

# **Hugh Chatham Memorial Hospital, Inc. and Affiliates**

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**Consolidated Financial Statements and**

**Supplementary Information**

**Years Ended September 30, 2018 and 2017**

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## **Independent Auditors' Report**

To the Board of Trustees  
Hugh Chatham Memorial Hospital, Inc. and Affiliates  
Elkin, North Carolina

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

We have audited the accompanying consolidated financial statements of Hugh Chatham Memorial Hospital, Inc. and Affiliates (the "Hospital"), which comprise the consolidated balance sheets as of September 30, 2018 and 2017, and the related consolidated statements of operations, and changes in net assets, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

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

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

### ***Auditors' Responsibility***

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Hospital's preparation and fair presentation of the consolidated 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 Hospital'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 consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

***Opinion***

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Hugh Chatham Memorial Hospital, Inc. and Affiliates as of September 30, 2018 and 2017, and the results of their operations, changes in net assets, and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

***Report on Supplementary Information***

Our audit was conducted for the purpose of forming an opinion on the consolidated financial statements taken as a whole. The consolidating information is presented for purposes of additional analysis rather than to present the financial position and results of operations of the individual organizations and is not a required part of the consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the consolidated financial statements taken as a whole.

*Dixon Hughes Goodman LLP*

**Charlotte, North Carolina**  
**January 22, 2019**

**Hugh Chatham Memorial Hospital, Inc. and Affiliates**  
**Consolidated Balance Sheets**  
**September 30, 2018 and 2017**

	<b>2018</b>	<b>2017</b>
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 8,283,303	\$ 13,198,882
Assets limited as to use	3,978,240	4,040,297
Patient accounts receivable (net of allowance for uncollectible accounts of approximately \$13,311,000 in 2018 and \$12,436,000 in 2017)	10,639,546	9,526,802
Other receivables	569,669	689,604
Supplies	861,070	922,659
Prepaid expenses	1,695,229	1,746,165
Total current assets	26,027,057	30,124,409
Assets limited as to use, net of current portion	982,677	936,196
Investments	143,378,268	132,802,723
Property and equipment, net	62,304,049	64,992,393
Investment in joint ventures	8,405,160	5,332,400
Intangible assets and goodwill, net	1,341,488	1,309,064
Other assets	81,290	81,290
Total assets	<u>\$ 242,519,989</u>	<u>\$ 235,578,475</u>

**Hugh Chatham Memorial Hospital, Inc. and Affiliates**  
**Consolidated Balance Sheets**  
**September 30, 2018 and 2017**

**(Continued)**

	<b>2018</b>	<b>2017</b>
<b>LIABILITIES AND NET ASSETS</b>		
Current liabilities:		
Current portion of capital lease obligations	\$ 39,474	\$ 17,685
Current portion of long-term debt	2,465,000	2,435,000
Interest payable	466,733	477,225
Accounts payable	2,682,485	2,324,535
Accrued expenses	8,979,225	7,971,628
Resident trust funds	63,000	62,927
Physician recruitment guarantee	177,342	218,651
Estimated third-party payor settlements payable	4,162,045	5,076,214
	<b>19,035,304</b>	<b>18,583,865</b>
Interest rate swaps	2,422,007	4,970,979
Capital lease obligations, less current portion	127,984	80,927
Long-term debt, less current portion	59,516,253	61,931,815
	<b>81,101,548</b>	<b>85,567,586</b>
Net assets:		
Unrestricted	157,508,450	146,386,620
Temporarily restricted	3,909,991	3,624,269
	<b>161,418,441</b>	<b>150,010,889</b>
Total liabilities and net assets	<b>\$ 242,519,989</b>	<b>\$ 235,578,475</b>

See accompanying notes.

**Hugh Chatham Memorial Hospital, Inc. and Affiliates**  
**Consolidated Statements of Operations**  
**Years Ended September 30, 2018 and 2017**

	<u>2018</u>	<u>2017</u>
Unrestricted revenues:		
Patient service revenue, net of contractual allowances, discounts and charity care	\$ 110,079,291	\$ 106,743,634
Provision for uncollectible accounts	<u>(16,893,472)</u>	<u>(14,305,066)</u>
Net patient service revenue	93,185,819	92,438,568
Other operating revenue	<u>1,881,075</u>	<u>1,855,598</u>
Total unrestricted revenues	<u>95,066,894</u>	<u>94,294,166</u>
Expenses:		
Salaries and wages	42,709,293	41,021,143
Employee benefits	11,526,933	10,674,350
Medical supplies and other expenses	35,398,406	32,915,641
Depreciation and amortization	6,088,220	6,446,036
Interest expense	<u>2,613,417</u>	<u>2,500,137</u>
Total expenses	<u>98,336,269</u>	<u>93,557,307</u>
Operating income (loss)	<u>(3,269,375)</u>	<u>736,859</u>
Nonoperating revenues and expenses:		
Investment income, net	12,119,476	12,289,948
Income from investment in joint venture	1,267,090	295,024
Change in value of interest rate swaps	2,548,972	3,447,664
Recognized losses on other than temporarily impaired investments	<u>(2,740,715)</u>	<u>(713,954)</u>
Total net nonoperating revenues and expenses	<u>13,194,823</u>	<u>15,318,682</u>
Excess of revenues over expenses	9,925,448	16,055,541
Change in net unrealized gains on investments	1,195,727	6,159,278
Gifts, grants and bequests	<u>655</u>	<u>576,109</u>
Increase in unrestricted net assets	<u>\$ 11,121,830</u>	<u>\$ 22,790,928</u>

See accompanying notes.

**Hugh Chatham Memorial Hospital, Inc. and Affiliates**  
**Consolidated Statements of Changes in Net Assets**  
**Years Ended September 30, 2018 and 2017**

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Total</u>
Balance, September 30, 2016	\$ 123,595,692	\$ 3,451,351	\$ 127,047,043
Excess of revenues over expenses	16,055,541	-	16,055,541
Change in net unrealized gains on investments	6,159,278	-	6,159,278
Gifts, grants and bequests	576,109	303,505	879,614
Net assets released from restrictions for operations	-	(130,587)	(130,587)
Change in net assets	<u>22,790,928</u>	<u>172,918</u>	<u>22,963,846</u>
Balance, September 30, 2017	<u>146,386,620</u>	<u>3,624,269</u>	<u>150,010,889</u>
Excess of revenues over expenses	9,925,448	-	9,925,448
Change in net unrealized gains on investments	1,195,727	-	1,195,727
Gifts, grants and bequests	655	343,997	344,652
Net assets released from restrictions for operations	-	(58,275)	(58,275)
Change in net assets	<u>11,121,830</u>	<u>285,722</u>	<u>11,407,552</u>
Balance, September 30, 2018	<u><u>\$ 157,508,450</u></u>	<u><u>\$ 3,909,991</u></u>	<u><u>\$ 161,418,441</u></u>

See accompanying notes.

**Hugh Chatham Memorial Hospital, Inc. and Affiliates**  
**Consolidated Statements of Cash Flows**  
**Years Ended September 30, 2018 and 2017**

	<u>2018</u>	<u>2017</u>
Operating activities:		
Change in net assets	\$ 11,407,552	\$ 22,963,846
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Loss (gain) on disposal of property and equipment	5,558	34,791
Contributions for long-term purposes	(344,652)	(879,614)
Net realized and unrealized gains on investments	(7,793,561)	(14,489,211)
Realized gain on investment in joint ventures	(1,004,357)	(675,705)
Depreciation and amortization	6,088,220	6,446,036
Deferred financing costs interest	49,438	49,438
Amortization of intangible asset included in medical supplies and other expenses	46,576	86,565
Provision for uncollectible accounts	16,893,472	14,305,066
Change in value of interest-rate swap	(2,548,972)	(3,447,664)
Changes in assets and liabilities:		
Patient accounts receivable	(18,006,216)	(14,180,072)
Other operating assets, net	232,460	458,523
Estimated third-party payor settlements	(914,169)	(229,528)
Accounts payable, accrued expenses, and other current liabilities	1,157,335	142,442
Net cash provided by operating activities	<u>5,268,684</u>	10,584,913
Investing activities:		
Purchase of property and equipment	(2,904,562)	(3,582,480)
Proceeds from sale of nursing center	6,055	1,760
(Payments) receipts of physician recruitment guarantees	(41,309)	29,833
Purchase of goodwill related to physician practice	(79,000)	(104,850)
Contribution to Alleghany Memorial Hospital, Inc. for investment in joint venture	(2,068,403)	-
Purchase of assets limited as to use	(26,511,820)	(26,511,820)
Sales of assets limited as to use	23,745,412	21,779,732
Net cash used by investing activities	<u>(7,853,627)</u>	(8,387,825)
Financing activities:		
Payment of accounts payable to purchase property and equipment	(110,006)	(160,339)
Contributions for long-term purposes	344,652	879,614
Payments on capital lease obligations	(130,282)	(7,813)
Payments on long-term debt	(2,435,000)	(2,400,000)
Net cash used by financing activities	<u>(2,330,636)</u>	(1,688,538)
Net increase (decrease) in cash and cash equivalents	<u>(4,915,579)</u>	508,550
Cash and cash equivalents, beginning of year	<u>13,198,882</u>	12,690,332
Cash and cash equivalents, end of year	<u>\$ 8,283,303</u>	<u>\$ 13,198,882</u>
Supplemental cash flow disclosure information:		
Cash paid during the year for interest, excluding amounts capitalized	<u>\$ 2,623,909</u>	<u>\$ 2,512,793</u>
Supplemental schedule of noncash investing and financial activities:		
Purchases of property and equipment included in accounts payable	<u>\$ 307,799</u>	<u>\$ 110,006</u>
Property and equipment financed with capital lease	<u>\$ 199,128</u>	<u>\$ 106,425</u>
Acquisition of intangible asset through physician recruitment guarantee	<u>\$ -</u>	<u>\$ 29,833</u>

See accompanying notes.

## **Notes to Consolidated Financial Statements**

### **1. Organization**

Hugh Chatham Memorial Hospital, Inc. is a not-for-profit acute care hospital located in Elkin, North Carolina. The Hospital provides birthing and acute care services in addition to retirement community and home health services, primarily to the residents of Surry County, North Carolina and surrounding counties.

During fiscal 1997, the Hugh Chatham Memorial Hospital Foundation (the "Foundation") was established. Substantially all of the funds solicited by the Foundation are intended by the contributor or are otherwise required to be transferred to Hugh Chatham Memorial Hospital, Inc. Additionally, the Foundation's Board of Trustees is appointed by Hugh Chatham Memorial Hospital, Inc.'s Board of Trustees. As a result, the Foundation has been consolidated for presentation purposes.

During fiscal 1958, the Hugh Chatham Memorial Hospital Auxiliary (the "Auxiliary") was established. This corporation was established to engage in activities that are devoted to charitable purposes, and shall promote, enhance, and support Hugh Chatham Memorial Hospital. Additionally, the Auxiliary's Board of Trustees is appointed by Hugh Chatham Memorial Hospital, Inc.'s Board of Trustees. As a result, the Auxiliary has been consolidated for presentation purposes.

### **2. Summary of Significant Accounting and Reporting Policies**

#### ***Principles of Consolidation***

The accompanying consolidated financial statements include the accounts of Hugh Chatham Memorial Hospital, Inc., the Foundation and the Auxiliary for the years ended September 30, 2018 and 2017. Collectively, they are referred to as the "Hospital." All significant intercompany transactions and balances have been eliminated in consolidation.

#### ***Use of Estimates***

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

#### ***Cash and Cash Equivalents***

Cash and cash equivalents include cash and short-term investments with original maturities of three months or less when purchased, excluding amounts whose use is limited.

#### ***Patient Accounts Receivable***

Patient accounts receivable are carried at the original charge less an estimate made for doubtful or uncollectible accounts. Allowances for uncollectible accounts are computed based on statistical information from current and prior years' experience. Patient accounts receivable are written off when deemed uncollectible.

## **Hugh Chatham Memorial Hospital, Inc. and Affiliates**

### **Notes to Consolidated Financial Statements**

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The Hospital grants credit to patients without collateral, substantially all of whom are from Surry county and surrounding areas. The Hospital's allowance for doubtful accounts for self-pay patients is 86% percent of self-pay accounts receivable at September 30, 2018 and 2017. The Hospital does not maintain a material allowance for doubtful accounts from third-party payors, nor did it have significant write-offs from third-party payors.

#### ***Supplies***

Supplies are stated at the lower of cost (weighted average method) or market.

#### ***Assets Limited as to Use***

Assets limited as to use include assets restricted by a third party for resident trust funds and assets restricted by trustee under an indenture agreement.

#### ***Investments and Investment Income***

Investments in equity securities with readily determinable fair values and all investments in debt securities are measured at fair value in the accompanying consolidated balance sheets. Investment income or loss (including realized gains and losses on investments, interest and dividends) is included in excess of revenues over expenses unless the income or loss is restricted by donor or law. Unrealized gains and losses on investments except those determined to be other than temporarily impaired are excluded from excess of revenues over expenses, as the investments do not include any trading securities. Any other-than-temporary declines are accounted for as a recognized loss within nonoperating revenues and expenses, whereby the historical cost of the related investment would be adjusted to the then-current fair market value.

#### ***Interest Rate Swaps***

The Hospital holds two interest rate swap agreements to mitigate variable interest rate exposure. The notional amounts dictate the payments between the counterparties. The changes in fair value and balance sheet classifications are consistent with accounting standards for derivative instruments (see Note 9).

#### ***Property and Equipment***

Property and equipment are recorded at cost, except donated assets, which are recorded at fair value at date of receipt. Depreciation for financial reporting purposes is calculated using the straight-line method over the estimated useful life as established by the American Hospital Association, with the following ranges:

Land improvements	5 to 25 years
Buildings	5 to 40 years
Fixed and moveable equipment	3 to 20 years

#### ***Investment in Joint Ventures***

During fiscal 1982, Hospice of Surry County, Inc. ("Hospice") was established. This corporation was established to engage in activities that are devoted to health, educational and research purposes, including the establishment of terminal care facilities. As of October 1, 2005, Hospice was transferred to a joint venture between Hugh Chatham Memorial Hospital, Inc. and Northern Hospital District of Surry County. In February 2018, the Hospital entered into a joint venture with Wake Forest University Baptist Medical Center to form Alleghany Health, LLC and operate hospital services at Alleghany Memorial Hospital, Inc. These investments are accounted for using the equity method (see Note 8).

#### ***Deferred Financing Costs***

Deferred financing costs are amortized over the period the related obligation is outstanding. Amortization is included in interest expense in the consolidated statements of operations. The Hospital reported interest expense of \$49,438 related to these amortized costs during the years ended September 30, 2018 and 2017.

**Hugh Chatham Memorial Hospital, Inc. and Affiliates**  
**Notes to Consolidated Financial Statements**

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***Intangible Assets and Goodwill***

Intangible assets and goodwill include physician contracts which are being amortized over the term of the agreements and goodwill related to the purchase of physician practices which are being tested annually for impairment. The physician contract assets are the result of physician income guarantees and are based on the expected payments over the term of the guarantees. The Hospital acquired goodwill through the purchase of physician practices. Fair value of the goodwill is determined using discounted cash flow analysis. There was no impairment calculated as of September 30, 2018 or 2017.

***Physician Recruitment Guarantee***

The Hospital accounts for physician income guarantee agreements based on the net present value of expected future payments.

***Temporarily Restricted Net Assets***

Temporarily restricted net assets are those whose use by the Hospital has been limited by donors to a specific time period or purpose. Temporarily restricted net assets are transferred to unrestricted net assets when donor restrictions as to time and purpose have been met, and are shown as assets released from restrictions in the accompanying consolidated financial statements.

***Net Patient Service Revenue***

The Hospital has agreements with third-party payors that provide for payments to the Hospital at amounts different from its established rates. Payment arrangements include prospectively determined rates per discharge, reimbursed costs, discounted charges and per diem payments. Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors and others for services rendered, including estimated retroactive adjustments due to future audits, reviews and investigations. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as adjustments become known or as years are no longer subject to such audits, reviews or investigations.

***Charity Care***

The Hospital maintains records to identify and monitor the level of charity care it provides. Since the Hospital does not pursue collection of amounts determined to qualify as charity care, estimated costs have been incurred, but associated charges have not been reflected in net patient service revenues. The Hospital estimates the costs incurred by multiplying the cost-to-charge ratio by the charges forgone by the Hospital. The amount of charity costs incurred were approximately \$1,088,000 and \$1,278,000 for the years ended September 30, 2018 and 2017, respectively.

***Income Taxes***

The Hospital, Foundation, and Auxiliary are not-for-profit corporations as described in Section 501(c)(3) of the Internal Revenue Code and are exempt from federal income taxes on related income pursuant to Section 501(a) of the Code; accordingly, the accompanying financial statements do not reflect a provision or liability for federal and state income taxes. The Hospital has determined that it does not have any material unrecognized tax benefits or obligations as of September 30, 2018.

***Donor-Restricted Gifts***

Unconditional promises to give cash and other assets to the Hospital are reported at fair value at the date the promise is received. Conditional promises to give and indications of intentions to give are reported at fair value at the date the gift is received. The gifts are reported as either temporarily restricted or permanently restricted support if they are received with donor stipulations that restrict the donated assets as to use or time. When a donor restriction expires, temporarily restricted net assets are reclassified as unrestricted net assets and are reported in the consolidated financial statements as net assets released from restriction.

**Hugh Chatham Memorial Hospital, Inc. and Affiliates**  
**Notes to Consolidated Financial Statements**

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***Operating Income (Loss)***

The consolidated statements of operations distinguishes between operating and nonoperating revenues and expenses. Operating revenues result from exchange transactions associated with providing health care services. Operating expenses are all expenses incurred to provide healthcare services. Nonoperating revenues and expenses include investment income and other transactions that are not directly attributable to providing health care services.

***Excess of Revenues over Expenses***

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

***Functional Expenses***

The Hospital does not present expense information by functional classification because its resources and activities are primarily related to providing healthcare services. Further, since the Hospital receives substantially all of its resources from providing healthcare services in a manner similar to a business enterprise, other indicators contained in these consolidated financial statements are considered important in evaluating how well management has discharged their stewardship responsibilities.

***Fair Value Measurements***

Fair value, as defined under generally accepted accounting principles, is an exit price representing 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. The Hospital utilizes market data or assumptions that market participants would use in pricing the asset or liability. Generally accepted accounting principles ("GAAP") establishes a three-tier fair value hierarchy, which prioritizes the inputs used in measuring fair value. These tiers include: Level 1, defined as observable inputs such as quoted prices in active markets; Level 2, defined as inputs other than quoted prices in active markets that are either directly or indirectly observable; and Level 3, defined as unobservable inputs about which little or no market data exists, therefore, requiring an entity to develop its own assumptions.

Assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement. The Hospital's assessment of the significance of a particular input to the fair value measurement requires judgment, and may affect the valuation of fair value assets and liabilities, and their placement within the fair value hierarchy levels.

***Medicare Incentive Payments for Meaningful Use of Electronic Health Records***

The American Recovery and Reinvestment Act of 2009 ("ARRA") established incentive payments under the Medicare and Medicaid programs for certain professionals and hospitals that "meaningfully use" certified electronic health record ("EHR") technology. The Hospital successfully demonstrated "meaningful use" during fiscal years 2018 and 2017. The Hospital recognizes payments using the cliff recognition method under the grant accounting model. Under the cliff recognition method, revenue is recorded once all conditions associated with grant compliance are met. The amount of grant income recognized is based on management's estimates, which are subject to change. During the years ended September 30, 2018 and 2017, the Hospital recognized revenue of \$193,000 and \$118,000 respectively, which has been included in other operating revenue in the consolidated statement of operations. Changes in management's estimates could impact the operations in the period in which the change occurs. The Hospital's attestation to meaningful use of EHR is subject to audit by the federal government or its designee.

## **Hugh Chatham Memorial Hospital, Inc. and Affiliates**

### **Notes to Consolidated Financial Statements**

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#### ***Recently Issued Accounting Pronouncements***

In February 2016, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2016-02, Leases (Topic 842), which supersedes Topic 840, Leases. ASU 2016-02 requires a lessee to recognize in the statement of financial position a liability to make lease payments (the lease liability) and a right-of-use asset representing its right to use the underlying asset for the lease term. For leases with a term of 12 months or less for which there is not an option to purchase the underlying asset that the lessee is reasonably certain to exercise, a lessee is permitted to make an accounting policy election by class of underlying asset not to recognize lease assets and lease liabilities and should recognize lease expense for such leases generally on a straight-line basis over the lease term. Certain qualitative disclosures along with specific quantitative disclosures will be required, so that users are able to understand more about the nature of an entity's leasing activities. ASU 2016-02 is effective for the Hospital's September 30, 2021 year end. At transition, lessees and lessors are required to recognize and measure leases at the beginning of the earliest period presented using a modified retrospective approach, which includes a number of optional practical expedients related to the identification and classification of leases that commenced before the effective date of ASU 2016-02. An entity that elects to use the practical expedients will, in effect, continue to account for leases that commenced before the effective date in accordance with previous GAAP unless the lease is modified, except that lessees are required to recognize a right-of-use asset and a lease liability for all operating leases at each reporting date based on the present value of the remaining minimum rental payments that were tracked and disclosed under previous GAAP. The Hospital is currently evaluating the effect the adoption of this standard will have on its consolidated financial statements.

In August 2016, the FASB issued ASU 2016-14, Not-For-Profit Entities (Topic 958): Presentation of Financial Statements of Not-For-Profit Entities. This amendment changes how a not-for-profit entity classifies its net assets, as well as the information it presents in financial statements and notes about its liquidity, financial performance and cash flows. This amendment requires amended presentation and disclosures to help not-for-profits provide more relevant information about their resources to donors, grantors and other users. The amendment will be effective for the Hospital's fiscal year ending September 30, 2019. The Hospital is currently evaluating the effect of the pending adoption of ASU 2016-14 on its consolidated financial statements.

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers (Topic 606). This standard outlines a single comprehensive model for companies to use in accounting for revenue arising from contracts with customers and supersedes most current revenue recognition guidance, including industry-specific guidance. The core principle of the revenue model is that revenue is recognized when a customer obtains control of a good or service. A customer obtains control when it has the ability to direct the use of and obtain the benefits from the good or service. Transfer of control is not the same as transfer of risks and rewards, as it is considered in current guidance. The Hospital will also need to apply new guidance to determine whether revenue should be recognized over time or at a point in time. In August 2015, the FASB issued ASU 2015-14 which defers the effective date of ASU 2014-09 one year. ASU 2014-09, as deferred by ASU 2015-14, will be effective for the Hospital's fiscal year ending September 30, 2020 using either of two methods: (a) retrospective to each prior reporting period presented with the option to elect certain practical expedients as defined within ASU 2014-09; or (b) retrospective with the cumulative effect of initially applying ASU 2014-09 recognized at the date of initial application and providing certain additional disclosures as defined in ASU 2014-09. The Hospital has not yet selected a transition method and is currently evaluating the effect of the pending adoption of ASU 2014-09 on its consolidated financial statements.

#### ***Subsequent Events***

The Hospital evaluated the effect subsequent events would have on the consolidated financial statements through January 22, 2019, which is the date the consolidated financial statements were available for issuance.

### **3. Net Patient Service Revenue, Less Provision for Uncollectible Accounts**

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

- **Medicare** - Inpatient acute care services rendered to Medicare program beneficiaries are paid at prospectively determined rates per discharge using a DRG (Diagnosis-Related Group) system. These rates vary according to patient classification and clinical, diagnostic and other factors. Inpatient non-acute services, and certain defined capital and medical education costs related to Medicare beneficiaries, are paid based on a cost reimbursement methodology. Inpatient capital costs are paid at prospectively determined rates as a component of the DRG payment. Certain outpatient services are paid based on APCs (Ambulatory Payment Classifications), the outpatient equivalent of DRGs. Certain outpatient Medicare services paid under a Medicare fee schedule and certain therapy charges are exempt from this payment method. The Hospital is reimbursed for cost-reimbursable items at a tentative rate, with final settlement determined after submission of annual cost reports by the Hospital and audits thereof by the Medicare fiscal intermediary. The Hospital's Medicare cost reports have been audited and final settled by the fiscal intermediary for cost report years ended through September 30, 2013, excluding the year ended September 30, 2012 which has been reopened.
- **Medicaid** - The North Carolina Department of Human Resources Division of Medical Assistance reimburses costs for Medicaid inpatient services using a payment per discharge system with case-mix adjustments based on DRGs similar to those used by the Medicare program. Outpatient services rendered to Medicaid program beneficiaries are reimbursed under a cost reimbursement methodology. The Hospital is reimbursed at a tentative rate with final settlement determined after it submits its annual Medicaid cost reports. The Hospital's Medicaid cost reports have been audited and final settled by the Medicaid program through September 30, 2014.
- **Other** - The Hospital has also entered into payment agreements with certain commercial insurance carriers, health maintenance organizations and preferred provider organizations, and directly with local employers. The bases for payment to the Hospital under these arrangements include prospectively determined rates per discharge, discounts from established charges, and prospectively determined daily rates.

Revenues from the Medicare and Medicaid programs accounted for approximately 44% and 41% of the Hospital's patient revenue for the years ended 2018 and 2017, respectively. Laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term.

Net patient service revenue increased approximately \$540,000 and \$613,000 in the years ended September 30, 2018 and 2017, respectively, due to prior-year retroactive adjustments varying from amounts previously estimated.

The Hospital recognizes patient service revenue associated with services provided to patients who have third-party payor coverage on the basis of contractual rates for the services rendered. For uninsured patients that do not qualify for charity care, the Hospital recognizes revenue on the basis of its standard rates for services provided (or on the basis of discounted rates, if negotiated or provided by policy). On the basis of historical experience, a significant portion of the Hospital's uninsured patients will be unable or unwilling to pay for the services provided. Thus, the Hospital records a significant provision for uncollectible accounts related to uninsured patients in the period the services are provided.

**Hugh Chatham Memorial Hospital, Inc. and Affiliates**  
**Notes to Consolidated Financial Statements**

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The composition of net patient service revenue for the years ended September 30 is as follows:

	<u>2018</u>	<u>2017</u>
Gross patient service charges	<b>\$ 316,858,245</b>	\$ 311,574,494
Less: contractual allowances and discounts	<b>(202,198,075)</b>	(199,637,846)
Less: charity care	<b>(4,580,879)</b>	(5,193,014)
Patient service revenue, net of contractual allowances, discounts and charity care	<b>110,079,291</b>	106,743,634
Less: provision for uncollectible accounts	<b>(16,893,472)</b>	(14,305,066)
Net patient service revenue	<b><u>\$ 93,185,819</u></b>	<b><u>\$ 92,438,568</u></b>

In April 2012, the Centers for Medicare and Medicaid Services (“CMS”) approved a North Carolina Medicaid Gap Assessment Plan (“GAP”) to reduce the gap between Medicaid/ uninsured costs and payments retroactive to January 1, 2011. Hospitals that participate in the program pay an assessment fee and, in turn, receive a payment from GAP.

The Hospital paid approximately \$2,258,000 and \$2,498,000 and recognized (received) approximately \$4,305,000 and \$5,270,000 for the years ended September 30, 2018 and 2017, respectively, for the GAP program. The net impact of approximately \$2,048,000 and \$2,772,000 is included in other operating revenue on the consolidated statement operations.

***Medicaid Disproportionate Share Program***

The Hospital participates in a voluntary Medicaid disproportionate share program (the “Program”). The Program allows the Hospital to receive additional annual Medicaid funding. Prior to 2001, funding was received prior to final approval of the Program by the Centers for Medicare and Medicaid Services (“CMS”) and was subject to final settlement by the state of North Carolina once approved by CMS. Beginning in 2001, CMS approved the Program year concurrent with the funding of the Program. Program years run concurrent with the federal fiscal year, which is the period from October 1 through September 30. Fiscal years through 2007 have been final settled or determined to be prospective and no settlement is anticipated. Fiscal years 2009 through 2013 are pending final settlement as of September 30, 2018; however, with increased history of no settlements being required, management released or reclassified all Program reserves in prior year. No Program monies were received during the year ending September 30, 2018. Management will continue to evaluate the program and the likelihood of settlement annually.

**Hugh Chatham Memorial Hospital, Inc. and Affiliates**  
**Notes to Consolidated Financial Statements**

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**4. Concentration of Credit Risk**

The Hospital maintains deposits at various financial institutions covered by federal depository insurance ("FDIC"). At various times throughout the year, the Hospital may maintain amounts in excess of the FDIC-insured limits. The Hospital believes that any credit risk related to these deposits is minimal.

The Hospital grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payor agreements. The mix of net patient receivables from patients and third-party payors as of September 30 was as follows:

	<u>2018</u>	<u>2017</u>
Medicare	14%	14%
Medicaid	4	4
Commercial insurance	57	61
Self-pay patients	<u>25</u>	<u>21</u>
	<u>100%</u>	<u>100%</u>

**5. Investments**

The composition of investments at September 30, 2018 and 2017 is set forth in the following table. Investments are stated at fair value.

	<u>2018</u>	<u>2017</u>
Cash and money market	\$ 3,116,714	\$ 4,007,615
U.S. government securities		
FNMA notes	5,842,686	6,021,035
Federal farm credit	959,360	970,160
U.S. Treasury notes	8,523,911	771,090
U.S. Treasury bonds	1,621,001	1,735,006
Corporate bonds	18,593,233	21,154,904
Equity securities		
Domestic equity securities	86,430,814	85,982,640
International equity securities	282,695	287,051
Mutual funds	17,753,567	11,662,517
Accrued interest	<u>254,287</u>	<u>210,705</u>
Total investments	<u>\$ 143,378,268</u>	<u>\$ 132,802,723</u>

**Hugh Chatham Memorial Hospital, Inc. and Affiliates**  
**Notes to Consolidated Financial Statements**

Investment income and gains (losses) on assets limited as to use, cash equivalents, and other investments are comprised of the following for the years ended September 30:

	<u>2018</u>	<u>2017</u>
Nonoperating revenues and expenses:		
Interest and dividends (net of expenses of approximately \$609,000 in 2018 and \$592,000 in 2017)	\$ 2,786,485	\$ 3,242,602
Recognized losses on other than temporarily impaired investments	(2,740,715)	(713,954)
Net realized gains on sale of investments	<u>9,332,991</u>	<u>9,047,346</u>
	<u>\$ 9,378,761</u>	<u>\$ 11,575,994</u>
Other changes in unrestricted net assets:		
Net unrealized gain on investments	<u>\$ 1,195,727</u>	<u>\$ 6,159,278</u>

The Hospital recorded a loss on investments held at September 30, 2018 and 2017 in nonoperating revenues and expenses that are considered other than temporarily impaired or for which there is a lack of ability and intent to hold the investment until recovery, based on the policy outlined in Note 2.

***Risks and Uncertainties***

The Hospital invests in various investment securities. Investment securities are exposed to various risks such as interest rate, market and credit risks. Due to the level of risk associated with certain investment securities, the possibility is reasonable that changes in the values of investment securities will occur in the near term and that these changes could materially affect the amounts reported in the consolidated balance sheets.

**6. Assets limited as to use**

The composition of assets limited as to use at September 30, 2018 and 2017 is set forth in the following table. Investments are stated at fair value.

	<u>2018</u>	<u>2017</u>
By third party for resident trust funds:		
Cash	\$ 63,000	\$ 62,927
By trustee under indenture agreement:		
Cash and money market	4,536,137	4,524,892
U.S. government securities		
Federal farm credit obligations	<u>361,780</u>	<u>388,674</u>
	<u>4,960,917</u>	<u>4,976,493</u>
Less current portion	<u>3,978,240</u>	<u>4,040,297</u>
Assets limited as to use, noncurrent	<u>\$ 982,677</u>	<u>\$ 936,196</u>

**Hugh Chatham Memorial Hospital, Inc. and Affiliates**  
**Notes to Consolidated Financial Statements**

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**7. Property and Equipment**

A summary of property and equipment as of September 30 is as follows:

	<u>2018</u>	<u>2017</u>
Property and equipment:		
Land and land improvements	\$ 11,716,212	\$ 11,732,616
Buildings	91,091,931	89,701,470
Fixed and movable equipment	<u>50,325,204</u>	<u>50,251,874</u>
	153,133,347	151,685,960
Less: accumulated depreciation	<u>(91,414,921)</u>	<u>(87,791,073)</u>
	61,718,426	63,894,887
Construction-in-progress	<u>585,623</u>	<u>1,097,506</u>
Property and equipment, net	<u>\$ 62,304,049</u>	<u>\$ 64,992,393</u>

There is \$81,290 in land held for sale in other assets on the consolidated balance sheet that was received as the result of a donation.

**8. Investment in Joint Venture**

On October 1, 2005, the Hospital entered into a joint venture with Northern Hospital District of Surry County to combine and operate the hospice services previously provided separately. Hospice of Surry County, Inc., d/b/a Mountain Valley Hospice and Palliative Care (the "Hospice"), is a tax-exempt entity under section 501(c)(3) and is audited separately from the Hospital. The Hospice is equally owned and controlled by the Hospital and Northern Hospital District of Surry County. The Hospital transferred assets including cash and capital assets to the new entity in exchange for the investment in joint venture.

On February 2, 2018, the Hospital entered into a joint venture with Wake Forest University Baptist Medical Center ("Wake Forest") to form Alleghany Health, LLC and operate hospital services at Alleghany Memorial Hospital, Inc. Alleghany Memorial Hospital, Inc. (the "Alleghany"), is a tax-exempt entity under section 501(c)(3). The Hospital transferred assets of approximately \$2,068,000 to Alleghany in exchange for the investment in joint venture.

Income or loss from joint ventures is reported on a consistent basis with the Hospital's reporting. The Hospital's portion of operating income or loss of the Hospice and Alleghany is reported as other operating revenue in unrestricted revenues; and nonoperating revenues and expenses of Hospice and Alleghany are reported as income from investment in joint venture in nonoperating revenues and expenses. The Hospital's portion of operating income (loss) reported for the years ended September 30, 2018 and 2017 was approximately \$(620,000) and \$(338,000), respectively. The Hospital's portion of nonoperating revenues for the years ended September 30, 2018 and 2017 was approximately \$1,267,000 and \$295,000, respectively. The total investment at September 30, 2018 and 2017 was approximately \$8,405,000 and \$5,332,000 respectively.

**Hugh Chatham Memorial Hospital, Inc. and Affiliates**  
**Notes to Consolidated Financial Statements**

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**9. Long-Term Debt**

Long-term debt at September 30 consists of the following:

	<u>2018</u>	<u>2017</u>
North Carolina Medical Care Commission Healthcare Facilities Refunding Revenue Bonds, Series 2015, serial bonds with principal maturing in varying annual amounts through fiscal year 2030, and interest paid semi-annually at 3.26%	\$ 22,195,000	\$ 23,845,000
North Carolina Medical Care Commission Variable Rate Demand Health Care Facilities Revenue Bonds, Series 2008, serial bonds with principal maturing in varying annual amounts through fiscal year 2038	<u>39,975,000</u>	<u>40,760,000</u>
	<b>62,170,000</b>	64,605,000
Less: current portion	<b>(2,465,000)</b>	(2,435,000)
Less: unamortized debt issuance costs	<b>(188,747)</b>	(238,185)
Long-term debt, net of current portion	<u><b>\$ 59,516,253</b></u>	<u>\$ 61,931,815</u>

During 2008, the Hospital issued \$45.4 million North Carolina Medical Care Commission Variable Rate Demand Health Care Facilities Revenue Bonds. Interest on the financing project is computed at variable rates subject to adjustment as stipulated in the loan agreements. During the year ended September 30, 2013, the Hospital converted the 2008 bonds to a direct purchase index interest rate mode with Wells Fargo Bank. At September 30, 2018 and 2017 interest on the bonds was for 3.52% and 4.09%, respectively.

Two interest rate swap agreements are being used to reduce interest rate risk and to manage interest expense. By entering into these agreements, the Hospital changed the fixed/variable interest rate mix of its debt portfolio. During the year ended September 30, 2008, the Hospital entered into an interest-rate swap agreement with a notional principal amount of approximately \$23 million related to existing debt. During the year ended September 30, 2009, the Hospital entered into a second interest rate swap agreement with a notional principal amount of approximately \$23 million related to existing debt. The agreements effectively converted variable-rate debt into fixed-rate debt. This reduced the Hospital's risk of incurring higher interest costs in periods of rising interest rates. These agreements effectively fixed the interest rate exposure on the variable-rate debt to fixed rates of 3.148% and 2.510% for each principal amount of approximately \$23 million exclusive of a portion of the direct purchase interest rate on the Series 2008 bonds. The conversion of the 2008 bonds to a direct purchase index interest rate mode resulted in the deemed issuance and sale of \$43,600,000 aggregate principal amount of the bonds for the purpose of refunding the 2008 Bonds. The swap agreements expire October 1, 2038. Based on forecasted market rates for the remaining period of the agreements, the combined fair value of the interest rate swap agreements resulted in a liability of the Hospital of approximately \$2,422,000 and \$4,971,000 at September 30, 2018 and 2017, respectively.



**Hugh Chatham Memorial Hospital, Inc. and Affiliates**  
**Notes to Consolidated Financial Statements**

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**10. Capital Lease Obligations**

The Hospital leases various vehicles under capital leases. The monthly payments range from \$234 to \$480 per month, including interest ranging from at approximately 3.4% to 9.4%. The leases expire on various dates through 2023.

At September 30, future minimum lease payments required under capital leases are as follows:

2019	\$	50,233
2020		50,233
2021		49,573
2022		38,041
2023		<u>5,855</u>
Total minimum lease payments		193,935
Less interest		<u>(26,477)</u>
		167,458
Less current portion		<u>(39,474)</u>
Noncurrent portion	\$	<u>127,984</u>

As of September 30, 2018, depreciable capital assets on the consolidated balance sheet included \$161,887 of equipment under capital leases, net of accumulated depreciation of \$37,241. Amortization of property under capital leases is included in depreciation and amortization expense.

**11. Temporarily Restricted Net Assets**

Temporarily restricted net assets are available for the following purposes at September 30:

	<u>2018</u>	<u>2017</u>
Capital campaign	\$ 3,562,990	\$ 3,433,108
Other	<u>347,001</u>	<u>191,161</u>
	<u>\$ 3,909,991</u>	<u>\$ 3,624,269</u>

**12. Board-Designated Endowment Funds**

The Foundation's board-designated endowment consists of funds established for a variety of purposes. The endowment includes no donor-restricted endowment funds and is therefore reported as unrestricted. As required by generally accepted accounting principles ("GAAP"), net assets associated with endowment funds are classified and reported based on the existence or absence of donor-imposed restrictions.

**Hugh Chatham Memorial Hospital, Inc. and Affiliates**  
**Notes to Consolidated Financial Statements**

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***Interpretation of Relevant Law***

The Foundation has interpreted the Uniform Prudent Management of Institutional Funds Act (UPMIFA) as requiring the preservation of the fair value of the original designated endowment funds, absent board action to the contrary. As a result of this interpretation, the Foundation classifies as board-designated net assets (a) the original value of gifts designated as endowment, (b) the original value of any subsequent designations to the endowment, and (c) accumulations to the endowment earnings at the discretion of the board is added to the fund. In accordance with UPMIFA, the Foundation considers the following factors in making a determination to appropriate or accumulate earnings within the endowment funds:

- The duration and preservation of the fund
- The purposes of the Foundation's endowment fund
- General economic conditions
- The possible effect of inflation and deflation
- The expected total return from income and the appreciation of investments
- Other resources of the Foundation
- The investment policies of the Foundation

**Endowment Net Asset Composition by Type of Fund as of September 30, 2018**

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Endowment funds				
Board-designated	<u>\$ 618,674</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 618,674</u>

**Endowment Net Asset Composition by Type of Fund as of September 30, 2017**

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Endowment funds				
Board-designated	<u>\$ 618,674</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 618,674</u>

***Return Objectives and Risk Parameters***

The Foundation has adopted investment and spending policies for endowment assets that attempt to provide a predictable stream of funding to programs supported by its endowment while seeking to maintain the purchasing power of the endowment assets. Endowment assets include those assets designated by the Board of the Foundation with the intent to hold the assets in perpetuity. Under this policy, as approved by the Board, the endowment assets are invested in a manner that is intended to produce results that exceed the price and yield results of the S&P 500 Index while assuming a moderate level of investment risk. The Foundation expects its endowment funds, over time, to provide an average rate of return on equity investments comparable to the S&P 500 average and a fixed-income yield comparable to market indices annually. Actual returns in any given year may vary from this amount.

***Spending Policy and How the Investment Objectives Relate to Spending Policy***

The Foundation has a policy of spending the net investment earnings of the assets, but spending is ultimately at the Board's discretion. Accordingly, over the long term, the Foundation expects the current spending policy to use investment earnings, in whole or in part, and allow its endowment to grow through earnings.

**13. Employee Health Benefit Plan**

The Hospital has a nontrusteed Employee Health Benefit Plan (the "Plan") for the purpose of providing health and welfare benefits for its employees and their eligible dependents. The Plan is funded by Hospital contributions and employee withholdings. Benefits provided are similar to those previously provided through group insurance contracts. Monthly contributions are made based upon expected claims for the year, and such contributions are recorded as expenses when made. Total employee health benefit plan expense for the years ended September 30, 2018 and 2017 was approximately \$7,098,000 and \$5,772,000 respectively. The Hospital's liability for claims payable of approximately \$736,000 and \$751,000 at September 30, 2018 and 2017, respectively, is included in accrued expenses within the accompanying consolidated balance sheets.

**14. Employee Savings Plan**

The Hospital's 401(k) plan covers substantially all employees who have completed one year of service and have attained 21 years of age. The Hospital contributes 50% of the first 4% of base compensation that an employee contributes to the 401(k) plan. The 401(k) plan also provides for a gain-sharing contribution to be made at the discretion of the Hospital's Board of Trustees. The Hospital's contribution to the 401(k) plan was approximately \$587,000 and \$577,000 for the years ended September 30, 2018 and 2017, respectively.

**15. Commitments and Contingencies**

The Hospital is subject to legal proceedings and claims that arise in the course of providing healthcare services. The Hospital is self-insured for malpractice claims up to \$1,000,000 per occurrence and is insured through a third-party general liability policy for claims arising that exceed this limit, with a maximum of \$5,000,000. At September 30, 2018 and 2017, the Hospital has recorded a liability for potential unasserted claims in the amount of approximately \$2,300,000 and \$1,800,000 respectively. This liability is included in accrued expenses within the accompanying consolidated balance sheets.

The Hospital is involved in litigation arising in the normal course of business. After consultation with legal counsel, management estimates these matters will be resolved without a material adverse effect on the Hospital's financial position or results of operations.

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, government healthcare program participation requirements, reimbursement for patient services, and Medicare and Medicaid fraud and abuse. Recently, government activity has increased with respect to investigations and allegations concerning possible violations of fraud and abuse statutes and regulations by healthcare providers.

## **Hugh Chatham Memorial Hospital, Inc. and Affiliates**

### **Notes to Consolidated Financial Statements**

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Management believes the Hospital is in compliance with fraud and abuse as well as other applicable government laws and regulations. Compliance with such laws and regulations can be subject to future government review and interpretation as well as regulatory actions unknown or unasserted at this time. 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.

The Hospital has a contract with an outside organization to provide equipment and staffing for a radiation oncology department. Fees paid to the organization total approximately \$1,155,000 for the years ended September 30, 2018 and 2017. The contract ended June 30, 2018 and was renewed through June 30, 2019.

The Hospital has committed to provide certain financial assistance pursuant to recruiting agreements with various physicians practicing in the communities it serves. In consideration for a physician relocating to the community and agreeing to engage in private practice for the benefit of the respective community, the Hospital may loan certain amounts of money to a physician, normally over a period of two years, to assist in establishing his or her practice. The Hospital has guarantee agreements with maximum payments of approximately \$1,430,000 and \$1,280,000 at September 30, 2018 and 2017, respectively, over periods of one to two years. The payments are forgiven over the two- to five-year contract periods.

As of September 30, 2018 and 2017, the Hospital had paid approximately \$1,253,000 and \$1,062,000, respectively, related to the agreements, and expected to make additional payments, which are recorded in physician recruitment guarantee liabilities in the accompanying consolidated financial statements, totaling approximately \$177,000 and \$219,000, respectively. During the years ended September 30, 2018 and 2017, approximately \$152,000 and \$238,000, respectively, was recorded as amortization expense related to the agreements.

#### **16. Management Agreement**

The Hospital entered into a management agreement in June 2006 with an unrelated corporation whereby the management company will perform management and administration services on a day-to-day basis. The agreement, which expired in June 2016 and was renewed in October 2016 with terms extended to September 2021, calls for a base management fee of approximately \$220,000 in the first year with annual increases to approximate the increase in consumer price index. In addition to the annual fee, the Hospital is required to pay the salaries, bonuses agreed upon by the Board, and all fringe benefits of the management company's key personnel who perform the administrative duties. The Hospital ended the management agreement in November 2017. For the years ended September 30, 2018 and 2017, the management fees were approximately \$35,000 and \$233,000, respectively. The amount of salary and fringe benefit expense related to the agreement was approximately \$39,000 and \$480,000 for the years ended September 30, 2018 and 2017, respectively.

The Hospital entered into a shared services agreement in July 2017 with Wake Forest whereby Wake Forest will perform operational and other services on a day-to-day basis. The agreement, which expires in June 2019, calls for annual shared service offerings approximately \$68,000 a year. For the years ended September 30, 2018 and 2017, the shared service fees were approximately \$68,000 and \$11,000, respectively.

#### **17. Fair Value of Financial Assets and Liabilities**

The carrying amounts of cash and cash equivalents and accounts receivable approximate fair value because of the short maturity of these financial instruments. Investments are reported at fair value. The carrying amounts of accounts payable, accrued liabilities, and estimated third-party settlements approximate fair value because of the short maturity of these financial instruments.

**Hugh Chatham Memorial Hospital, Inc. and Affiliates**  
**Notes to Consolidated Financial Statements**

Prices for certain cash equivalents, such as commercial paper and money market mutual funds, and investment securities are readily available in the active markets in which those securities are traded, and the resulting fair values are categorized as Level 1. Prices for mortgage-backed securities and interest rate swaps are determined on a recurring basis based on inputs that are readily available in public markets or can be derived from information available in publicly quoted markets and are categorized as Level 2. Interest rate swap values are based on present value of discounted future cash flows.

There were no changes during the years ended September 30, 2018 and 2017 to the Hospital's valuation techniques used to measure asset and liability fair values on a recurring basis.

The following table sets forth by level within the fair value hierarchy the Hospital's financial assets and liabilities accounted for at fair value on a recurring basis as of September 30, 2018 and 2017. Assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement. The Hospital's assessment of the significance of a particular input to the fair value measurement requires judgment, and may affect the valuation of fair value assets and liabilities and their placement within the fair value hierarchy levels.

**Assets (Liabilities) at Fair Value as of September 30, 2018**

	<u>(Level 1)</u>	<u>(Level 2)</u>	<u>(Level 3)</u>
Assets:			
Mutual funds	\$ 17,753,567	\$ -	\$ -
Marketable equity securities			
Domestic equity securities	86,430,814	-	-
International equity securities	282,695	-	-
U.S. government securities			
FNMA notes	5,842,686	-	-
U.S. Treasury notes	8,523,911	-	-
U.S. Treasury bonds	1,621,001	-	-
Federal farm credit obligations	1,321,139	-	-
Corporate bonds	<u>18,593,233</u>	-	-
Total assets	<u>\$140,369,044</u>	<u>\$ -</u>	<u>\$ -</u>
Liabilities:			
Interest rate swaps	<u>\$ -</u>	<u>\$ 2,422,007</u>	<u>\$ -</u>

**Assets (Liabilities) at Fair Value as of September 30, 2017**

	<u>(Level 1)</u>	<u>(Level 2)</u>	<u>(Level 3)</u>
Assets:			
Mutual funds	\$ 11,662,517	\$ -	\$ -
Marketable equity securities			
Domestic equity securities	85,982,640	-	-
International equity securities	287,051	-	-
U.S. government securities			
FNMA notes	6,021,035	-	-
U.S. Treasury notes	771,090	-	-
U.S. Treasury bonds	1,735,006	-	-
Federal farm credit obligations	1,358,835	-	-
Corporate bonds	<u>21,154,904</u>	-	-
Total assets	<u>\$128,973,078</u>	<u>\$ -</u>	<u>\$ -</u>
Liabilities:			
Interest rate swaps	<u>\$ -</u>	<u>\$ 4,970,979</u>	<u>\$ -</u>

**Hugh Chatham Memorial Hospital, Inc. and Affiliates**  
**Notes to Consolidated Financial Statements**

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There was no Level 3 activity during the years ended September 30, 2018 and 2017.

The Hospital has approximately \$7,716,000 and \$8,595,000 of cash and cash equivalents and \$254,000 and \$211,000 of accrued interest included in assets limited as to use and investments as of September 30, 2018 and 2017, respectively, which were not classified as a level.

**18. Related-Party Transactions**

The Hospital has sold supplies and provided other services to Hospice. Total supplies and services amounted to approximately \$34,000 and \$45,000 for the years ended September 30, 2018 and 2017, respectively. In addition, at September 30, 2018 and 2017, Hospice owed balances of approximately \$1,000 and \$1,100, respectively, related to these supplies and services.

The Hospital has sold supplies and provided other services to Alleghany. Total supplies and services amounted to approximately \$7,000 for the year ended September 30, 2018. In addition, at September 30, 2018, Alleghany owed a balance of approximately \$4,000 related to these supplies and services.

***Supplementary Information***

**Hugh Chatham Memorial Hospital, Inc. and Affiliates**  
**Consolidating Balance Sheet Information**  
**September 30, 2018**

	<u>Hospital</u>	<u>Foundation</u>	<u>Auxiliary</u>	<u>Eliminations</u>	<u>Consolidated</u>
<b>ASSETS</b>					
Cash and cash equivalents	\$ 7,588,956	\$ 499,544	\$ 194,803	\$ -	\$ 8,283,303
Assets limited as to use	3,978,240	-	-	-	3,978,240
Patient accounts receivable (net of allowance for uncollectible accounts of approximately \$13,311,000)	10,639,546	-	-	-	10,639,546
Other receivables	789,222	4,950	-	(224,503)	569,669
Unconditional promises to give, current	-	236,800	-	(236,800)	-
Supplies	845,141	-	15,929	-	861,070
Prepaid expenses	1,695,229	-	-	-	1,695,229
<b>Total current assets</b>	<b>25,536,334</b>	<b>741,294</b>	<b>210,732</b>	<b>(461,303)</b>	<b>26,027,057</b>
Assets limited as to use, net of current portion	982,677	-	-	-	982,677
Investments	142,043,077	1,335,191	-	-	143,378,268
Property and equipment, net	62,304,049	-	-	-	62,304,049
Investment in joint ventures	8,405,160	-	-	-	8,405,160
Intangible assets and goodwill, net	1,341,488	-	-	-	1,341,488
Other assets	-	81,290	-	-	81,290
<b>Total assets</b>	<b>\$ 240,612,785</b>	<b>\$ 2,157,775</b>	<b>\$ 210,732</b>	<b>\$ (461,303)</b>	<b>\$ 242,519,989</b>
<b>LIABILITIES AND NET ASSETS</b>					
Current liabilities:					
Current portion of capital lease obligations	\$ 39,474	\$ -	\$ -	\$ -	\$ 39,474
Current portion of long-term debt	2,465,000	-	-	-	2,465,000
Interest payable	466,733	-	-	-	466,733
Accounts payable	2,672,854	-	9,631	-	2,682,485
Accrued expenses	8,979,225	224,503	192,000	(416,503)	8,979,225
Resident trust funds	63,000	-	-	-	63,000
Physician recruitment guarantee	177,342	-	-	-	177,342
Estimated third-party payor settlements payable	4,162,045	-	-	-	4,162,045
<b>Total current liabilities</b>	<b>19,025,673</b>	<b>224,503</b>	<b>201,631</b>	<b>(416,503)</b>	<b>19,035,304</b>
Interest rate swaps	2,422,007	-	-	-	2,422,007
Capital lease obligations, less current portion	127,984	-	-	-	127,984
Long-term debt, less current portion	59,516,253	-	-	-	59,516,253
	<b>81,091,917</b>	<b>224,503</b>	<b>201,631</b>	<b>(416,503)</b>	<b>81,101,548</b>
Net assets:					
Unrestricted	156,375,956	1,168,193	9,101	(44,800)	157,508,450
Temporarily restricted	3,144,912	765,079	-	-	3,909,991
	<b>159,520,868</b>	<b>1,933,272</b>	<b>9,101</b>	<b>(44,800)</b>	<b>161,418,441</b>
<b>Total liabilities and net assets</b>	<b>\$ 240,612,785</b>	<b>\$ 2,157,775</b>	<b>\$ 210,732</b>	<b>\$ (461,303)</b>	<b>\$ 242,519,989</b>

**Hugh Chatham Memorial Hospital, Inc. and Affiliates**  
**Consolidating Statement of Operations Information**  
**Year Ended September 30, 2018**

	<u>Hospital</u>	<u>Foundation</u>	<u>Auxiliary</u>	<u>Eliminations</u>	<u>Consolidated</u>
Unrestricted revenues:					
Patient service revenue, net of contractual allowances, discounts and charity care	\$ 110,079,291	\$ -	\$ -	\$ -	\$ 110,079,291
Provision for uncollectible accounts	(16,893,472)	-	-	-	(16,893,472)
Net patient service revenue	93,185,819	-	-	-	93,185,819
Other operating revenue	1,814,087	-	111,788	(44,800)	1,881,075
Total unrestricted revenues	94,999,906	-	111,788	(44,800)	95,066,894
Expenses:					
Salaries and wages	42,606,994	84,223	18,076	-	42,709,293
Employee benefits	11,522,381	4,552	-	-	11,526,933
Medical supplies and other expenses	35,283,810	66,424	48,172	-	35,398,406
Depreciation and amortization	6,088,220	-	-	-	6,088,220
Interest expense	2,613,417	-	-	-	2,613,417
Total expenses	98,114,822	155,199	66,248	-	98,336,269
Operating income (loss)	(3,114,916)	(155,199)	45,540	(44,800)	(3,269,375)
Nonoperating revenues and expenses:					
Investment income, net	12,050,522	68,954	-	-	12,119,476
Income from investment in joint venture	1,267,090	-	-	-	1,267,090
Change in value of interest rate swaps	2,548,972	-	-	-	2,548,972
Recognized losses on other than temporarily impaired investments	(2,717,923)	(22,792)	-	-	(2,740,715)
Total net nonoperating revenues and expenses	13,148,661	46,162	-	-	13,194,823
Excess of revenues over (under) expenses	10,033,745	(109,037)	45,540	(44,800)	9,925,448
Change in net unrealized gains on investments	1,093,707	102,020	-	-	1,195,727
Gifts, grants and bequests	-	655	-	-	655
Increase (decrease) in unrestricted net assets	<u>\$ 11,127,452</u>	<u>\$ (6,362)</u>	<u>\$ 45,540</u>	<u>\$ (44,800)</u>	<u>\$ 11,121,830</u>