,000 in 2005. For more information on the plans, contact the District's human resources office.

Deferred compensation plan - The District has a deferred compensation plan created in accordance with Internal Revenue Code Section 457 (the 457 Plan). The deferred compensation is not available to employees until termination, retirement, death, or unforeseeable emergency. The District does not allow new contributions to the 457 Plan, as it was replaced by the 401(a) plan.

Note 6 - Line of Credit

The District has a line of credit with a bank with a \$750,000 limit through October 2007. Advances under the line of credit bear interest at 1.0% under the New York prime rate (7.75% at December 31, 2006). The outstanding balance of the line of credit was \$0 at December 31, 2006 and 2005.

A schedule of changes in the District's line of credit for the years ended December 31, 2006 and 2005 follows:

Beginning Balance January 1, 2006	Additions	Reductions	Ending Balance December 31, 2006
\$ -	\$ -	\$ -	\$ -
Beginning Balance January 1, 2005	Additions	Reductions	Ending Balance December 31, 2005
\$ 258,456	\$ -	\$ 258,456	\$ -

**PUBLIC HOSPITAL DISTRICT NO. 1,
SNOHOMISH COUNTY, WASHINGTON
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NOTES TO FINANCIAL STATEMENTS**

Note 7 - Long-Term Debt

	2006	2005
<p>Unlimited Tax General Obligation Refunding Bonds, 1995, due serially on December 1 in amounts ranging from \$650,000 in 2007 to \$760,000 in 2010 at interest rates ranging from 5.30% to 5.65%, including unamortized discount and capitalized losses of \$159,292 and \$198,732 at December 31, 2006 and 2005, respectively. Outstanding bonds are subject to redemption at the option of the District.</p>	\$ 2,674,530	\$ 3,236,268
<p>Limited Tax General Obligation Refunding Bonds, 1995, due serially on December 1 in amounts ranging from \$135,000 in 2007 to \$135,000 in 2008 at interest rates ranging from 5.30% to 5.40%, including unamortized discount of \$16,949 and \$25,423 at December 31, 2006 and 2005, respectively. Outstanding bonds are subject to redemption at the option of the District.</p>	253,051	374,577
<p>Limited Tax General Obligation Bonds, 1998, due serially in amounts ranging from \$385,000 in 2007 to \$415,000 in 2008 at interest rates ranging from 5.05% to 5.50%.</p>	800,000	1,165,000
<p>Limited Tax General Obligation Bonds, 2004, due serially in amounts ranging from \$580,000 in 2009 to \$940,000 in 2018 at interest rates ranging from 3.00% to 4.62% including unamortized discount of \$55,879 and \$60,789 at December 31, 2006 and 2005, respectively. Bonds maturing after December 1, 2014 are subject to redemption at the option of the District after December 31, 2013.</p>	7,350,299	7,364,211
<p>Note payable to a bank, due in monthly payments including interest at a variable rate. Payments are based on the current interest rate. At December 31, 2005, the interest rate and monthly payment were 7.25% and \$2,087, respectively.</p>	63,590	83,447
<p>Note payable to a bank, due in monthly payments of \$11,211, including interest at 4.64%, through September 2011. The note is secured by equipment.</p>	565,684	
<p>Note payable to a bank, due in quarterly payments of \$260,935, including interest at 4.64%, through July 2011. The note is secured by equipment.</p>	4,364,167	

**PUBLIC HOSPITAL DISTRICT NO. 1,
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NOTES TO FINANCIAL STATEMENTS**

Note 7 - Long-Term Debt (continued)

	<u>2006</u>	<u>2005</u>
Equipment contracts, due in monthly payments totaling \$21,700, including interest from 4.41% to 10.06%. Collateralized by equipment.	484,834	696,152
	16,556,155	12,919,655
Less current portion	<u>2,356,746</u>	<u>1,347,630</u>
Long-term debt, net of current portion	<u>\$ 14,199,409</u>	<u>\$ 11,572,025</u>

A schedule of changes in the District's long-term obligations, net of any discounts or premiums, for the years ended December 31, 2006 and 2005 follows:

	Beginning Balance January 1, 2006	Additions	Reductions	Ending Balance December 31, 2006	Amounts Due Within One Year
Unlimited tax general obligation refunding bonds, 1995	\$ 3,236,268		\$ 561,738	\$ 2,674,530	\$ 650,000
Limited tax general obligation refunding bonds, 1995	374,577		121,526	253,051	135,000
Limited tax general obligation bond, 1998	1,165,000		365,000	800,000	385,000
Limited tax general obligation bond, 2004	7,364,211		13,912	7,350,299	
Note payable to bank	83,447		19,857	63,590	24,051
Note payable to bank		\$ 591,796	26,112	565,684	107,875
Note payable to bank		4,572,110	207,943	4,364,167	856,157
Capital leases	<u>696,152</u>		<u>211,318</u>	<u>484,834</u>	<u>198,663</u>
Total long-term debt	12,919,655	5,163,906	1,527,406	16,556,155	2,356,746
Estimated medical malpractice costs	<u>169,819</u>			<u>169,819</u>	
Total noncurrent liabilities	<u>\$ 13,089,474</u>	<u>\$ 5,163,906</u>	<u>\$ 1,527,406</u>	<u>\$ 16,725,974</u>	<u>\$ 2,356,746</u>

**PUBLIC HOSPITAL DISTRICT NO. 1,
SNOHOMISH COUNTY, WASHINGTON
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NOTES TO FINANCIAL STATEMENTS**

Note 7 - Long-Term Debt (continued)

	Beginning Balance January 1, 2005	Additions	Reductions	Ending Balance December 31, 2005	Amounts Due Within One Year
Unlimited tax general obligation refunding bonds, 1995	\$ 3,786,827		\$ 550,559	\$ 3,236,268	\$ 620,000
Limited tax general obligation refunding bonds, 1995	661,103		286,526	374,577	130,000
Limited tax general obligation bond, 1998	1,340,000		175,000	1,165,000	365,000
Limited tax general obligation bond, 2004	7,359,301		(4,910)	7,364,211	
Note payable to bank	103,670		20,223	83,447	22,541
Capital leases	418,035	\$ 415,417	137,300	696,152	210,089
Total long-term debt	13,668,936	415,417	1,164,698	12,919,655	1,347,630
Estimated medical malpractice costs	175,899		6,080	169,819	
Total noncurrent liabilities	<u>\$ 13,844,835</u>	<u>\$ 415,417</u>	<u>\$ 1,170,778</u>	<u>\$ 13,089,474</u>	<u>\$ 1,347,630</u>

**PUBLIC HOSPITAL DISTRICT NO. 1,
SNOHOMISH COUNTY, WASHINGTON
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NOTES TO FINANCIAL STATEMENTS**

Note 7 - Long-Term Debt (continued)

Scheduled principal and interest repayments on long-term debt are as follows:

	<u>Principal</u>	<u>Interest</u>
2007	\$ 2,158,083	\$ 726,605
2008	2,270,781	616,129
2009	2,372,287	501,140
2010	2,474,014	393,355
2011	1,428,276	277,864
2012-2016	3,770,000	905,830
2017-2018	<u>1,830,000</u>	<u>124,650</u>
	16,303,441	<u>\$ 3,545,573</u>
Less amount representing net unamortized bond discounts, premiums, and capitalized loss on bond defeasance	<u>(232,120)</u>	
	<u>\$ 16,071,321</u>	

Scheduled principal and interest repayments on capital lease obligations are as follows:

2007	\$ 222,622
2008	211,839
2009	<u>95,132</u>
	529,593
Less amount representing interest	<u>44,759</u>
Present value of capital lease payments	<u>\$ 484,834</u>

The District has pledged to levy taxes and set aside net revenue of the Hospital, if necessary, sufficient to make principal and interest payments on all of the bonds. Further, bond funds (Note 3) collateralize the general obligation bonds.

Note 8 - 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 percent 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.

**PUBLIC HOSPITAL DISTRICT NO. 1,
SNOHOMISH COUNTY, WASHINGTON
dba VALLEY GENERAL HOSPITAL
NOTES TO FINANCIAL STATEMENTS**

Note 8 - Property Taxes (continued)

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 2006 and 2005, the District's regular tax levy was \$0.12 and \$0.13 per \$1,000 on a total assessed valuation of \$10,169,884,052 and \$8,916,818,603 for a total regular levy of \$1,213,717 and \$1,153,858, respectively. There is a voter-approved tax levy for service of the unlimited tax general obligation bonds. For 2006 and 2005, the tax levy for bond service was \$.07 and \$.08 per \$1,000 on the total assessed valuation for a total additional levy of \$737,245 and \$736,782, respectively.

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

Note 9 - Leases

The District leases operating space and miscellaneous equipment under operating leases expiring at various dates through 2019. Rental expense under all operating leases for the years ended December 31, 2006 and 2005 was \$860,000 and \$584,000, respectively.

Future minimum lease payments under noncancelable operating leases for the years ending December 31 are as follows:

2007	\$ 891,000
2008	827,000
2009	770,000
2010	672,000
2011	511,000
2012 - 2016	2,409,510
2017 - 2019	<u>841,829</u>
	<u><u>\$ 6,922,339</u></u>

**PUBLIC HOSPITAL DISTRICT NO. 1,
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NOTES TO FINANCIAL STATEMENTS**

Note 10 - Contingencies

Risk pools - The District participates in public entity risk pools for various programs, including employee health benefits and workers' compensation.

Compliance with laws and regulations - The District is subject to many complex federal, state, and local laws and regulations. Compliance with these laws and regulations is subject to government review and interpretation, and unknown or unasserted regulatory actions. Government activity with respect to investigations and allegations regarding possible violations of these laws and regulations by health care providers, including those related to medical necessity, coding, and billing for services, has increased significantly. Violations of these laws can result in large fines and penalties, sanctions on providing future services, and repayment of past patient service revenues. The District has implemented a voluntary corporate compliance program which includes guidance for all District employees' adherence to applicable laws and regulations. Management believes any actions that may result from investigations of noncompliance with laws and regulations will not have a material effect on the District's future financial position or results of operations.

Risk management - The District is exposed to various risks of loss from torts; theft of, damage to, and destruction of assets; business interruption; errors and omissions; employee injuries and illnesses; and natural disasters. Commercial insurance coverage is purchased for claims arising from such matters and no claims have exceeded such coverage during any of the past three years.

Note 11 - Concentration of Credit Risk

The Hospital grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payor agreements. The mix of receivables from patients and third-party payors at December 31, 2006 and 2005 was as follows:

	<u>2006</u>	<u>2005</u>
Medicare	16%	25%
Medicaid	11%	12%
Blue Cross	8%	5%
Blue Shield	11%	6%
Other third-party payors	40%	31%
Patients	14%	21%
	<u>100%</u>	<u>100%</u>

The Hospital has a contractual agreement with an external agency that structures third-party commercial loans with self-pay patients. Self-pay accounts are sold with recourse to the third-party. As of December 31, 2006, \$259,477 was outstanding with the third-party.