



CUMBERLAND COUNTY HOSPITAL SYSTEM, INC.
(d/b/a Cape Fear Valley Health System)

Financial Statements and Other Financial Information

September 30, 2019

(With Independent Auditors' Report Thereon)

CUMBERLAND COUNTY HOSPITAL SYSTEM, INC.
(d/b/a Cape Fear Valley Health System)

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KPMG LLP
4242 Six Forks Road
Suite 850
Raleigh, NC 27609

Independent Auditors' Report

The Board of Trustees
Cumberland County Hospital System, Inc.
(d/b/a Cape Fear Valley Health System):

We have audited the accompanying financial statements of Cumberland County Hospital System, Inc. (d/b/a Cape Fear Valley Health System) and its aggregate discretely presented component units (the Health System) as of and for the year ended September 30, 2019, and the related notes to the financial statements, which collectively comprise the Health System's 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 U.S. generally accepted accounting principles; 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.

Auditors' Responsibility

Our responsibility is to express opinions on these financial statements based on our audit. We conducted our audit 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 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 auditors' 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 opinions.

Opinions

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of Cumberland County Hospital System, Inc. (d/b/a Cape Fear Valley Health System) and its aggregate discretely presented component units as of September 30, 2019, and the respective changes in net position, and cash flows for the year then ended, in accordance with U.S. generally accepted accounting principles.



Other Matters

Required Supplementary Information

U.S. generally accepted accounting principles require that Management's Discussion and Analysis on pages 3 through 8, and the Required Supplementary Information under Governmental Accounting Standards Board (GASB) Statement No. 68, *Accounting and Financial Reporting for Pensions*, on pages 50 and 51 be presented to supplement the financial statements. Such information, although not a part of the financial statements, is required by the GASB who considers it to be an essential part of financial reporting for placing the financial statements in an operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the financial statements, and other knowledge we obtained during our audit of the financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Supplementary Information

Our audit was conducted for the purpose of forming an opinion on the financial statements as a whole. The combining schedule of assets, deferred outflows of resources, liabilities, deferred inflows of resources and net position, as of September 30, 2019 and the combining schedule of revenues, expenses, and changes in net position, for the year ended September 30, 2019 (the Combining Information) are the responsibility of management and were derived from and relate directly to the underlying accounting and other records used to prepare the financial statements. Such information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the Combining Information is fairly stated in all material respects in relation to the financial statements as a whole.

KPMG LLP

January 30, 2020

CUMBERLAND COUNTY HOSPITAL SYSTEM, INC.
(d/b/a Cape Fear Valley Health System)

Management's Discussion and Analysis (Unaudited)

September 30, 2019

(Dollar amounts in thousands)

This section of Cumberland County Hospital System, Inc.'s (d/b/a Cape Fear Valley Health System) (the Health System) annual financial report presents management's analysis of the Health System's financial performance during the years ended September 30, 2019 and 2018. Please read this analysis in conjunction with the financial statements, which follow this section. Except as otherwise noted, the financial highlights in this analysis refer exclusively to the primary enterprise as described in note 1 to the financial statements.

Overview of the Financial Statements

This annual financial report includes the independent auditors' report, managements' discussion and analysis, the financial statements of the Health System and required supplementary and combining information. The financial statements also include notes that explain in more detail some of the information in the financial statements. As required by U.S. generally accepted accounting principles (GAAP), the financial statements also include the Health System's discretely presented component units, the Cape Fear Valley Medical Foundation, Inc. (the Foundation), Bladen Healthcare, LLC (d/b/a Cape Fear Valley – Bladen County Hospital) (Bladen County Hospital), Hoke Healthcare, LLC (HHC), Fayetteville Ambulatory Surgical Center (FASC), and its blended component unit, Cape Fear Insurance, Ltd. SPC. (Cape Fear Insurance).

Required Financial Statements

The Health System's financial statements report information of the Health System using accounting methods similar to those used by private sector healthcare organizations. These statements offer short and long-term financial information about its activities. The balance sheet includes all of the Health System's assets, deferred outflows of resources, liabilities, and deferred inflows of resources and provides information about the nature and amounts of investments in resources (assets) and the obligations to the Health System's creditors (liabilities). The balance sheet also provides the basis for evaluating the capital structure of the Health System and assessing the liquidity and financial flexibility of the Health System.

Revenues and expenses are accounted for in the statement of revenues, expenses, and changes in net position. This statement measures the results of the Health System's operations and can be used to determine whether the Health System has successfully recovered all of its costs through its fees and other sources of revenue.

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 also provides information on where the cash came from, what the cash was used for, and the change in the cash balance during the reporting period.

Financial Analysis of the Health System

The balance sheet and the statement of revenues, expenses, and changes in net position report the net position of the Health System and the changes in them. The Health System's net position, the difference between assets and deferred outflows of resources and liabilities and deferred inflows of resources, is a way to measure financial health or financial position. Over time, increases, or decreases in the Health System's net position are one indicator of whether its financial health is improving or deteriorating. However, one will need to consider other nonfinancial factors such as changes in economic conditions, population growth, and new or changed governmental legislation.

CUMBERLAND COUNTY HOSPITAL SYSTEM, INC.
(d/b/a Cape Fear Valley Health System)

Management's Discussion and Analysis (Unaudited)

September 30, 2019

(Dollar amounts in thousands)

Net Position

A summary of the Health System's balance sheets as of September 30, 2019 and 2018 is presented in Table A-1:

TABLE A-1
CAPE FEAR VALLEY HEALTH SYSTEM

Condensed Balance Sheets

September 30, 2019 and 2018

	<u>2019</u>	<u>2018</u>
Current assets	\$ 200,371	208,633
Capital assets – net	335,631	314,732
Other noncurrent assets and deferred outflows of resources	<u>527,039</u>	<u>484,541</u>
Total assets and deferred outflows of resources	\$ <u>1,063,041</u>	<u>1,007,906</u>
Current liabilities	\$ 140,481	128,461
Long-term debt – including current maturities	226,635	235,568
Other noncurrent liabilities and deferred inflows of resources	<u>135,345</u>	<u>116,333</u>
Total liabilities and deferred inflows of resources	<u>502,461</u>	<u>480,362</u>
Net investment in capital assets	108,996	79,164
Unrestricted	<u>451,584</u>	<u>448,380</u>
Total net position	<u>560,580</u>	<u>527,544</u>
Total liabilities, deferred inflows of resources, and net position	\$ <u>1,063,041</u>	<u>1,007,906</u>

The net position of the Health System increased \$33,036 and \$31,116 during 2019 and 2018, respectively. The increase in net position for 2019 and 2018 was due to favorable results of operations and favorable returns on the Health System's investments.

CUMBERLAND COUNTY HOSPITAL SYSTEM, INC.
(d/b/a Cape Fear Valley Health System)

Management's Discussion and Analysis (Unaudited)

September 30, 2019

(Dollar amounts in thousands)

Revenues, Expenses, and Changes in Net Position

While the balance sheet shows the net position, the statement of revenues, expenses, and changes in net position provides information about the nature and source of changes to net position.

Table A-2

CAPE FEAR VALLEY HEALTH SYSTEM

Condensed Statement of Revenues,
Expenses, and Changes in Net Position

Years ended September 30, 2019 and 2018

	<u>2019</u>	<u>2018</u>
Operating revenues	\$ 808,604	818,599
Operating expenses	<u>797,537</u>	<u>801,005</u>
Operating income	11,067	17,594
Nonoperating income	<u>21,969</u>	<u>13,522</u>
Excess of revenues over expenses and increase in net position	<u>\$ 33,036</u>	<u>31,116</u>

The Health System's operating revenues decreased \$9,995, or 1.2%, in 2019 compared to 2018 and increased \$64,054, or 8.5%, in 2018 compared to 2017. The decrease in 2019 operating revenue was due to reductions in third party settlements. Operating expenses decreased \$3,468, or 0.4%, in 2019 compared to 2018. The decrease is due to changes in the pension plan. Nonoperating income increased \$8,447 in 2019 compared to 2018. This change is attributed to an increase in dividends and interest from investments.

CUMBERLAND COUNTY HOSPITAL SYSTEM, INC.
(d/b/a Cape Fear Valley Health System)

Management's Discussion and Analysis (Unaudited)

September 30, 2019

(Dollar amounts in thousands)

Capital Assets and Debt Administration

Capital Assets

The Health System has invested \$335,631 and \$314,732 in net capital assets as shown in Table A-3, as of September 30, 2019 and 2018, respectively. Construction in progress decreased \$15,296 during 2019. This decrease in 2019 is attributed to a new electronic medical record system being placed into service in May of 2019, which resulted in equipment increasing \$34,336 during 2019.

Table A-3

CAPE FEAR VALLEY HEALTH SYSTEM

Capital Assets

September 30, 2019 and 2018

	<u>2019</u>	<u>2018</u>
Land and land improvements	\$ 33,232	32,898
Buildings	459,844	453,069
Equipment	362,714	328,378
Construction in progress	<u>2,756</u>	<u>18,052</u>
Subtotal	858,546	832,397
Accumulated depreciation	<u>(522,915)</u>	<u>(517,665)</u>
Net capital assets	<u>\$ 335,631</u>	<u>314,732</u>

CUMBERLAND COUNTY HOSPITAL SYSTEM, INC.
(d/b/a Cape Fear Valley Health System)

Management's Discussion and Analysis (Unaudited)

September 30, 2019

(Dollar amounts in thousands)

Debt Administration

Table A-4

CAPE FEAR VALLEY HEALTH SYSTEM

Debt

September 30, 2019 and 2018

	<u>2019</u>	<u>2018</u>
Hospital Facility Revenue Bonds:		
Series 2017	\$ 152,000	152,000
Series 2012A	70,355	77,990
	<u>222,355</u>	<u>229,990</u>
Unamortized bond premium	4,280	5,578
Less current maturities	<u>(8,030)</u>	<u>(7,635)</u>
Long-term debt – less current maturities	<u>\$ 218,605</u>	<u>227,933</u>

At September 30, the Health System had \$222,355 and \$229,990 of long-term bond principal outstanding in 2019 and 2018, respectively. The Health System made principal payments on Series 2012A in the amount of \$7,635 and \$7,325 during 2019 and 2018, respectively. In November 2017, the Health System issued \$152,000 in Health Care Facilities Revenue Refunding Bonds, Series 2017 through the Public Finance Authority. The proceeds of the Series 2017 Bonds were used to (1) refund the Series 2008A Bonds and (2) pay certain expenses incurred with the issuance of the Series 2017 Bonds. More detailed information about the Health System's long-term debt is presented in note 5 to the financial statements.

HHC, a North Carolina limited liability company, owns a 60-acre medical campus in Raeford, Hoke County, North Carolina. The sole member of HHC is the Health System. HHC has engaged in a multiyear effort to bring healthcare services to the residents of Hoke County. HHC requested that the United States Department of Agriculture – Rural Development (the USDA) provide permanent financing for Hoke Community Medical Center through its Community Facilities Direct Loan and Guaranteed Loan Programs. HHC obtained permanent financing from the USDA in the form of two fixed-rate, 40-year loans that totaled \$68,448. In addition, the USDA provided a guaranteed loan of \$27,311. The guaranteed loan was made in the form of taxable bonds issued by HHC. More detailed information is presented in note 5 to the financial statements.

CUMBERLAND COUNTY HOSPITAL SYSTEM, INC.
(d/b/a Cape Fear Valley Health System)

Management's Discussion and Analysis (Unaudited)

September 30, 2019

(Dollar amounts in thousands)

Finance Contact

The Health System's financial statements are designed to present users with a general overview of the Health System's finances and to demonstrate the Health System's accountability. If you have any questions about the report or need additional financial information, please contact the Chief Financial Officer, Cape Fear Valley Health System, Post Office Box 2000, Fayetteville, North Carolina 28302.

CUMBERLAND COUNTY HOSPITAL SYSTEM, INC.
(d/b/a Cape Fear Valley Health System)

Balance Sheet

September 30, 2019

(In thousands)

Assets and Deferred Outflows of Resources	Primary enterprise	Component units
Current assets:		
Cash and cash equivalents	\$ 48,058	11,351
Short-term investments	1,908	7,240
Patient accounts receivable – net	97,165	9,019
Estimated third-party payor settlements	—	4,787
Other accounts receivable	34,334	701
Assets limited as to use – cash and investments – current portion:		
Designated for self-insurance	3,000	—
Inventories	11,211	793
Prepaid expenses	4,695	211
Total current assets	200,371	34,102
Capital assets – net	335,631	101,103
Other noncurrent assets:		
Assets limited as to use – cash and investments:		
Designated for capital improvements	121,102	—
Designated for self-insurance	51,703	—
Bond proceeds held by Trustee	—	6,439
Total assets limited as to use	172,805	6,439
Investments	261,572	—
Other assets	20,459	276
Total other noncurrent assets	454,836	6,715
Total assets	990,838	141,920
Deferred outflows of resources	72,203	511
Total assets and deferred outflows of resources	\$ 1,063,041	142,431
Liabilities, Deferred Inflows of Resources, and Net Position		
Current liabilities:		
Accounts payable	\$ 32,671	1,906
Salaries and benefits payable	37,052	1,872
Other liabilities and accruals	22,592	25,572
Estimated third-party payor settlements	48,166	11,136
Current maturities of long-term debt	8,030	1,662
Total current liabilities	148,511	42,148
Long-term debt – less current maturities	218,605	87,932
Interest rate swap liability	39,990	—
Net pension liability	45,995	505
Other liabilities	46,973	—
Total liabilities	500,074	130,585
Deferred inflows of resources	2,387	76
Net position:		
Net investment in capital assets	108,996	7,871
Restricted for debt service	—	5,871
Unrestricted	451,584	(7,401)
Restricted – by donor	—	4,025
Restricted – nonexpendable	—	1,404
Total net position	560,580	11,770
Total liabilities, deferred inflows of resources and net position	\$ 1,063,041	142,431

See accompanying notes to financial statements.

CUMBERLAND COUNTY HOSPITAL SYSTEM, INC.
(d/b/a Cape Fear Valley Health System)

Statement of Revenues, Expenses, and Changes in Net Position

Year ended September 30, 2019

(In thousands)

	Primary enterprise	Component units
Revenues:		
Net patient service revenue	\$ 756,359	78,914
Other revenue	52,245	6,023
Total revenues	808,604	84,937
Operating expenses:		
Salaries	391,950	36,970
Fringe benefits	80,984	9,463
Medical supplies	133,282	14,763
Professional fees	33,305	2,329
Purchased services	50,600	3,388
Other expenses	68,229	9,610
Depreciation and amortization	28,766	7,068
Interest expense	10,421	3,523
Total operating expenses	797,537	87,114
Operating income (loss)	11,067	(2,177)
Nonoperating income:		
Net investment income	21,604	135
Other nonoperating income	365	88
Total nonoperating income	21,969	223
Excess (deficit) of revenues over (under) expenses and change in net position	33,036	(1,954)
Net position:		
Beginning of year	527,544	15,546
Cash distributions	—	(1,822)
End of year	\$ 560,580	11,770

See accompanying notes to financial statements.

CUMBERLAND COUNTY HOSPITAL SYSTEM, INC.
(d/b/a Cape Fear Valley Health System)

Statement of Cash Flows

Year ended September 30, 2019

(In thousands)

	Primary enterprise	Component units
Cash flows from operating activities:		
Receipts from patients and insurers	\$ 748,838	91,343
Payments to employees	(469,248)	(46,316)
Payments to vendors	(281,767)	(42,850)
Payments to pension plan	(10,084)	(96)
Other	53,791	6,053
Net cash provided by operating activities	41,530	8,134
Cash flows from capital and related financing activities:		
Purchases of capital assets	(33,556)	(610)
Proceeds from the sale of capital assets	14	1
Principal and interest payments on debt	(18,631)	(5,495)
Funds received from component units, net	14,744	—
Other long-term assets	(6,703)	(75)
Net cash used in capital and related financing activities	(44,132)	(6,179)
Cash flows from investing activities:		
Interest and dividends on investments	23,954	188
Proceeds from the sale and maturity of investments	176,733	3
Purchases of investments	(198,277)	(495)
Dividends paid	—	(1,822)
Other investing cash flows	365	10
Net cash provided by (used in) investing activities	2,775	(2,116)
Net increase (decrease) in cash and cash equivalents	173	(161)
Cash and cash equivalents:		
Beginning of year	50,885	11,512
End of year	\$ 51,058	11,351
Reconciliation of cash and cash equivalents to the balance sheet:		
Cash and cash equivalents	48,058	11,351
Investments	3,000	—
Total cash and cash equivalents	\$ 51,058	11,351
Reconciliation of operating income to net cash provided by operating activities:		
Operating income (loss)	\$ 11,067	(2,177)
Adjustments to reconcile operating income to net cash provided by operating activities:		
Interest expense considered capital financing activity	10,421	3,524
Provision for bad debts	192,626	40,131
Depreciation and amortization	28,766	7,068
Loss on the disposal of capital assets	1,546	59
Vesting of Premier, Inc. stock options	(2,764)	—
Changes in operating assets and liabilities:		
Patient and other accounts receivable	(198,330)	(34,657)
Inventory, prepaid expenses and other assets	(4,357)	3,366
Accounts payable	5,276	(848)
Salaries and benefits payable	(6,398)	(43)
Other liabilities and accruals	5,494	(15,277)
Estimated third-party payor settlements	(1,817)	6,988
Net cash provided by operating activities	\$ 41,530	8,134
Noncash investing, capital, and financing activities:		
Property and equipment acquired through accounts payable	\$ 17,196	—

See accompanying notes to financial statements.

CUMBERLAND COUNTY HOSPITAL SYSTEM, INC.
(d/b/a Cape Fear Valley Health System)

Notes to Financial Statements

September 30, 2019

(Dollar amounts in thousands)

(1) Reporting Entity

Cumberland County Hospital System, Inc. (d/b/a Cape Fear Valley Health System) (the Health System) was incorporated under the laws of North Carolina on July 7, 1964, by the Board of Commissioners of Cumberland County (the County) for the primary purpose of operating and maintaining certain hospital facilities, owned by the County, under the terms and conditions of a management lease agreement with the County. On May 4, 2006, a transfer agreement (the Transfer Agreement) was entered into with the County converting the Health System, as permitted under North Carolina General Statute (NCGS) § 131E-8, from a public hospital to a private, nonprofit hospital system. The articles of incorporation provide for the Health System to be governed by a board of trustees (the Board of Trustees), the majority of which are to be appointed by the County.

The Transfer Agreement also contains certain covenants that give the County a reversionary interest in the facilities and related property. Such covenants relate to the Health System's operation as a community general hospital, including the provision of services to indigent patients and adhering to certain requirements covering additional liens, additional debt, and disposition of assets, maintaining certain financial strength ratios, and maintaining tax-exempt status among other criteria. In addition, the Transfer Agreement provides for an annual payment in lieu of taxes by the Health System to the County (note 11).

The Health System includes the following described facilities, all located in Fayetteville, North Carolina;

- Cape Fear Valley Medical Center, a 576-bed regional referral, acute care hospital (includes 52 beds temporarily licensed since May 2011 due to high census)
- Cape Fear Valley Rehabilitation Center, a 78-bed rehabilitation facility
- Behavioral Health Care of Cape Fear Valley Health System, a 32-bed psychiatric facility
- Highsmith-Rainey Specialty Hospital, a 66-bed long-term acute care hospital
- Health Pavilion North, a multispecialty outpatient facility
- Cumberland County Emergency Medical Services, the HealthPlex of Cape Fear Valley Health System (a medically oriented wellness center), and primary care and specialty care practices are also members of the obligated group.

These facilities are owned and operated by the Health System and are members of the Health System's obligated group under its Master Trust Indenture executed in connection with the issuance of certain long-term debt obligations. Each member of the obligated group is jointly and severally liable for the repayment of principal and interest of the Health System's long-term debt obligations under the Hospital Facility Revenue Bonds.

The assets, liabilities, revenue, and expenses of all these facilities are included in the primary enterprise accompanying financial statements.

CUMBERLAND COUNTY HOSPITAL SYSTEM, INC.
(d/b/a Cape Fear Valley Health System)

Notes to Financial Statements

September 30, 2019

(Dollar amounts in thousands)

Cape Fear Insurance, Ltd., SPC (Cape Fear Insurance) is not a member of the obligated group. Cape Fear Insurance is a wholly owned, captive insurance company domiciled in the Cayman Islands. Although legally separate, the principal activity of Cape Fear Insurance is to provide professional and general liability insurance coverage to the Health System and to purchase reinsurance policies from external markets. The Health System appoints the voting majority of Cape Fear Insurance's Board of Directors. Since Cape Fear Insurance provides services entirely to the primary enterprise, the blending method has been used to incorporate its financial statements into the Health System's financial statements. Under the blending method, transactions between Cape Fear Insurance and the Health System that generate intercompany receivables, payables, revenues, and expenses are eliminated. After eliminations, the remaining balances and transactions of Cape Fear Insurance are included in the Health System's assets, liabilities, revenues, and expenses.

The following is a summary of Cape Fear Insurance's condensed financial information as of and for the year ended September 30, 2019:

CAPE FEAR INSURANCE

Condensed Summary of Net Position

September 30, 2019

Assets:	
Current assets	\$ 3,456
Noncurrent assets	<u>43,005</u>
Total assets	<u>\$ 46,461</u>
Liabilities and net position:	
Current liabilities	\$ 5,203
Noncurrent liabilities	20,446
Net position – unrestricted	<u>20,812</u>
Total liabilities and net position	<u>\$ 46,461</u>

CUMBERLAND COUNTY HOSPITAL SYSTEM, INC.

(d/b/a Cape Fear Valley Health System)

Notes to Financial Statements

September 30, 2019

(Dollar amounts in thousands)

CAPE FEAR INSURANCE

Condensed Summary of Revenues,
Expenses, and Changes in Net Position

Year ended September 30, 2019

Total operating revenues	\$	135
Total operating expenses		<u>1,186</u>
Operating loss		(1,051)
Total nonoperating gains, net		<u>1,922</u>
Excess of revenues over expenses and increase in net position		871
Net position:		
Beginning of year		<u>19,941</u>
End of year	\$	<u><u>20,812</u></u>

CAPE FEAR INSURANCE

Condensed Summary of Cash Flows

Year ended September 30, 2019

Cash flows from operating activities	\$	(4,285)
Cash flows from investing activities		<u>4,052</u>
Net decrease in cash and cash equivalents		(233)
Cash and cash equivalents at beginning of year		<u>464</u>
Cash and cash equivalents at end of year	\$	<u><u>231</u></u>

CUMBERLAND COUNTY HOSPITAL SYSTEM, INC.
(d/b/a Cape Fear Valley Health System)

Notes to Financial Statements

September 30, 2019

(Dollar amounts in thousands)

Discretely Presented Component Units

As required by U.S. generally accepted accounting principles (GAAP), these financial statements reflect the activities of the Health System and its discretely presented component units. The discretely presented component units of the Health System, all of which are nonmajor, include the following:

- Bladen Healthcare, LLC (d/b/a Cape Fear Valley – Bladen County Hospital) (Bladen County Hospital); a critical access hospital
- Hoke Healthcare, LLC (HHC), which operates a medical office building, opened in the first quarter of 2013, and Cape Fear Valley Hoke Hospital opened in March 2015
- Fayetteville Ambulatory Surgical Center (FASC), a surgical center
- Cape Fear Valley Medical Foundation, Inc. (d/b/a Cape Fear Valley Health Foundation) (the Foundation); a nonstock charitable corporation

Under the discrete presentation method, intercompany receivables, payables, revenues, and expenses are not eliminated. The discretely presented component units' financial statements are included in a separate column apart from the Health System's (primary enterprise) financial statements.

In June 2008, the Health System, through its 100% owned affiliate Bladen Healthcare, LLC, began operating Bladen Hospital and related enterprises pursuant to a five-year lease agreement, with an option to purchase and related agreements with the County of Bladen. Bladen Hospital is a critical access hospital located in Elizabethtown, North Carolina, which operates 25 general acute care beds. The Health System exercised the purchase option and, on March 19, 2012, acquired Bladen Hospital and related enterprises, which is now owned and operated through Bladen Healthcare, LLC.

In June 2009, the Health System established Hoke Healthcare, LLC, a 100% owned subsidiary of the Health System, to conduct healthcare activities in Hoke County, NC. HHC is operated by a Board of Managers, which are appointed by the Health System's Board of Trustees.

In April 2019, the Health System purchased an additional 46.24% interest in Fayetteville Ambulatory Surgical Center (FASC) bringing total ownership to 68.31%. As a result of this transaction, FASC is now presented as a discretely presented component unit of the Health System. Due to this change in reporting entity, opening net position for the component units increased by \$5,076.

The Foundation is a legally separate, nonstock charitable corporation. Its purpose is to solicit and receive contributions to assist with and further the mission of the Health System. The Foundation has been included as a component unit because almost all of the resources it holds are available to benefit the Health System and its patients.

Bladen County Hospital, HHC, Hoke Imaging, FASC, and the Foundation are not members of the obligated group as defined in the Health System's Master Trust Indenture. Combined, they account for approximately 9.5% of the total reporting entity revenues for the year ended September 30, 2019.

CUMBERLAND COUNTY HOSPITAL SYSTEM, INC.
(d/b/a Cape Fear Valley Health System)

Notes to Financial Statements

September 30, 2019

(Dollar amounts in thousands)

(2) Summary of Significant Accounting and Reporting Policies

(a) Basis of Accounting

The financial statements have been prepared on the accrual basis of accounting using the economic resources measurement focus in accordance with GAAP as prescribed by the Governmental Accounting Standards Board (GASB).

(b) Use of Estimates

The preparation of financial statements in conformity with GAAP 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. The Health System considers critical accounting policies to be those that require more significant judgments and estimates in the preparation of its financial statements, including the following: recognition of net patient service revenues; valuation of accounts receivable, including contractual allowances and provisions for bad debt; reserves for losses and expenses related to employee healthcare, professional liabilities, workers' compensation, general liabilities; valuation of pension and other retirement obligations; and estimated third-party payor settlements. Management relies on historical experience and on other assumptions believed to be reasonable under the circumstances in making its judgments and estimates. Actual results could differ from those estimates.

(c) Cash and Cash Equivalents

For purposes of the statement of cash flows, all highly liquid investments with an original maturity of three months or less at the time of purchase, and which are not limited as to their use or have not been designated as short- or long-term investments, are considered to be cash equivalents and are recorded at cost, which approximates fair value.

(d) Patient Accounts Receivable – Net

The Health System's patient accounts receivable is recorded net of allowances for uncollectible accounts of \$113,398 at September 30, 2019. The Health System's net patient service revenue is presented net of provision for uncollectible accounts of \$192,626 for the year ended September 30, 2019.

(e) Inventories

Inventories are stated at the lower of cost (first-in, first-out method) or market.

(f) Investments

Investments in marketable debt and equity securities with readily determinable fair values, including assets whose use is limited, are reported at fair value in the accompanying balance sheet. An investment net gain of \$21,604 for the year ended September 30, 2019, is included in nonoperating income in the accompanying financial statements.

CUMBERLAND COUNTY HOSPITAL SYSTEM, INC.
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(Dollar amounts in thousands)

(g) Assets Limited as to Use

Assets limited as to use consist of cash and investments set aside by the Health System's Board of Trustees for future capital improvements over which the Board of Trustees maintains control and may, at its discretion, subsequently use for other purposes. In addition, assets limited as to use consist of restricted cash held by trustee for debt service assets designated for capital improvements and investments designated to cover self-insurance claims.

(h) Other Assets

Other assets consist of goodwill, deposits, and investments in certain healthcare-related businesses.

(i) Capital Assets

Capital assets are recorded at cost or, if donated, at fair value on the date of receipt. Depreciation is provided over the estimated useful life of each class of depreciable assets and is computed using the straight-line method. Such depreciation is included in depreciation and amortization in the accompanying financial statements.

<u>Property classification</u>	<u>Estimated lives (years)</u>
Land improvements	12–20
Buildings	10–90
Equipment	3–20

Expenditures for repairs and maintenance are charged to expense as incurred, unless the betterments extend the useful lives of the assets, at which point these costs are capitalized. Interest cost incurred on borrowed funds, less any interest earned on temporary investment of those funds, during the period of construction of qualified capital assets is capitalized as a component of the cost of acquiring those assets.

(j) Deferred Outflows and Inflows of Resources

Deferred outflows of resources consist of the unamortized amounts related to long-term debt refunding transactions, the accumulated valuation loss of the interest rate swap that is an effective hedge, the differences between expected and actual experience of pension plan participants, the net difference between expected and actual earnings on pension plan investments, pension plan assumption changes and contributions made to the pension plan subsequent to the measurement date.

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The balance of the deferred outflows of resources at September 30, 2019 is composed of the following:

Loss on refunding of debt	\$	13,629
Accumulated valuation loss of the interest rate swap		39,990
Differences between expected and actual experience of pension plan participants		2,765
Net difference between expected and actual earnings on pension plan investments		1,928
Pension plan assumption changes		3,807
Contributions made to the pension plan after the measurement date		10,084
	\$	72,203

Deferred inflows of resources consist of pension plan assumption changes. More detailed information regarding pension-related deferred outflows and inflows of resources is presented in note 12(g) to the financial statements.

(k) Interest Rate Swap

The fair value of the Health System's interest rate swap agreement, which is developed based on a mark-to-market pricing service using the zero-coupon method, is reported on the accompanying balance sheet as a liability and related accumulated losses are reported as a deferred outflow of resources because Health System management has determined that the interest rate swap is an effective hedging instrument. Net cash settlement amounts are included in interest expense in the accompanying statement of revenues, expenses and changes in net position.

(l) Net Pension Liability

Net pension liability represents the portion of the present value of projected benefit payments attributed to past periods of service to be provided through the Health System's pension plan to current active and inactive employees less the fiduciary net position of the pension plan. Investments that comprise the fiduciary net position are reported at fair value or at the net asset value (NAV) per share as a practical expedient to fair value.

(m) Net Position

The financial statements utilize a net position presentation. Net position is categorized as net investment in capital assets, restricted for debt service, restricted by donors, restricted - nonexpendable and unrestricted.

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Net investment in capital assets is intended to reflect the portion of net position that is associated with nonliquid capital assets, less outstanding debt associated with the capital assets. Net position restricted for debt service consists of assets that are restricted, committed, or assigned to expenditure for principal and interest based on third-party mandate. Net position restricted by donors consists of assets that are restricted through external constraints imposed by contributors and donors. Net position restricted – nonexpendable consists of the minority ownership interest in FASC. Unrestricted net position has no third-party restrictions on use. When both restricted and unrestricted resources are available for use, generally it is the Health System’s policy to use restricted resources first and then unrestricted resources when they are needed.

(n) Revenues and Expenses

All revenue and expenses directly related to the delivery of healthcare services are included in operating revenue and expenses in the accompanying statement of revenues, expenses, and changes in net position. Nonoperating revenues and expenses consist of those revenues and expenses that are related to financing and investing types of activities and result from nonexchange transactions or investment income.

(o) Net Patient Service Revenue

Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors. 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. The effect of these settlement adjustments to net patient service revenue was an increase of \$8,967 in 2019.

(p) Charity Care

The Health System 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 Health System does not pursue collection of amounts determined to qualify as charity care, they are not reported as revenue.

(q) 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.

(r) Fair Value Measurements

The fair value of a financial instrument is the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. GASB Statement No. 72, *Fair Value Measurement and Application*, establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The fair value hierarchy gives the highest priority to quoted market prices in active markets of identical assets (Level 1) and the lowest priority to unobservable inputs (Level 3).

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(s) Income Taxes Disclosure

The Health System and the Foundation are exempt from federal income taxes on related income under Section 501(a) of the Internal Revenue Code as organizations described in Section 501(c)(3). The unrelated business income generated by the Health System and the income generated by the Health System's taxable component are not material to the financial statements. Accordingly, no provision for income taxes is required in the accompanying financial statements.

Cape Fear Insurance is incorporated in the Cayman Islands and is generally not subject to income or capital gains taxes in the United States of America or the Cayman Islands. Accordingly, no provision for income taxes was made in the accompanying financial statements for this entity.

(3) Cash, Investments, and Assets Limited as to Use

(a) Deposits

Custodial credit risk for deposits is the risk that in the event of a financial institution failure, the Health System's deposits may not be returned. As of September 30, 2019, the Health System's deposits had a carrying amount of \$48,058, and a bank balance of \$51,821. Of the bank balance, \$586 is covered by federal depository insurance. The remaining balance of \$51,235 is subject to custodial risk as it was neither insured nor collateralized.

(b) Investments and Assets Limited as to Use

The Health System holds a combination of money market and fixed-income securities, including securities issued by government-sponsored enterprises, such as the Federal Home Loan Mortgage Corporation, the Federal National Mortgage Association, and the Government National Mortgage Association. Effective with the execution of the Transfer Agreement, the Health System is no longer subject to NCGS §159-30; as such, the Health System holds certain nongovernmental equity investments.

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The Health System's investments and assets limited as to use are categorized by investment type and mature as follows as of September 30, 2019:

Investment type	Fair value	Investment maturities (in years)			
		Less than 1	1-5	6-10	More than 10
Cash and cash equivalents	\$ 2,221	2,221	—	—	—
U.S. Treasury and agency obligations	27,830	2,687	20,780	3,139	1,224
Mortgage-backed securities	41,618	—	2,751	6,492	32,375
Corporate obligations	45,499	—	19,885	10,643	14,971
Mutual funds—fixed income	79,266	—	79,266	—	—
Other	6,172	—	—	—	6,172
	202,606	\$ 4,908	122,682	20,274	54,742
Equity securities	236,679				
Total investments and assets limited as to use	\$ 439,285				

(c) Fair Value Hierarchy

Fair value measurements reflected in the financial statements provide a framework for measuring fair value. GASB Statement No. 72 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. GAAP provides a hierarchy that prioritizes the inputs to fair value measurement based on the extent to which inputs to valuation techniques are observable in the market place.

The fair value hierarchy presented below categorizes the inputs to valuation techniques used to measure fair value into three levels:

- Level 1 – Inputs are quoted prices for identical assets or liabilities in active markets that the Health System can access at the measurement date.
- Level 2 – Inputs other than quoted prices included within Level 1 that are observable for an asset or liability, either directly or indirectly.
- Level 3 – Inputs are unobservable for an asset or liability.

The hierarchy assigns a higher priority to observable inputs that reflect verifiable information obtained from independent sources, and a lower priority to unobservable inputs that would reflect the Health System's assumptions about how market participants would value an asset or liability based on the best information available.

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For marketable securities, fair value is determined by quoted prices in active markets. Market quotations include the last reporting price or, if such prices are unavailable, bid-ask price. Market securities utilizing Level 1 inputs include cash and cash equivalents, exchange traded equity securities, fixed-income mutual funds, and most U.S. government debt securities.

Marketable securities utilizing Level 2 inputs include mortgage-backed securities and corporate obligations. These securities are valued using market corroborated pricing, matrix pricing, or other pricing models that utilize observable inputs such as yield curves. Pricing models are based on accepted industry modeling techniques that attempt to maximize the use of inputs from market-based (third party) sources. Differences may exist between the fair values of assets and liabilities using indicative quotations or pricing models and their realizable value.

Fair value measurements for which the measurement was based on NAV are reported using NAV as a practical expedient, as outlined in GASB Statement No. 72. The following table presents the Health System's investments and assets whose use is limited measured at estimated fair value aggregated by the level in the fair value hierarchy at September 30, 2019:

Fair value measurements at September 30, 2019 using				
	Total	Level 1	Level 2	Level 3
Investment by fair value level:				
Cash and cash equivalents	\$ 2,221	2,221	—	—
U.S. Treasury and agency obligations	27,830	27,830	—	—
Equity securities	236,679	236,679	—	—
Mortgage-backed securities	41,618	—	41,618	—
Corporate obligations	45,499	—	45,499	—
Mutual funds—fixed income	79,266	79,266	—	—
Other	6,172	—	6,172	—
	439,285	\$ 345,996	93,289	—
Total investments measured at NAV	—			
Total investments and assets whose use is limited	\$ 439,285			

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(d) Credit Risk

Credit risk is the risk that the Health System will not recover its investments due to the failure of the counterparty to fulfill its obligation. At September 30, 2019, the investments in fixed-income securities subject to credit risk, as a percentage of the Health System's total investment portfolio, were rated by Moody's as follows:

	<u>AAA</u>	<u>AA</u>	<u>A</u>	<u>BBB</u>	<u>Not rated</u>
Cash and cash equivalents	0.5%	—%	—%	—%	—%
U.S. Treasury and agency obligations	5.8	—	—	—	0.5
Mortgage-backed securities	0.3	0.1	0.4	0.2	8.5
Corporate obligations	0.3	1.7	5.3	2.0	1.1
Mutual funds—fixed income	—	—	—	—	18.0
Other	0.3	0.2	0.4	—	0.5
	<u>7.2%</u>	<u>2.0%</u>	<u>6.1%</u>	<u>2.2%</u>	<u>28.6%</u>

The Health System's investment policy requires that fixed-income securities rated below "BBB" by at least one major rating agency not exceed 5% of the Health System's portfolio. At September 30, 2019, the Health System met this requirement.

The Health System held a fixed-income mutual fund, the PIMCO Total Return Fund, totaling \$79,266 as of September 30, 2019, that was not rated.

(e) Custodial Credit Risk

Custodial credit risk is the risk that, in the event of the failure of the counterparty, the Health System will not be able to recover the value of its investments or collateral securities that are in the possession of a third party.

Fixed-income investments and equity securities are exposed to custodial credit risk if the securities are uninsured, are not registered in the name of the Health System, and are held by either the counterparty or the counterparty's trust department or agent, but not in the Health System's name. As of September 30, 2019, all of the Health System's fixed-income investments and equity securities are held by the Health System's custodial bank in the Health System's name and are, therefore, not exposed to custodial credit risk.

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(f) Interest Rate Risk

Interest rate risk is the risk that fair value of the Health System's investments will decrease as a result of an increase in interest rates. The Health System maintains a formal investment policy to manage its exposure to fair value losses arising from increasing interest rates by holding equity investments in addition to fixed-income investments and by allocating its fixed-income investments between both short- and long-term investments. Short-term funds, which are investments with a time horizon of one year or less, amount to \$4,908 as of September 30, 2019. The remaining portfolio is allocated to long-term investments. Within the long-term section of the portfolio, the Health System's targeted allocations are approximately 50% fixed-income investments, 40% equity investments, and 10% global real estate investments.

The Health System invests in mortgage-backed securities. The fair values of these securities are based on cash flows from principal and interest payments on the underlying mortgages. Prepayments reduce the future cash flows of these investments and consequently their fair values. Therefore, these securities are sensitive to decreases in interest rates, which may result in an increase in prepayments by mortgagees. As of September 30, 2019, the Health System had \$41,618, invested in this type of asset-backed security.

Investment securities, in general, are exposed to various risks such as interest rate, credit, and overall market volatility. Due to the level of risk associated with certain investment securities, it is reasonably possible that changes in the fair values of investment securities will occur in the near term and that such changes could materially affect the amounts reported in the financial statements. Refer to the distribution of maturities for the reporting entity's debt-related investments as of September 30, 2019 in the preceding investment composition tables.

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(4) Capital Assets

A summary of the Health System's changes in capital assets during the year ended September 30, 2019 is as follows:

	<u>Balance beginning</u>	<u>Additions</u>	<u>Transfers/ disposals</u>	<u>Balance ending</u>
Depreciable capital assets:				
Land improvements	\$ 11,245	390	(56)	11,579
Buildings	453,069	7,979	(1,204)	459,844
Equipment	328,378	57,782	(23,446)	362,714
Depreciable capital assets – gross	792,692	66,151	(24,706)	834,137
Accumulated depreciation	(517,665)	(28,093)	22,843	(522,915)
Depreciable capital assets – net	275,027	38,058	(1,863)	311,222
Nondepreciable capital assets:				
Land	21,653	—	—	21,653
Construction in progress	18,052	38,561	(53,857)	2,756
Nondepreciable capital assets	39,705	38,561	(53,857)	24,409
Net capital assets	\$ 314,732	76,619	(55,720)	335,631

Depreciation expense for the Health System was \$28,093 for the year ended September 30, 2019.

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A summary of HHC's changes in capital assets during the year ended September 30, 2019 is as follows:

	<u>Balance beginning</u>	<u>Additions</u>	<u>Transfers/ disposals</u>	<u>Balance ending</u>
Depreciable capital assets:				
Land improvements	\$ 279	—	—	279
Buildings	89,763	47	—	89,810
Equipment	16,513	374	(652)	16,235
Depreciable capital assets – gross	106,555	421	(652)	106,324
Accumulated depreciation	(17,731)	(4,774)	181	(22,324)
Depreciable capital assets – net	88,824	(4,353)	(471)	84,000
Nondepreciable capital assets:				
Land	2,612	313	(298)	2,627
Net capital assets	\$ 91,436	(4,040)	(769)	86,627

Depreciation expense for HHC was \$4,774 for the year ended September 30, 2019.

(5) Long-Term Debt

In September 2008, the Health System issued \$152,000 in Health Care Facilities Revenue Bonds, Series 2008A (the Series 2008A Bonds) and \$133,335 in Health Care Facilities Revenue Bonds, Series 2008C (the Series 2008C Bonds) through the North Carolina Medical Care Commission. The Series 2008A Bonds were payable at a weekly rate as determined by the remarketing agent and were backed by a letter of credit from Branch Banking and Trust Company (BB&T) in the amount of \$153,700. The Series 2008C Bonds were fully registered, whereby interest was payable at fixed rates ranging from 3.10% to 4.75% for 2010 to 2019 and 5.25% to 5.63% for 2020 to 2033. The Series 2008C Bonds were refinanced in December 2012 in connection with the issuance of the Series 2012A Bonds. The Series 2008A Bonds were refunded in November 2017 in connection with the issuance of the Series 2017 Bonds.

In December 2012, the Health System issued \$108,195 in Health Care Facilities Revenue Refunding Bonds, Series 2012A (the Series 2012A Bonds) through the North Carolina Medical Care Commission. The proceeds of the Series 2012A Bonds were used to (1) refund in advance the Series 2008C Bonds and (2) pay certain expenses incurred with the issuance of the Series 2012A Bonds. The Series 2012A Bonds are fully registered, whereby interest is payable at fixed rates ranging from 2.00% to 5.00% for 2013 to 2022 and 3.5% to 5.00% for 2023 to 2034.

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Under the terms of the advance refunding related to the issuance of the Series 2012A Bonds, the bond indenture permits the Series 2008C bonds to be defeased in whole or in part with no security requirement by the bond indenture or any obligation of the Health System if the bond trustee holds cash or defeasance obligations sufficient to provide for the payment of such 2008C bonds. At the issuance of the respective Series 2012A bonds, the Health System secured a sufficient amount of cash to meet all scheduled principal and interest payments associated with outstanding balances on the Health System's Series 2008C Bonds.

The difference between the reacquisition price and the net carrying amount of the previously existing Series 2008C Bonds is being deferred and amortized as a component of interest expense over the remaining scheduled life of the old debt, which represents the shorter of the original amortization period remaining from the prior refunding or the life of the latest refunding debt. At September 30, 2019, the unamortized deferred loss of \$13,629 is included in deferred outflows of resources in the Health Systems' accompanying balance sheet.

In November 2017, the Health System issued \$152,000 in Health Care Facilities Revenue Refunding Bonds, Series 2017 (the Series 2017 Bonds) through the Public Finance Authority. The proceeds of the Series 2017 Bonds were used to (1) refund the Series 2008A Bonds and (2) pay certain expenses incurred with the issuance of the Series 2017 Bonds. The Series 2017 Bonds were purchased and are held by BB&T Community Holdings Co. and bear interest at a variable rate that is determined monthly and equal to 68% of One-Month LIBOR plus 0.63% per annum.

The bonds are governed by multiple bond documents that include the Master Trust Indenture, supplemental master trust indentures and trust agreements that will be referred to collectively herein as the "Bond Indenture." The Bond Indenture includes covenants that require the Health System to maintain specified financial ratios, levels of working capital, and equity and other nonfinancial covenants.

Both the Series 2012A and the Series 2017 Bonds contain a provision that in an event of default, outstanding amounts become immediately due if the Health System is unable to make payment or fails to comply with these covenants. The Health System had previously entered into an interest rate swap agreement with Citibank, N.A., New York, with respect to the Health Care Facilities Revenue Bonds, Series 2006B (the Series 2006B Bonds) in a notional amount of \$202,275 (the Swap Agreement) (note 7). In conjunction with the refunding of the Series 2006B Bonds and the issuance of the Series 2008A and 2008C Bonds, the Health System terminated approximately 30% of the Swap Agreement, and therefore, the outstanding notional amount of the Swap Agreement is \$137,000 after the refunding.

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The debt service requirements of the Series 2012A Bonds and Series 2017 Bonds, as of September 30, 2019 (over the next five years and in five-year increments thereafter), are as follows:

	<u>Principal</u>	<u>Interest</u>	<u>Interest rate swap – net</u>	<u>Total</u>
Years ending				
September 30:				
2020	\$ 8,030	5,170	3,914	17,114
2021	8,435	4,779	3,914	17,128
2022	8,860	4,358	3,914	17,132
2023	9,305	3,908	3,914	17,127
2024	9,785	3,432	3,914	17,131
2025–2029	55,735	14,000	15,923	85,658
2030–2034	68,630	8,381	8,752	85,763
2035–2038	53,575	1,945	1,133	56,653
Total	\$ <u>222,355</u>	<u>45,973</u>	<u>45,378</u>	<u>313,706</u>

The variable interest related to the Series 2017 Bonds included in the schedule above is based on the rate in effect at the financial statement date, which was 1.5% per annum at September 30, 2019.

A summary of long-term debt as of September 30, 2019 is as follows:

Hospital Facility Revenue Bonds, Series 2017 serial and term bonds, payable annually from 2025 to 2037 in amounts ranging from \$7,850 to \$18,780, plus interest at variable rate that is determined monthly and equal to 68% of One-Month LIBOR plus 0.63% per annum.	152,000
Hospital Facility Revenue Bonds, Series 2012A serial and term bonds, payable annually through 2034 in installments ranging from \$2,200 to \$9,785, plus interest at rates ranging from 2.00% to 5.00% per annum.	<u>70,355</u>
	222,355
Unamortized premium	4,280
Less current maturities	<u>(8,030)</u>
Total	\$ <u>218,605</u>

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A summary of the Health System's changes in long-term debt during the year ended September 30, 2019 is as follows:

	Beginning balance	Additions	Payments	Ending balance	Amounts due within one year
Series 2012A serial and term bonds	77,990	—	(7,635)	70,355	8,030
Series 2017 serial and term bonds	152,000	—	—	152,000	—
Total	\$ 229,990	—	(7,635)	222,355	8,030

A summary of HHC's changes in long-term debt during the year ended September 30, 2019 is as follows:

	Beginning balance	Additions	Payments	Ending balance	Amounts due within one year
Series 2013A taxable bond	\$ 23,643	—	(503)	23,140	527
Series 2013B taxable bond	2,627	—	(56)	2,571	59
USDA Direct Loan	64,708	—	(971)	63,737	1,003
Total	\$ 90,978	—	(1,530)	89,448	1,589

HHC owns a 60-acre medical campus in Raeford, Hoke County, North Carolina, that was developed in two phases. HHC obtained permanent financing for Health Pavilion Hoke from the United States Department of Agriculture (USDA) in March 2013 in the form of a \$38,448, fixed-rate, 40-year direct loan (the Phase 1 Direct Loan) that bears interest at 3.125%.

HHC requested that the USDA provide permanent financing for Phase 2 through its Community Facilities Direct Loan and Guaranteed Loan Program. Under the USDA Community Facilities Guaranteed Loan Program, the USDA guarantees a portion of the loan (e.g., 90%) with the full faith and credit of the United States of America and partners with a private lender who agrees to service the loan and hold the nonguaranteed portion of the loan (e.g., 10%). The USDA agreed to provide permanent financing for this phase through a fixed-rate, 40-year, \$30,000 direct loan bearing interest at 3.50% (the Phase 2 Direct Loan) and a fixed-rate, 30-year, \$27,311 guaranteed loan (the Guaranteed Loan) bearing interest at 4.75%. The Guaranteed Loan was made in the form of taxable bonds issued by HHC (Hoke Community Medical Center Project), Series 2013A in the principal amount of \$24,579 (the Series 2013A Bonds) to Farm Credit Services of America, Cobank, and Agstart Financial Services, each held an equal share. HHC also issued Taxable Bonds (Hoke Community Medical Center Project), Series 2013B in the principal amount of \$2,732 (the Series 2013B Bonds) to BB&T.

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The Series 2013A Bonds, which are 90% of the principal amount of the Guaranteed Loan, represent the guaranteed portion of the Guaranteed Loan. The Series 2013B Bonds, which are 10% of the Guaranteed Loan, represent the nonguaranteed portion of the Guaranteed Loan and bear interest at 8%. Both loans have a final maturity date of October 1, 2043.

The Series 2013A Bonds contains a provision that in an event of default, outstanding amounts become immediately due if the Health System is unable to make payment.

The debt service requirements of the Phase 1 Direct Loan, the Series 2013A Bonds, the Series 2013B Bonds, and the Phase 2 Direct loan as of September 30, 2019 (over the next five years and in five-year increments thereafter) are as follows:

	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
Years ending September 30:			
2020	\$ 1,589	3,394	4,983
2021	1,650	3,330	4,980
2022	1,714	3,264	4,978
2023	1,780	3,196	4,976
2024	1,848	3,125	4,973
2025–2029	10,382	14,446	24,828
2030–2034	12,578	12,172	24,750
2035–2039	15,261	9,392	24,653
2040–2044	16,864	6,022	22,886
2045–2049	12,010	3,502	15,512
2050–2054	12,414	1,394	13,808
2055–2057	1,358	48	1,406
Total	<u>\$ 89,448</u>	<u>63,285</u>	<u>152,733</u>

(6) Bank Line of Credit

At September 30, 2019, the Health System had an unsecured bank line of credit with no amounts outstanding and could borrow a total of \$15,000 on the line of credit with Branch Banking and Trust Company, which expires on February 28, 2021. Interest on outstanding amounts accrues at the one-month LIBOR rate plus 1.75%. The Health System borrowed and repaid \$12,000 under the line of credit during the year ended September 30, 2019.

In addition, the Health System had a secured bank line of credit with no amounts outstanding and could borrow a total of \$60,000 on the line of credit with Branch Banking and Trust Company, which expires on February 28, 2021. Interest on outstanding amounts accrues at the one-month LIBOR rate plus .75%. The Health System borrowed and repaid \$15,000 under the line of credit during the year ended September 30, 2019.

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(7) Interest Rate Swap

On April 1, 2006, the Health System entered into the Swap Agreement (note 5) as a means to lower its borrowing costs on the Series 2006B Bonds when compared against fixed-rate bonds at the time of issuance. The agreement was effective May 4, 2006, with a notional amount of \$202,275.

Under the Swap Agreement, the Health System pays the swap provider fixed amounts based on a fixed rate of 3.91%, and the swap provider pays to the Health System floating amounts based on 63.50% of the British Bankers' Association 30-day LIBOR, plus 0.20%. Each such amount is based on the outstanding notional amount of the Swap Agreement.

On September 18, 2008, in conjunction with the issuance of the Series 2008A Bonds and the refunding of the Series 2006B Bonds, the Health System terminated \$65,275 of the notional amount of the swap, reducing the associated notional amount to \$137,000. The significant terms of the swap remain unchanged as of September 30, 2019.

The significant terms and features of the Swap Agreement are as follows:

Corresponding bond series		2017
Swap type		Floating to fixed
Notional amount	\$	137,000
Effective date		September 18, 2008
Termination date		October 1, 2036
Final bond maturity		October 1, 2036
Health System pays		3.91%
Health System receives		63.50% of 30 day LIBOR + 0.20%
Net cash payments remitted by Health System for the year ended September 30, 2019	\$	2,973
Swap fair value – September 30, 2019		39,990
Classification		Deferred outflow of resources

(a) Fair Value

As of September 30, 2019, the swap has a negative fair value of \$39,990 developed by a mark-to-market pricing service using the zero-coupon method. This method calculates the future net settlement payments required by the swap, assuming that the current forward rates implied by the yield curve correctly anticipate future spot interest rates. These payments are then discounted using the spot rates implied by the current yield curve for hypothetical zero-coupon bonds due on the date of each future net settlement of the swap and is, therefore, categorized as a Level 2 security.

The Health System has determined that its interest rate swap is an effective hedging derivative. Because the swap is an effective hedge, the changes in its fair value of \$14,682 for the year ended

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September 30, 2019 are deferred and are reported on the accompanying balance sheet as changes in deferred outflows of resources.

(b) Credit Risk

The Health System seeks to limit its counterparty risk by contracting only with highly rated entities. As of September 30, 2019, the credit rating for the counterparty of the interest rate swap was rated A1 by Moody's Investors Service (Moody's), A+ by Standard & Poor's (S&P), and A+ by Fitch Investors Services (Fitch). To mitigate the potential for credit risk, under the terms of the Swap Agreement if the counterparty's credit quality falls below AA – for Fitch or S&P or Aa3 for Moody's and the swap has a fair value that is positive in favor of the Health System, the fair value of the swap will be collateralized by the counterparty with U.S. government securities. Collateral would be posted by the counterparty with a third-party custodian.

(c) Basis Risk

The Health System is exposed to basis risk on its interest rate swap agreement because the variable rate payments received by the Health System on these hedging derivative instruments are based on a rate or index (30-day LIBOR) other than the interest rates that the Health System pays on its hedged variable rate debt (SIFMA).

(d) Termination Risk

The swap uses the International Swap Dealers Association Master Agreement (the Master Agreement), which includes standard termination events, such as failure to pay and bankruptcy. The Master Agreement also includes an "additional termination event." The Master Agreement can be terminated if, at any time, a relevant rating with respect to a party declines below the termination level or is withdrawn, or if any party has no relevant rating but was previously rated by such rating agency. The termination levels are, with respect to Moody's, Baa3; S&P, BBB-; and Fitch, BBB-.

The payments from the Health System to the swap counterparty are insured by Ambac Financial Group, Inc. (Ambac). This insurance provides protection to the swap counterparty in the event the Health System fails to make payments due under the swap.

When the Health System entered into the swap in 2006, Ambac was rated AAA by each of three rating agencies. Under the terms of the Swap Agreement, an "insurer event" will occur if both Moody's and S&P's ratings for Ambac fall below the A category. If an insurer event happens, and the Health System were downgraded below the A category, the Health System would be required to post collateral in an amount equal to the market value of the swap minus a threshold of up to \$5 million, as defined in the Swap Agreement.

In 2011, Ambac's rating had been withdrawn by Moody's, by S&P, and by Fitch. Accordingly, an insurer event had occurred as a result. As of September 30, 2019, the Health System was rated A3 by Moody's Investors Service and A-by S&P; however, the Health System is not required to post collateral based on its current rating.

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(e) Rollover Risk

Rollover risk is the risk that occurs when the term of the swap does not match the term or maturity of the debt associated with the hedge. The Health System does not have rollover risk.

(8) Net Patient Service Revenue

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

Medicare – Inpatient acute care services rendered to Medicare program beneficiaries are paid primarily at prospectively determined rates per discharge. These rates vary according to a patient classification system that is based on clinical, diagnostic, and other factors and cover both operating and capital costs. Outpatient services are reimbursed at prospectively determined rates. The Health System is reimbursed for cost reimbursable items at a tentative rate, with final settlement determined after submission of annual cost reports by the Health System, and audits thereof, by the Medicare fiscal intermediary. The Health System's cost reports have been audited by the Medicare fiscal intermediary for cost report periods through September 30, 2013. Bladen County Hospital cost reports have been audited through 2013. The cost reports for Highsmith-Rainey have been audited through 2017; however, audits are incomplete for fiscal years 2006 and 2007. HHC's cost reports have been audited through 2015.

Medicaid – The North Carolina Department of Health and Human Services Division of Medical Assistance reimburses costs for "inpatient" Medicaid services using a payment per discharge system with case-mix adjustments based on diagnostic-related groups, similar to those used by the Medicare program. The Health System is reimbursed for "outpatient" costs at a tentative rate, with final settlement determined after submission of annual Medicaid cost reports by the Health System, and audits thereof, by the Medicaid fiscal intermediary. The Health System recognizes the impact of new information obtained from audits or reviews as it is obtained. The Health System's Medicaid cost reports have been audited by the Medicaid program through September 30, 2013. Bladen County Hospital cost reports have been audited through 2016, with Highsmith-Rainey being audited through 2016. HHC's cost reports have been audited through 2015.

Laws governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by material amounts in the future.

The Health System receives supplemental Medicaid funds under the North Carolina Medicaid Reimbursement Initiative (the MRI Program) based on the costs related to the treatment of a disproportionate share of indigent patients. This program was amended in 2012 to provide additional funds to cover a portion of the unreimbursed costs of treating uninsured patients. The amended funding plan is referred to as the GAP Plan. The GAP Plan requires hospitals to pay assessments into a state fund as a condition to receive the additional funds. The state submitted the GAP Plan to Centers for Medicare and Medicaid Services for approval in January 2010. It was approved in April 2012, retroactive to the submission date of January 2010.

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The funds received under the MRI Program and the GAP Plan are included in net patient service revenue, and the assessments paid are included in other operating expenses in the accompanying statement of revenues, expenses, and changes in net position. A summary of the funds received and assessments paid under these programs during fiscal year 2019 is as follows:

MRI funds received	\$	45,123
GAP Plan funds received		17,154
Less assessments paid		<u>(7,966)</u>
Net amounts recognized	\$	<u>54,311</u>

Other – The Health System has also entered into payment agreements with certain commercial insurance carriers, health maintenance organizations, preferred provider organizations, and directly with local employers. The basis for payment to the Health System under these arrangements includes prospectively determined rates per discharge, discounts from established charges, and prospectively determined daily rates.

The Health System's payor mix as a percent of gross revenue was as follows for the year ended September 30, 2019:

Medicare	46.8%
Medicaid	20.0
Tricare	8.1
Self-pay	7.2
Commercial, managed care, and other	<u>17.9</u>
Total	<u>100.0%</u>

The healthcare industry is subject to numerous laws and regulations of federal, state, and local governments. These laws and regulations include, but are not necessarily limited to, matters such as licensure, accreditation, and government healthcare program participation requirements, reimbursement for patient services, and Medicare and Medicaid fraud and abuse. Government activity has increased with respect to investigations and/or allegations concerning possible violations of fraud and/or abuse statutes and regulations by healthcare providers. Violations of these laws and regulations could result in expulsion from government healthcare programs, together with the imposition of significant fines and penalties, as well as significant repayments for patient services previously billed. Compliance with such laws and regulations can be subject to future government review and interpretation, as well as regulatory actions unknown or unasserted at this time. Management is proactively monitoring compliance with these matters through its corporate compliance program to mitigate the inherent risks of operating in the healthcare industry.

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(9) Charity Care

The Health System maintains records to identify and monitor the level of care it provides without charge or at discounted rates to those patients who are unable to meet their financial obligation, including low income, uninsured, underinsured, or medically indigent patients. Key elements used to determine eligibility for financial assistance include a patient's demonstrated inability to pay based on family size and household income relative to federal income poverty guidelines. All other avenues to obtain financial assistance, including applying for other governmental programs such as Medicaid, must be exhausted prior to receiving financial assistance from the Health System. The estimated cost of services provided under the Health System's charity care policy, based on applying an estimated cost to charge ratio to the amount of applicable charges foregone, was approximately \$15,960 for the year ended September 30, 2019.

(10) Risk Management

The Health System is exposed to various risks of losses related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. The Health System is self-insured for medical malpractice through an offshore captive (Cape Fear Insurance) and self-insured for workers' compensation up to the various limits discussed below. The Health System has purchased commercial insurance to cover losses exceeding the self-insurance limits.

(a) Estimated Malpractice Costs

The Health System is self-insured for medical malpractice risks up to \$5,000 per claim and an annual aggregate of \$25,000, on a claims-made basis. In addition, the Health System has an excess coverage policy, which is limited to annual costs of \$50,000.

Losses from asserted and unasserted claims identified under the Health System's incident reporting system, and possible losses attributable to incidents that may have occurred, but that have not been identified under the incident reporting system, are accrued based on estimates that incorporate the Health System's past experience, as well as other considerations, including the nature of each claim or incident and relevant trend factors. The Health System has retained an independent actuary to assist management in preparing such estimates. Accrued malpractice losses have not been discounted.

The following is a summary of the activity in the liability for medical malpractice claims for the year ended September 30, 2019.

Year ended September 30	Beginning balance	Incurred claims	Paid claims	Ending balance
2019	\$ 30,802	1,115	(1,043)	30,874

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The current portion of the above liability was approximately \$1,700 as of September 30, 2019 and is included in the accompanying balance sheet within other liabilities and accruals. The remaining noncurrent portion is included in other liabilities in the accompanying balance sheet. The Health System transfers funds to Cape Fear Insurance for the payment of medical malpractice claim settlements. Independent actuaries have been retained to assist the Health System with the annual determination of funds to be transferred.

(b) Workers' Compensation

The Health System is self-insured for workers' compensation claims up to \$750 per incident. The Health System has an excess coverage policy with statutory limits. The Health System has utilized independent actuaries to assist management in estimating the ultimate cost of the self-insurance portion of the settlement of such claims.

The following is a summary of the activity in the liability for workers' compensation claims for the year ended September 30, 2019.

<u>Year ended September 30</u>	<u>Beginning balance</u>	<u>Incurred claims</u>	<u>Paid claims</u>	<u>Ending balance</u>
2019	\$ 4,901	432	(964)	4,369

The current portion of the above liability was \$1,300 as of September 30, 2019 and is reflected in the accompanying balance sheet within other current liabilities and accruals. The remaining noncurrent portion is included in other liabilities in the accompanying balance sheet. Workers' compensation expense for the year ended September 30, 2019 was \$589.

(c) Employee Health Benefit

The Health System self-insures employee health and dental claims. The Health System's accrued employee health and dental costs totaled \$6,151 at September 30, 2019, and are included in other liabilities and accruals in the accompanying balance sheet.

<u>Year ended September 30</u>	<u>Beginning balance</u>	<u>Incurred claims</u>	<u>Paid claims</u>	<u>Ending balance</u>
2019	\$ 3,663	45,127	(42,639)	6,151

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(11) Commitments and Contingencies

(a) Leases

The Health System leases various types of equipment and outpatient clinic locations. These leases are classified as operating leases with various expiration dates through 2026. Management expects that in the normal course of events leases will be renewed or replaced by other leases. Minimum lease payments projected below also include servicing and licensing agreements.

Total expenses for all operating leases and related agreements, including the payment in lieu of taxes (note 11(b)), were \$12,298 for the year ended September 30, 2019.

Future minimum payments that have noncancelable lease terms in excess of one year as of September 30, 2019 are as follows:

		Minimum lease payments
Years ending September 30:		
2020	\$	1,969
2021		1,971
2022		342
2023		254
2024		254
2025–2029		508
Total	\$	5,298

(b) Transfer Agreement

The Transfer Agreement specifies that a payment in lieu of taxes will be paid by the Health System to the County on each July 1, beginning on July 1, 2006. The annual payment in lieu of taxes includes a base payment, as specified in the Transfer Agreement. The annual payment also includes an additional payment that shall be an amount equal to the ad valorem taxes that would have been received by the County on any real property acquired by or for the use of the Health System after January 1, 1998.

Effective with the year ended September 30, 2010, the base payment shall be the previous agreement year's base payment amount adjusted by the most recently published consumer price index for South Urban Size C Communities. Future estimated payments disclosed in the table below do not include a consumer price index adjustment or the additional payment in lieu of taxes specified under the Transfer Agreement. The Health System made payments including these adjustments totaling \$3,950 for 2019. These payments are reflected in other expenses in the accompanying statement of revenues, expenses, and changes in net position.

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Future estimated minimum payments in lieu of taxes required under the Transfer Agreement as of September 30, 2019 are as follows:

	<u>Minimum payments</u>
Years ending September 30:	
2020	\$ 3,950
2021	3,950
2022	3,950
2023	3,950
2024	3,950
2025–2029	19,750
Each five-year period thereafter	19,750

(c) Healthcare Industry Matters

The healthcare industry continues to attract legislative interest and public attention. In recent years, an increasing number of legislative proposals have been introduced or proposed in Congress and in some state legislatures that, like the Medicare Modernization Act, would affect major changes in the healthcare system. The Patient Protection and Affordable Care Act, enacted in 2010, resulted in significant changes to the healthcare payment and delivery system. The legislation resulted in changes in Medicare, Medicaid, and other state and federal programs, and cost controls on hospitals. While the Health System is planning and preparing for the certain changes called for in the legislation, it cannot predict the ultimate impact of future healthcare legislation at the state or national level. Changes in the administration at both the state and national level will impact the interpretation of governmental healthcare programs and the effect that any legislation, interpretation, or change may have on the Health System is unknown. Such effects may include material adverse changes to the amounts of reimbursement received by the Health System.

(d) Legal and Regulatory Matters

The Health System is involved in litigation, administrative proceedings, and regulatory examinations arising in the normal course of business. The Health System's management believes that the ultimate outcome of these matters will not have a material impact on the Health System's net position, operations, or cash flows.

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(12) Pension Plan

The Health System has a single-employer defined benefit pension plan (the Plan) administered by the Pension Committee of the Health System. The Plan provides retirement benefits to plan members and beneficiaries. Employees of the Health System and Bladen County Hospital, a discretely presented component unit, are eligible to become participants in the Plan on the first day of the Plan year in which the employee has completed five years of credited service and attained the age of 25. Accordingly, the amounts disclosed herein relate to the Plan as a whole.

The Plan provides pension benefits to vested participants and their beneficiaries who have attained at least five years of service. Retirement benefits are calculated as follows:

- For participants whose sum of age and service as of January 1, 2009 is at least 85: The amount of annual benefit is a product of (a) 1.15% of average compensation times the years of credited service (not to exceed 25 years) and (b) 0.65% of average compensation which is in excess of 1/6 of the current taxable wage base times the years of credited service (not to exceed 25 years).
- For participants whose sum of age and service as of January 1, 2009 is less than 85: The amount of annual benefit is a product of (a) 0.82% of the participant's average compensation times the years of credit service (not to exceed 35 years) and (b) 0.46% of the participant's average compensation which is in excess of 1/6 of the current taxable wage base times the years of credited service (not to exceed 35 years).

If a vested participant dies prior to their annuity starting date, the participant's beneficiary will receive a life annuity equal to the actuarial equivalent of the participant's vested accrued benefit as of the date of the participant's death. If a participant dies after the annuity starting date, payments shall be made in accordance with the method of payment elected by the participant.

The Health System reserves the right to amend or terminate the Plan at any time. Separate financial statements for the Plan have not been issued. The Plan is not subject to the requirements of the Employee Retirement Income Security Act of 1974. The Plan was closed to new employees hired on or after July 1, 2011, through an amendment to the Plan effective July 1, 2011.

Effective January 1, 2015 the Plan was amended to limit compensation to include regular hours worked, paid time off used, administrative time, education time, funeral leave, jury duty and at-risk compensation as reported on the employees' W-2 for federal income tax purposes. The defined benefit dollar limitation at normal retirement was also updated to \$35. The limit is indexed each year at 2%.

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Effective September 30, 2018, the Plan was amended to eliminate future accruals for participants with less than 30 years of credited service as of December 31, 2018. As a result of this Plan change, a favorable adjustment of \$6,824 was recorded in pension expense for the year ended September 30, 2019.

(a) Employees Covered by Benefit Terms

The total pension liability at September 30, 2019 was based on plan membership data as of January 1, 2018 and rolled forward to the measurement date, or September 30, 2018 as follows:

Active plan members	\$	2,148
Retired		732
Terminated vested		<u>1,547</u>
Total members	\$	<u><u>4,427</u></u>

(b) Contributions

Contribution requirements are established and may be amended by the Health System. Administrative costs of the Plan are paid by the Health System. Currently, employee contributions are not permitted. The Health system's funding policy is to contribute such actuarially determined amounts as are necessary to provide assets sufficient to meet the benefits to be paid to plan members and to meet the minimum actuarially determined funding requirements. The Health System's actual contributions to the Plan for the reporting periods ended September 30, 2019 were \$10,084.

(c) Investments

Policies pertaining to the allocation of investments within the Plan are established and may be amended by the Compensation and Investment Committee of the Board of Trustees (the Committee). The Committee's responsibilities include, but are not limited to: (1) ensure that the Plan's assets are managed in compliance with applicable laws and regulations; (2) periodically review expected levels of benefit payments for the next 12 months and ensure that the Plan's assets are invested such that the Plan can meet its benefit obligations when due; (3) undertake, on a periodic basis, a review of the Plan's financial status to determine the optimum strategic asset allocation guidelines for the Plan; (4) retain, at its discretion, investment managers, trustees and other professionals to facilitate and assist with the management of the Plan; and (5) review the performance of the Plan's investment managers. It is the goal of the Health System to maintain an adequate but not excessive funding level. As such, a portion of the Plan's assets will, therefore, be invested in a manner consistent with the Plan's liabilities, cash flow requirements, and risk tolerance. The remainder of the assets in the Plan will have a long-term investment objective to outperform an appropriate composite benchmark based on the underlying asset class allocations over rolling three-year periods.

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The following table illustrates the approved asset allocation policy:

Investment type	% Range of allocation		
	Minimum	Target	Maximum
Liability matching assets	25 %	30 %	40 %
Fixed-income investments	5	10	15
Equity investments	45	55	65
Real estate investments	—	5	10

Asset allocations falling outside the minimum and maximum ranges may be rebalanced back to target levels using normal Plan cash flows (contributions, benefit distributions, etc.). Asset allocations below minimum and above maximum ranges by more than 5% will be re-balanced to target levels, or levels within the prescribed ranges by the reallocation of assets by the Plan's investment managers.

Permitted securities in which assets of the Plan may be invested include any of the following:

Liability matching assets:

- Treasury bills
- Money market funds
- Commercial paper
- Certificates of deposit
- Banker's acceptances
- Certificates of deposit or other cash equivalents
- High-quality credit issues
- Fixed-income derivative contracts
- Commingled funds that invest in securities in accordance with the investment policy

Equity securities:

- American Depository Receipts (ADRs)
- Issues convertible into common stock
- Large cap domestic equity securities
- Mid cap domestic equity securities
- Small cap domestic equity securities
- International equity securities
- Emerging market equity securities
- Mutual funds
- Commingled funds that invest in securities in accordance with the investment policy

Fixed-income securities:

- U.S. government and agency obligations
- Nonderivative mortgage-backed and asset-backed securities
- Corporate and utility bonds
- Commercial paper
- Certificates of deposit or other cash equivalents
- Yankee issues
- Closed-end bond funds
- Commingled funds that invest in securities in accordance with the investment policy

Real estate:

- Real estate investment trusts
- Global real estate securities
- Commingled funds that invest in securities in accordance with the investment policy

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Investments are reported at fair value or at the net asset value (NAV) per share as a practical expedient to fair value if quoted market prices are not available. Management reviews and evaluates the fair value provided by the external investment managers, as well as the valuation methods and assumptions used in determining the fair value of such investments. Although management believes the fair value estimated for interests in its real estate and commingled funds that do not have readily determinable market values to be reasonable, such estimated fair values (amounting to \$17,078 at September 30, 2018) may differ from the ultimate realizable value of the investments. In addition, these investments are generally less liquid than investments with a readily determinable market value. Short-term investments are reported at cost, which approximates fair value. Securities traded on a national or international exchange are valued at the last reported sales price at current exchange rates.

The following investments represented 5% or more of the Plan's fiduciary net position at September 30, 2018:

Vanguard Mid Capitalization Index Signal Fund	\$	58,227
Causeway International Value Fund		33,508
JP Morgan High Yield Pension Trust Fund		<u>17,078</u>
Total	\$	<u><u>108,813</u></u>

The fiduciary net position of the Plan was invested as follows at September 30, 2018:

Liability matching assets	\$	28,610
Equity securities		108,527
Fixed-income securities		<u>43,623</u>
Total	\$	<u><u>180,760</u></u>

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The following tables present the Plan's assets measured at estimated fair value aggregated by the level in the fair value hierarchy at September 30, 2019, respectively:

	<u>Total</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Plan assets by fair value level:				
Liability matching assets:				
Cash equivalents	\$ 5,213	5,213	—	—
U.S. Treasury and agency obligations	6,319	6,319	—	—
Equity securities	108,527	108,527	—	—
Fixed income:				
Corporate obligations	29,074	—	29,074	—
Mortgage-backed securities	12,737	—	12,737	—
Other obligations	1,812	—	1,812	—
	<u>163,682</u>	\$ <u>120,059</u>	<u>43,623</u>	<u>—</u>

Plan assets measured at NAV:

Liability matching assets	<u>17,078</u>
Total pension plan assets	\$ <u>180,760</u>

	<u>Fair value</u>	<u>Unfunded commitments</u>	<u>Redemption frequency</u>	<u>Redemption notice period</u>
Multistrategy hedge fund (1)	\$ 17,078	—	No limit	3 days or less

(1) This fund invests in a diversified portfolio of debt securities as well as in one other collective investment trust fund. The value of the Plan's interest in the fund is determined on a daily basis based on its undivided interest of the fund's earnings and assets. Income and expenses are allocated based on relative net assets.

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(d) Actuarial Assumptions

The total pension liability at September 30, 2019 was determined using the following actuarial assumptions:

General inflation	2.50 %
Salary increases (varies, weighted average)	2.35
Investment rate of return (net of pension plan investment expense, including inflation)	7.25

The actuarial assumptions used in the September 30, 2018 valuations were based on the results of an actuarial experience study that is conducted every few years. Mortality rates used in the September 30, 2018 valuations were based on the RP-2014 Healthy Annuitant/Non Annuitant Mortality Table for Males and Females, as appropriate (adjusted to remove scale MP-2014 mortality improvements), with generational projections for mortality improvements based on Scale MP-2017.

The long-term expected rate of return on pension plan investments was determined using a building-block method in which best-estimate ranges of expected real rates of return are developed for each major asset class. These ranges are combined to produce the long-term expected rate of return by weighting the expected real rates of return, which are net of related investment expenses, by the target asset allocation percentage and by adding expected inflation. The target allocation and best estimates of arithmetic real rates of return for each major asset class are summarized in the following table:

Asset class	Target allocation	Long-term expected rate of return
Liability matching assets	30%	3.61%
Fixed-income securities	10%	5.00%
Equity securities	55%	7.10%
Real estate	5%	6.70%

The discount rate used to measure the total pension liability for the year ended September 30, 2019 (based on a September 30, 2018 measurement date) was 7.25%. The projection of cash flows used to determine the discount rate assumed that Health System contributions will be made based on rates determined by the actuary and retiree benefits are paid out according to the plans' formulae and assumptions. Based on those assumptions, the pension plan's fiduciary net position was projected to be available to make all projected future benefit payments of current active and inactive employees. Therefore, the long-term expected rate of return on pension plan investments was applied to all periods of projected benefit payments to determine the total pension liability.

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(e) Changes in the Net Pension Liability

The following table presents the Plans' changes in the net pension liability:

	Increase (decrease)		
	Total pension liability (a)	Plan fiduciary net position (b)	Net pension liability (a) – (b)
Balance recognized at October 1, 2018**	\$ 227,001	169,873	57,128
Changes recognized for the fiscal year:			
Service cost	2,365	—	2,365
Interest	16,314	—	16,314
Plan changes	(6,824)	—	(6,824)
Differences between expected and actual experience	(1,717)	—	(1,717)
Changes in assumptions	(1,034)	—	(1,034)
Contributions from the employer	—	10,264	(10,264)
Net investment income	—	9,945	(9,945)
Administrative expenses	—	(477)	477
Benefit payments	(8,845)	(8,845)	—
Net changes	259	10,887	(10,628)
Balance recognized at September 30, 2019**	\$ 227,260	180,760	46,500

** Based on September 30, 2018 measurement date

CUMBERLAND COUNTY HOSPITAL SYSTEM, INC.
(d/b/a Cape Fear Valley Health System)

Notes to Financial Statements

September 30, 2019

(Dollar amounts in thousands)

(f) Sensitivity of the Net Pension Liability to Changes in the Discount Rate

The following table presents the net pension liability of the Health System at September 30, 2019, calculated using the discount rate of 7.25% at September 30, as well as what the Health System's net pension liability would be if it were calculated using a discount rate that is one percentage-point lower or one percentage-point higher than the current rate:

	1% Decrease (6.25%)	Current rate (7.25%)	1% Increase (8.25%)
Total pension liability*	\$ 257,210	227,260	201,714
Plan fiduciary net position*	180,760	180,760	180,760
Net pension liability*	<u>\$ 76,450</u>	<u>46,500</u>	<u>20,954</u>

* Based on September 30, 2018 measurement date

(g) Pension Expense, Deferred Outflows of Resources and Deferred Inflows of Resources

For the year ended September 30, 2019, the Health System recognized pension expense of \$3,027. At September 30, 2019, the Health System reported deferred outflows of resources and deferred inflows or resources related to pension from the following sources:

	Deferred outflows of resources *	Deferred inflows of resources *
Differences between expected and actual experience	\$ 3,054	—
Net difference between expected and actual earnings on pension plan investments	1,964	—
Assumption changes	3,898	(2,463)
Contributions made after the measurement date	<u>10,084</u>	<u>—</u>
Total	<u>\$ 19,000</u>	<u>(2,463)</u>

* Based on a September 30, 2018 measurement date

CUMBERLAND COUNTY HOSPITAL SYSTEM, INC.
(d/b/a Cape Fear Valley Health System)

Notes to Financial Statements

September 30, 2019

(Dollar amounts in thousands)

Deferred outflows of resources resulting from employer contributions made after the measurement date in the amount of \$10,084 as of September 30, 2019 will be recognized as a reduction of the net pension liability in the year ended September 30, 2020. Amounts reported as deferred outflows of resources and deferred inflows of resources related to the accumulated net differences between expected and actual experience, projected and actual earnings on pension plan investments and assumption changes as of September 30, 2019 will be recognized in pension expense for each of the year ended September 30 as follows:

	Amount
2020	\$ 4,137
2021	1,571
2022	490
2023	255
2024	—
	\$ 6,453

(13) Investments in Joint Ventures

The Health System purchased a 33% equity interest in Woodstock Custom Vision, LLC in March 2018. The investment is accounted for using the equity method. The Health System's investment in Woodstock Custom Vision, LLC as of September 30, 2019 is \$5,570 and is reflected within other assets in the accompanying balance sheet.

The Health System purchased a 22% limited partnership interest in Fayetteville Ambulatory Surgery Center Limited Partnership in October 1995. In April 2019, the Health System purchased 46% of the General Partnership for a total investment of 68%. The investment is accounted for using the equity method. The Health System's investment in Fayetteville Ambulatory Surgery Center Limited Partnership as of September 30, 2019 is \$7,464 and is reflected within other assets in the accompanying balance sheet.

The Health System has a 49% equity interest in Valley Regional Imaging. The investment is accounted for using the equity method. The Health System's investment in Valley Regional Imaging as of September 30, 2019 is \$1,276 and is reflected within other assets in the accompanying balance sheet.

The Health System is an investor in other medical-related organizations that are accounted for using the cost method and had a carrying amount of \$116 as of September 30, 2019 and is reflected within other assets in the accompanying balance sheet. Information about the availability of separate financial statements of the above-mentioned organizations may be obtained from the Health System's office of financial services.

CUMBERLAND COUNTY HOSPITAL SYSTEM, INC.
(d/b/a Cape Fear Valley Health System)

Notes to Financial Statements

September 30, 2019

(Dollar amounts in thousands)

(14) Management Services Agreement

On November 3, 2014, the Health System entered into a management services agreement with Harnett Health System, Inc. (Harnett), effective as of that date. Under the management services agreement, the Health System is supervising and managing the day-to-day operations of Harnett and its various affiliates, including Betsy Johnston Memorial Hospital in Dunn, North Carolina and its provider-based location, Central Harnett Hospital, in Lillington, North Carolina (collectively, Harnett Health System). In conjunction with the management services agreement, the Health System also extended a Line of Credit to Harnett and was granted certain rights to assume an ownership interest in Harnett Health System in the future. As of September 30, 2019, Harnett has no outstanding balance against the extended line of credit.

(15) Affiliation with Campbell University School of Medicine

The Health System and the Campbell University School of Medicine (Campbell) entered into an Affiliation agreement in 2014 related to medical education and training and the creation of an academic medical center at Cape Fear Valley Medical Center. Since that time, Campbell and the Health System have worked to develop and gain approval of the residencies necessary to begin the residency program at Cape Fear Valley Medical Center, and the program received state legislative support in 2019. There are currently six approved residency programs (internal medicine, general surgery, emergency medicine, OB/GYN, psychiatry and transitional). The Health System and Campbell have entered into a 20 year master affiliation agreement as of June 2018.

(16) Subsequent Events

The Health System has evaluated subsequent events for potential recognition and/or disclosure through January 30, 2020, the date of issuance of these financial statements.

REQUIRED SUPPLEMENTARY INFORMATION

CUMBERLAND COUNTY HOSPITAL SYSTEM, INC.

(d/b/a Cape Fear Valley Health System)

Required Supplementary Information under GASB Statement No. 68

Schedule of Changes in Net Pension Liability and Related Ratios (Unaudited)

September 30, 2019, 2018, 2017, 2016 and 2015

(In thousands)

	<u>2019</u>	<u>2018</u>	<u>2017</u>	<u>2016</u>	<u>2015</u>
Total pension liability:					
Service cost	\$ 2,365	3,236	3,705	3,441	4,004
Interest cost	16,314	16,094	15,562	16,329	15,409
Changes in benefit terms	(6,824)	(4,861)	(6,943)	(20,289)	—
Differences between expected and actual experiences	(1,717)	1,206	6,908	824	1,605
Changes in assumptions	(1,034)	4,263	(3,609)	4,270	—
Benefit payments, including refunds of employee contributions	<u>(8,845)</u>	<u>(8,410)</u>	<u>(7,748)</u>	<u>(8,326)</u>	<u>(8,830)</u>
Net change in total pension liability	259	11,528	7,875	(3,751)	12,188
Total pension liability – beginning	<u>227,001</u>	<u>215,473</u>	<u>207,598</u>	<u>211,349</u>	<u>199,161</u>
Total pension liability – ending (a)	<u>227,260</u>	<u>227,001</u>	<u>215,473</u>	<u>207,598</u>	<u>211,349</u>
Plan fiduciary net position:					
Contributions – employer	10,264	9,712	10,089	12,405	10,337
Net investment income	9,945	15,456	9,995	340	15,089
Benefit payments, including refunds of employee contributions	(8,845)	(8,410)	(7,748)	(8,326)	(8,830)
Administrative expense	<u>(477)</u>	<u>(561)</u>	<u>(569)</u>	<u>(544)</u>	<u>(504)</u>
Net change in plan fiduciary net position	10,887	16,197	11,767	3,875	16,092
Plan fiduciary net position – beginning	<u>169,873</u>	<u>153,676</u>	<u>141,909</u>	<u>138,034</u>	<u>121,942</u>
Plan fiduciary net position – ending (b)	<u>180,760</u>	<u>169,873</u>	<u>153,676</u>	<u>141,909</u>	<u>138,034</u>
Net pension liability – ending (a) – (b)	\$ <u>46,500</u>	\$ <u>57,128</u>	\$ <u>61,797</u>	\$ <u>65,689</u>	\$ <u>73,315</u>
Plan fiduciary net position as a percentage of the total pension liability	79.54 %	74.83 %	71.32 %	68.36 %	65.31 %
Covered – employee payroll	\$ 132,964	137,006	146,329	157,305	150,236
Net pension liability as a percentage of covered-employee payroll	34.97 %	41.69 %	42.23 %	41.76 %	48.80 %

Note to schedule:

Measurement date is September 30 of prior fiscal year.

See accompanying independent auditors' report.

CUMBERLAND COUNTY HOSPITAL SYSTEM, INC.

(d/b/a Cape Fear Valley Health System)

Required Supplementary Information under GASB Statement No. 68

Schedule of Contributions (Unaudited)

Last 10 Fiscal years

(In thousands)

	<u>2019</u>	<u>2018</u>	<u>2017</u>	<u>2016</u>	<u>2015</u>	<u>2014</u>	<u>2013</u>	<u>2012</u>	<u>2011</u>	<u>2010</u>
Actuarially determined contribution	\$ 6,688	10,199	9,777	10,050	12,405	10,337	10,337	10,131	9,684	7,963
Contributions made in relation to the actuarially determined contribution	<u>10,084</u>	<u>10,084</u>	<u>9,712</u>	<u>10,089</u>	<u>12,405</u>	<u>10,337</u>	<u>10,337</u>	<u>10,131</u>	<u>9,684</u>	<u>7,963</u>
Contribution deficiency (excess)	\$ <u>(3,396)</u>	<u>115</u>	<u>65</u>	<u>(39)</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>
Covered – employee payroll	\$ 128,984	132,964	137,006	146,329	157,305	150,236	145,472	145,472	145,384	144,737
Contributions as a percentage of covered – employee payroll	7.82%	7.58%	7.09%	6.89%	7.89%	6.88%	7.11%	6.96%	6.66%	5.50%

Notes to schedule:

Valuation date: Actuarially determined contribution rates are calculated as of October 1, one year prior to the end of the fiscal year in which contributions are reported

Methods and assumptions used to determine contribution rates:

Actuarial cost method: Projected Unit Credit
 Asset valuation method: Three-year smoothing
 IRS Limit increases: 2.50%
 Salary increases: Varies by age
 Investment rate of return: 7.25%, net of pension plan investment expense, including inflation
 Retirement age: Varies by age and service
 Mortality age: Based on the RP-2014 Healthy Annuitant/Non Annuitant Mortality Table for Males or Females, as appropriate, (adjusted to remove Scale MP-2014 mortality improvements), with generational projections for mortality improvements based on Scale MP-2017.

See accompanying independent auditors' report.

COMBINING INFORMATION

CUMBERLAND COUNTY HOSPITAL SYSTEM, INC.
(d/b/a Cape Fear Valley Health System)

Combining Schedule of Assets, Deferred Outflows of Resources, Liabilities, Deferred Inflows of Resources and Net Position

September 30, 2019

(In thousands)

Assets and Deferred Outflows of Resources	Obligated group	Nonobligated group					Subtotal	Eliminations	Total Reporting Entity
	Cape Fear Valley Medical Center	Cape Fear Insurance, Ltd. SPC	Hoke Health Services, LLC	Bladen Healthcare, LLC	Cape Fear Valley Health Foundation	Fayetteville Ambulatory Surgery Center			
Current assets:									
Cash and cash equivalents	\$ 47,827	231	5,430	4,350	643	928	11,582	—	59,409
Short-term investments	1,908	—	—	—	7,240	—	7,240	—	9,148
Patient accounts receivable – net	97,165	—	4,744	3,286	—	989	9,019	—	106,184
Estimated third-party payor settlements	—	—	—	4,787	—	—	4,787	—	4,787
Other accounts receivable	34,113	221	256	171	129	145	922	(29,596)	5,439
Assets limited as to use – cash and investments – current portion:									
Designated for self-insurance	—	3,000	—	—	—	—	3,000	—	3,000
Inventories	11,211	—	361	418	—	14	793	—	12,004
Prepaid expenses	4,691	4	51	139	—	21	215	—	4,906
Total current assets	196,915	3,456	10,842	13,151	8,012	2,097	37,558	(29,596)	204,877
Capital assets – net	335,631	—	86,619	10,779	—	3,705	101,103	—	436,734
Other noncurrent assets:									
Assets limited as to use – cash and investments:									
Designated for capital improvements	121,102	—	—	—	—	—	—	—	121,102
Designated for self-insurance	8,698	43,005	—	—	—	—	43,005	—	51,703
Bond proceeds held by trustee	—	—	6,439	—	—	—	6,439	—	6,439
Total assets limited as to use	129,800	43,005	6,439	—	—	—	49,444	—	179,244
Investments	261,572	—	—	—	—	—	—	—	261,572
Other assets	20,459	—	—	276	—	—	276	(2,983)	17,752
Total other noncurrent assets	411,831	43,005	6,439	276	—	—	49,720	(2,983)	458,568
Total assets	944,377	46,461	103,900	24,206	8,012	5,802	188,381	(32,579)	1,100,179
Deferred outflows of resources	72,203	—	—	511	—	—	511	—	72,714
Total assets and deferred outflows of resources	\$ 1,016,580	46,461	103,900	24,717	8,012	5,802	188,892	(32,579)	1,172,893

See accompanying independent auditors' report.

CUMBERLAND COUNTY HOSPITAL SYSTEM, INC.
(d/b/a Cape Fear Valley Health System)

Combining Schedule of Assets, Deferred Outflows of Resources, Liabilities, Deferred Inflows of Resources and Net Position

September 30, 2019

(In thousands)

Liabilities, Deferred Inflows of Resources and Net Position	Obligated group	Nonobligated group					Subtotal	Eliminations	Total Reporting Entity
	Cape Fear Valley Medical Center	Cape Fear Insurance, Ltd. SPC	Hoke Health Services, LLC	Bladen Healthcare, LLC	Cape Fear Valley Health Foundation	Fayetteville Ambulatory Surgery Center			
Current liabilities:									
Accounts payable	\$ 31,604	1,067	702	796	49	359	2,973	—	34,577
Salaries and benefits payable	37,052	—	680	789	—	403	1,872	—	38,924
Other liabilities and accruals	18,456	4,136	19,042	5,944	—	586	29,708	(29,596)	18,568
Estimated third-party payor settlements	48,166	—	3,667	7,469	—	—	11,136	—	59,302
Current maturities of long-term debt	8,030	—	1,589	73	—	—	1,662	—	9,692
Total current liabilities	143,308	5,203	25,680	15,071	49	1,348	47,351	(29,596)	161,063
Long-term debt – less current maturities	218,605	—	87,856	9	—	67	87,932	—	306,537
Interest rate swap liability	39,990	—	—	—	—	—	—	—	39,990
Pension liability	45,995	—	—	505	—	—	505	—	46,500
Other liabilities	26,527	20,446	—	—	—	—	20,446	—	46,973
Total liabilities	474,425	25,649	113,536	15,585	49	1,415	156,234	(29,596)	601,063
Deferred inflows of resources	2,387	—	—	76	—	—	76	—	2,463
Net position:									
Net investment in capital assets	108,996	—	(2,826)	10,697	—	—	7,871	—	116,867
Restricted for debt service	—	—	6,265	(394)	—	—	5,871	—	5,871
Unrestricted	430,772	20,812	(13,075)	(1,247)	3,938	2,983	13,411	(2,983)	441,200
Restricted – by donors	—	—	—	—	4,025	—	4,025	—	4,025
Restricted – nonexpendable	—	—	—	—	—	1,404	1,404	—	1,404
Total net position	539,768	20,812	(9,636)	9,056	7,963	4,387	32,582	(2,983)	569,367
Total liabilities, deferred inflows of resources and net position	\$ 1,016,580	46,461	103,900	24,717	8,012	5,802	188,892	(32,579)	1,172,893

See accompanying independent auditors' report.

CUMBERLAND COUNTY HOSPITAL SYSTEM, INC.
(d/b/a Cape Fear Valley Health System)

Combining Schedule of Revenues, Expenses, and Changes in Net Position

Year ended September 30, 2019

(In thousands)

	Obligated group	Nonobligated group					Subtotal	Eliminations	Total Reporting Entity
	Cape Fear Valley Medical Center	Cape Fear Insurance, Ltd. SPC	Hoke Health Services, LLC	Bladen Healthcare, LLC	Cape Fear Valley Health Foundation	Fayetteville Ambulatory Surgery Center			
Revenues:									
Net patient service revenue	\$ 756,359	—	40,193	23,976	—	14,745	78,914	—	835,273
Other revenues	52,110	135	2,478	1,822	1,720	3	6,158	(135)	58,133
Total revenues	<u>808,469</u>	<u>135</u>	<u>42,671</u>	<u>25,798</u>	<u>1,720</u>	<u>14,748</u>	<u>85,072</u>	<u>(135)</u>	<u>893,406</u>
Operating expenses:									
Salaries	391,950	—	17,942	15,824	—	3,204	36,970	—	428,920
Fringe benefits	80,984	—	2,636	5,880	—	947	9,463	—	90,447
Medical supplies	133,282	—	7,340	1,853	—	5,570	14,763	—	148,045
Professional fees	33,305	—	244	2,055	—	30	2,329	—	35,634
Purchased services	50,600	—	1,337	1,044	—	1,007	3,388	—	53,988
Other expenses	67,043	1,186	3,396	2,981	1,465	1,768	10,796	(135)	77,704
Depreciation and amortization	28,766	—	4,774	1,251	—	1,043	7,068	—	35,834
Interest expense	10,421	—	3,468	2	—	53	3,523	—	13,944
Total operating expenses	<u>796,351</u>	<u>1,186</u>	<u>41,137</u>	<u>30,890</u>	<u>1,465</u>	<u>13,622</u>	<u>88,300</u>	<u>(135)</u>	<u>884,516</u>
Operating income (loss)	<u>12,118</u>	<u>(1,051)</u>	<u>1,534</u>	<u>(5,092)</u>	<u>255</u>	<u>1,126</u>	<u>(3,228)</u>	<u>—</u>	<u>8,890</u>
Nonoperating income:									
Net investment income	19,682	1,922	—	—	135	—	2,057	(770)	20,969
Other nonoperating income	365	—	78	3	—	7	88	—	453
Total nonoperating income	<u>20,047</u>	<u>1,922</u>	<u>78</u>	<u>3</u>	<u>135</u>	<u>7</u>	<u>2,145</u>	<u>(770)</u>	<u>21,422</u>
Excess (deficit) of revenues over (under) expenses and change in net position	<u>32,165</u>	<u>871</u>	<u>1,612</u>	<u>(5,089)</u>	<u>390</u>	<u>1,133</u>	<u>(1,083)</u>	<u>(770)</u>	<u>30,312</u>
Net position:									
Beginning of the year	507,603	19,941	(11,248)	14,145	7,573	5,076	35,487	(3,452)	539,638
Cash Distributions	—	—	—	—	—	(1,822)	(1,822)	1,239	(583)
End of the year	<u>\$ 539,768</u>	<u>20,812</u>	<u>(9,636)</u>	<u>9,056</u>	<u>7,963</u>	<u>4,387</u>	<u>32,582</u>	<u>(2,983)</u>	<u>569,367</u>

See accompanying independent auditors' report.