

Hugh Chatham Memorial Hospital, Inc. and Affiliates

Consolidated Financial Statements and

Supplementary Information

Years Ended September 30, 2019 and 2018

Table of Contents

Independent Auditors' Report	1
Consolidated Financial Statements:	
Consolidated Balance Sheets	3
Consolidated Statements of Operations	5
Consolidated Statements of Changes in Net Assets	6
Consolidated Statements of Cash Flows	7
Notes to Consolidated Financial Statements	8
Supplementary Information:	
Consolidating Balance Sheet Information	28
Consolidating Statement of Operations Information	29

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, 2019 and 2018, 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, 2019 and 2018, 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.

New Accounting Pronouncements

As discussed in Note 2 to the financial statements, the Hospital adopted Financial Accounting Standards Board Accounting Standards Update ("ASU") 2016-14, *Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities* and ASU 2014-09, *Revenue from Contracts with Customers (Topic 606)* in 2019. Our opinion is not modified with respect to these matters.

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 28, 2020**

Hugh Chatham Memorial Hospital, Inc. and Affiliates
Consolidated Balance Sheets
September 30, 2019 and 2018

	2019	2018 (As Adjusted)
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 4,210,932	\$ 8,283,303
Assets limited as to use	4,100,521	3,978,240
Patient accounts receivable, net	11,157,378	10,573,712
Other receivables	1,108,631	635,503
Supplies	827,718	861,070
Prepaid expenses	1,976,849	1,695,229
Total current assets	23,382,029	26,027,057
Assets limited as to use, net of current portion	1,024,620	982,677
Investments	147,882,912	143,378,268
Property and equipment, net	59,214,369	62,304,049
Investment in joint ventures	8,284,529	8,405,160
Intangible assets and goodwill, net	1,303,099	1,341,488
Other assets	81,290	81,290
Total assets	<u>\$ 241,172,848</u>	<u>\$ 242,519,989</u>

Hugh Chatham Memorial Hospital, Inc. and Affiliates
Consolidated Balance Sheets
September 30, 2019 and 2018

(Continued)

	2019	2018 (As Adjusted)
LIABILITIES AND NET ASSETS		
Current liabilities:		
Current portion of capital lease obligations	\$ 76,828	\$ 39,474
Current portion of long-term debt	2,495,000	2,465,000
Interest payable	440,898	466,733
Accounts payable	2,692,215	2,682,485
Accrued expenses	8,720,494	8,979,225
Resident trust funds	73,882	63,000
Physician recruitment guarantee	154,753	177,342
Estimated third-party payor settlements payable	865,782	4,162,045
	<u>15,519,852</u>	<u>19,035,304</u>
Total current liabilities		
Interest rate swaps	6,877,967	2,422,007
Capital lease obligations, less current portion	224,841	127,984
Long-term debt, less current portion	57,070,690	59,516,253
	<u>79,693,350</u>	<u>81,101,548</u>
Net assets:		
Without donor restrictions	157,449,914	157,508,450
With donor restrictions	4,029,584	3,909,991
	<u>161,479,498</u>	<u>161,418,441</u>
Total liabilities and net assets	<u>\$ 241,172,848</u>	<u>\$ 242,519,989</u>

See accompanying notes.

Hugh Chatham Memorial Hospital, Inc. and Affiliates
Consolidated Statements of Operations
Years Ended September 30, 2019 and 2018

	<u>2019</u>	<u>2018</u> <u>(As Adjusted)</u>
Unrestricted revenues:		
Net patient service revenue	\$ 101,926,149	\$ 92,655,469
Other operating revenue	2,042,790	2,262,669
Net assets released from restriction	66,263	58,275
Total unrestricted revenues	<u>104,035,202</u>	<u>94,976,413</u>
Expenses:		
Salaries and wages	46,236,366	42,741,421
Employee benefits	12,672,739	11,985,609
Medical supplies and other expenses	36,041,945	34,377,252
Depreciation and amortization	5,887,592	6,088,220
Interest expense	2,557,150	2,613,417
Total expenses	<u>103,395,792</u>	<u>97,805,919</u>
Operating income (loss)	<u>639,410</u>	<u>(2,829,506)</u>
Nonoperating revenues and expenses:		
Investment income, net	8,903,271	12,119,476
Income (loss) from investment in joint ventures	(1,065,920)	828,757
Change in value of interest rate swaps	(4,455,960)	2,547,436
Recognized losses on other than temporarily impaired investments	(2,572,524)	(2,740,715)
Total net nonoperating revenues and expenses	<u>808,867</u>	<u>12,754,954</u>
Excess of revenues over expenses	1,448,277	9,925,448
Change in net unrealized gains (losses) on investments	(1,506,813)	1,195,727
Gifts, grants and bequests	-	655
Change net assets without donor restrictions	<u>\$ (58,536)</u>	<u>\$ 11,121,830</u>

Hugh Chatham Memorial Hospital, Inc. and Affiliates
Consolidated Statements of Changes in Net Assets
Years Ended September 30, 2019 and 2018

	Without Donor Restriction	With Donor Restriction	Total
Balance, September 30, 2017 (As Adjusted)	\$ 146,386,620	\$ 3,624,269	\$ 150,010,889
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 (As Adjusted)	<u>157,508,450</u>	<u>3,909,991</u>	<u>161,418,441</u>
Excess of revenues over expenses	1,448,277	-	1,448,277
Change in net unrealized losses on investments	(1,506,813)	-	(1,506,813)
Gifts, grants and bequests	-	185,856	185,856
Net assets released from restrictions for operations	-	(66,263)	(66,263)
Change in net assets	<u>(58,536)</u>	<u>119,593</u>	<u>61,057</u>
Balance, September 30, 2019	<u>\$ 157,449,914</u>	<u>\$ 4,029,584</u>	<u>\$ 161,479,498</u>

See accompanying notes.

Hugh Chatham Memorial Hospital, Inc. and Affiliates
Consolidated Statements of Cash Flows
Years Ended September 30, 2019 and 2018

	<u>2019</u>	<u>2018</u>
Operating activities:		
Change in net assets	\$ 61,057	\$ 11,407,552
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Loss (gain) on disposal of property and equipment	(182,224)	5,558
Contributions for long-term purposes	(185,856)	(344,652)
Net realized and unrealized gains on investments	(1,348,842)	(7,793,561)
Realized loss (gain) on investment in joint ventures	1,070,631	(1,005,893)
Depreciation and amortization	5,887,592	6,088,220
Deferred financing costs interest	49,437	49,438
Amortization of intangible asset included in medical supplies and other expenses	38,389	46,576
Provision for uncollectible accounts	-	16,893,472
Change in value of interest-rate swap	4,455,960	(2,547,436)
Changes in assets and liabilities:		
Patient accounts receivable	(583,666)	(18,006,216)
Other operating assets, net	(721,396)	232,460
Estimated third-party payor settlements	(3,296,263)	(914,169)
Accounts payable, accrued expenses, and other current liabilities	43,845	1,157,335
Net cash provided by operating activities	<u>5,288,664</u>	<u>5,268,684</u>
Investing activities:		
Purchase of property and equipment	(2,668,031)	(2,904,562)
Proceeds from sale of hospice building	237,029	6,055
(Payments) receipts of physician recruitment guarantees	(22,589)	(41,309)
Purchase of goodwill related to physician practice	-	(79,000)
Contribution to Alleghany Memorial Hospital, Inc. for investment in joint venture	(950,000)	(2,068,403)
Purchase of assets limited as to use and investments	(50,406,371)	(26,511,820)
Sales of assets limited as to use and investments	47,086,345	23,745,412
Net cash used by investing activities	<u>(6,723,617)</u>	<u>(7,853,627)</u>
Financing activities:		
Payment of accounts payable to purchase property and equipment	(307,799)	(110,006)
Contributions for long-term purposes	185,856	344,652
Payments on capital lease obligations	(50,475)	(130,282)
Payments on long-term debt	(2,465,000)	(2,435,000)
Net cash used by financing activities	<u>(2,637,418)</u>	<u>(2,330,636)</u>
Net decrease in cash and cash equivalents	<u>(4,072,371)</u>	<u>(4,915,579)</u>
Cash and cash equivalents, beginning of year	<u>8,283,303</u>	<u>13,198,882</u>
Cash and cash equivalents, end of year	<u>\$ 4,210,932</u>	<u>\$ 8,283,303</u>
Supplemental cash flow disclosure information:		
Cash paid during the year for interest, excluding amounts capitalized	<u>\$ 2,582,985</u>	<u>\$ 2,623,909</u>
Supplemental schedule of noncash investing and financial activities:		
Purchases of property and equipment included in accounts payable	<u>\$ -</u>	<u>\$ 307,799</u>
Property and equipment financed with capital lease	<u>\$ 184,686</u>	<u>\$ 199,128</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, 2019 and 2018. 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

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, 2019 and 2018. 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 were excluded from excess of revenues over expenses, as the investments did 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 approximately \$49,000 related to these amortized costs during the years ended September 30, 2019 and 2018.

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

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, 2019 or 2018.

Physician Recruitment Guarantee

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

Adoption of New Accounting Standards Updates

During fiscal year 2019, the Hospital adopted ASU 2016-14, *Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities*. This guidance is intended to improve the net asset classification requirements and the information presented in the financial statements and notes about a not-for-profit entity's liquidity, financial performance, and cash flows. The 2018 financial statements have been adjusted to reflect retrospective application of the new accounting guidance.

A recap of the net asset reclassifications driven by the adoption of ASU 2016-14 as of September 30, 2018 is as follows:

<u>Net Asset Classifications</u>	<u>ASU 2016-14 Classifications</u>		
	<u>Without Donor Restrictions</u>	<u>With Donor Restrictions</u>	<u>Total Net Assets</u>
As previously presented			
Unrestricted	\$ 157,508,450	\$ -	\$ 157,508,450
Temporarily restricted	-	3,909,991	3,909,991
Net assets as reclassified	\$ 157,508,450	\$ 3,909,991	\$ 161,418,441

Net assets with donor restrictions are those whose use by the Hospital has been limited by donors to a specific time period or purpose. Net assets with donor restrictions are transferred to net assets without donor restrictions 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.

During the year ended September 30, 2019, the Hospital also adopted ASU 2014-09, *Revenue from Contracts with Customers (Topic 606)* and ASU 2015-14, *Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date, using the modified retrospective method (ASC 606)*. The information in the prior year comparative period has not been restated and continues to be reported under the accounting standards in effect for that period. The primary changes of the adoption relate to the presentation of certain information, as described below, and expanded disclosures in this note related to revenue recognition principles, disaggregation of revenues, and other matters.

As a result of the adoption of ASC 606, estimated uncollectible amounts from patients that was previously presented as the provision for uncollectible accounts in the consolidated statement of operations is now considered implicit price concessions (as defined in ASC 606) and therefore included in net patient service revenues in 2019. Such implicit price concessions reflected in net patient service revenue for the year ended September 30, 2019 were \$17,716,001. Prior to October 1, 2018, the provision for bad debts has been presented consistent with the previous revenue recognition standards separately as a component of patient service revenue. Upon adoption of ASC 606, the allowance for doubtful accounts of \$13,311,000 at October 1, 2018, was reclassified as a direct reduction of accounts receivable. Such implicit price concessions continue to be presented as a direct reduction of the accounts receivable.

Hugh Chatham Memorial Hospital, Inc. and Affiliates

Notes to Consolidated Financial Statements

Management has determined that the Hospital has an unconditional right to payment only subject to the passage of time for services provided to date based on just the need to either finalize billing for such services (i.e. charge lag) or to discharge the patient and bill for such services for patients who are still receiving inpatient care in our facilities at the balance sheet date. Accordingly, the Hospital accrues revenues and the related accounts receivable for services performed but not yet billed at the balance sheet date for in-house patients. Thus, management has determined that they do not have any amounts that should be reflected separately as contract assets.

As part of the adoption of ASC 606, the Hospital elected certain available practical expedients under the standard. First, the Hospital has elected the practical expedient allowed under FASB ASC 606-10-18 and does not adjust the promised amount of consideration from patients and third-party payors for the effects of a significant financing component due to the Hospital's expectation that the period between the time the service is provided to a patient and the time that the patient or a third-party payor pays for that service will be one year or less. However, the Hospital does, in certain instances, enter into payment agreements with patients that allow payments in excess of one year. For those cases, the financing component is not deemed to be significant to the contract. Additionally, the Hospital has applied the practical expedient provided by FASB ASC 340-40-25-4 and all incremental customer contract acquisition costs are expenses as they are incurred, as the amortization period of the asset that the Hospital otherwise would have recognized is one year or less in duration.

Net Patient Service Revenue

Net patient service revenue is reported at the amount that reflects the consideration to which the Hospital expects to be entitled in exchange for providing patient care. These amounts are due from patients, third-party payors (including health insurer and government programs) and others. This also includes variable consideration for retroactive revenue adjustments due to settlement of audit, reviews and investigations by third-party payors. Generally, the Hospital bills the patients and third party payors several days after the services are performed or the patient is discharged from the facility. Revenue is recognized as performance obligations are satisfied.

Performance obligations are determined based on the nature of the services provided by the Hospital. Revenue for performance obligations satisfied over time is recognized based on actual charges incurred in relation to total expected charges. The Hospital believes that this method provides a faithful depiction of the transfer of services over the term of the performance obligation based on the inputs needed to satisfy the obligations. Generally, performance obligations satisfied over time relate to patients in our hospital receiving inpatient acute care services. The Hospital measures the performance obligation from admission in to the hospital to the point when it is no longer required to provide services to that patient, which is generally the time of discharge. Revenue for performance obligations satisfied at a point in time generally relate to patients receiving outpatient services or patients and the Hospital does not believe it is required to provide additional goods or services.

Because all of its performance obligations relate to contracts with a duration of less than one year, the Hospital has elected to apply the optional exemption provided in FASB ASC 606-10-50-14(a) and, therefore, is not required to disclose the aggregate amount of the transaction price allocated to performance obligations that are unsatisfied or partially unsatisfied at the end of the reporting period. The unsatisfied or partially unsatisfied performance obligations referred to above are primarily related to inpatient acute care services at the end of the reporting period. The performance obligations for these contracts are generally completed when patients are discharged, which generally occurs within days or weeks of the end of the reporting period.

The Hospital determines the transaction price based on standard charges for goods and services provided, reduced by contractual adjustments provided to third-party payors, discounts provided to uninsured patients in accordance with the Hospital's policy and implicit price concessions provided to uninsured patients. The Hospital determines its estimates of explicit price concessions for contractual adjustments based on contractual agreements, or discount policies and historical experience. The Hospital determines its estimate of implicit price concessions based on its historical collection experience with this class of patients using a portfolio approach as a practical expedient to account for patient contracts as collective groups rather than individually. Management believes that the financial effects of using this practical expedient are not materially different from an individual contract approach.

Hugh Chatham Memorial Hospital, Inc. and Affiliates

Notes to Consolidated Financial Statements

The Hospital has agreements with third-party payors that provide for payments to the Hospital at amounts different from its established rates. A significant portion of the Hospital's net patient service revenues are derived from the third-party payor programs. Revenues received under third-party arrangements are subject to audit and retroactive adjustment.

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 \$1,357,000 and \$1,088,000 for the years ended September 30, 2019 and 2018, 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, 2019.

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 with donor restrictions if they are received with donor stipulations that restrict the donated assets as to use or time. When a donor restriction expires, net assets with donor restrictions are reclassified as net assets without donor restrictions and are reported in the consolidated financial statements as net assets released from restriction.

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 net assets without donor restrictions, 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).

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 year 2018. 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 year ended September 30, 2019, the Hospital did not recognize any revenue. During the year ended September 30, 2018, the Hospital recognized revenue of \$193,000, 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.

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, 2020, 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.

Subsequent Events

The Hospital evaluated the effect subsequent events would have on the consolidated financial statements through January 28, 2020, which is the date the consolidated financial statements were available for issuance.

3. 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. 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, 2015, excluding the year ended September 30, 2012, which has been reopened and the year ended September 30, 2014, which has been amended and tentatively settled.
- **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 43% and 44% of the Hospital's patient revenue for the years ended 2019 and 2018, 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 \$3,971,000 and \$540,000 in the years ended September 30, 2019 and 2018, respectively, due changes in amounts previously estimated as a result of final settlements and changes in estimates.

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

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 implicit price concessions/uncollectible accounts related to uninsured patients in the period the services are provided.

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

	<u>2019</u>	<u>2018</u>
Gross patient service charges	\$ 345,298,928	\$ 316,858,245
Less: contractual allowances, discounts, and price concessions	(237,808,978)	(202,728,042)
Less: charity care	<u>(5,563,801)</u>	<u>(4,581,262)</u>
Patient service revenue, net of contractual allowances, discounts, price concessions and charity care	101,926,149	109,548,941
Less: provision for uncollectible accounts	<u>-</u>	<u>(16,893,472)</u>
Net patient service revenue	<u>\$ 101,926,149</u>	<u>\$ 92,655,469</u>

The Hospital's revenues from third-party payors and others for the years ended September 30 are as follows:

	<u>2019</u>	<u>2018</u>
Medicare	\$ 37,830,070	\$ 34,389,241
Medicaid	8,470,051	7,699,658
Commercial insurance	45,425,465	41,293,797
Self-pay patient	7,798,034	7,088,765
Other	<u>2,402,529</u>	<u>2,184,008</u>
	<u>\$ 101,926,149</u>	<u>\$ 92,655,469</u>

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 \$2,198,000 and \$2,258,000 and recognized (received) approximately \$3,818,000 and \$4,305,000 for the years ended September 30, 2019 and 2018, respectively, for the GAP program. The net impact of approximately \$1,620,000 and \$2,048,000 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, 2019; however, with increased history of no settlements being required, management released or reclassified all Program reserves in 2017. No Program monies were received during the year ending September 30, 2019. 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

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>2019</u>	<u>2018</u>
Medicare	11%	14%
Medicaid	3	4
Commercial insurance	65	57
Self-pay patients	<u>21</u>	<u>25</u>
	<u>100%</u>	<u>100%</u>

5. Investments

The composition of investments at September 30, 2019 and 2018, is set forth in the following table. Investments are stated at fair value.

	<u>2019</u>	<u>2018</u>
Cash and money market	\$ 6,282,191	\$ 3,116,714
U.S. government securities		
FNMA notes	5,820,926	5,842,686
Federal farm credit	994,260	959,360
U.S. Treasury notes	10,087,500	8,523,911
U.S. Treasury bonds	1,904,971	1,621,001
Corporate bonds	20,004,365	18,593,233
Equity securities		
Domestic equity securities	84,592,454	86,430,814
International equity securities	288,944	282,695
Mutual funds	17,676,880	17,753,567
Accrued interest	<u>230,421</u>	<u>254,287</u>
Total investments	<u>\$ 147,882,912</u>	<u>\$ 143,378,268</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>2019</u>	<u>2018</u>
Nonoperating revenues and expenses:		
Interest and dividends (net of expenses of approximately \$596,000 in 2019 and \$609,000 in 2018)	\$ 3,288,451	\$ 2,786,485
Recognized losses on other than temporarily impaired investments	(2,572,524)	(2,740,715)
Net realized gains on sale of investments	<u>5,614,820</u>	<u>9,332,991</u>
	<u>\$ 6,330,747</u>	<u>\$ 9,378,761</u>
Other changes in net assets without donor restrictions:		
Net unrealized (loss) gain on investments	<u>\$ (1,506,813)</u>	<u>\$ 1,195,727</u>

The Hospital recorded a loss on investments held at September 30, 2019 and 2018, 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, 2019 and 2018, is set forth in the following table. Investments are stated at fair value.

	<u>2019</u>	<u>2018</u>
By third party for resident trust funds:		
Cash	\$ 73,882	\$ 63,000
By trustee under indenture agreement:		
Cash and money market	4,716,375	4,536,137
U.S. government securities		
Federal farm credit obligations	<u>334,884</u>	<u>361,780</u>
	<u>5,125,141</u>	<u>4,960,917</u>
Less current portion	<u>4,100,521</u>	<u>3,978,240</u>
Assets limited as to use, noncurrent	<u>\$ 1,024,620</u>	<u>\$ 982,677</u>

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

7. Property and Equipment

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

	<u>2019</u>	<u>2018</u>
Property and equipment:		
Land and land improvements	\$ 11,712,351	\$ 11,716,212
Buildings	91,567,354	91,091,931
Fixed and movable equipment	<u>51,629,230</u>	<u>50,325,204</u>
	154,908,935	153,133,347
Less: accumulated depreciation	<u>(96,345,324)</u>	<u>(91,414,921)</u>
	58,563,611	61,718,426
Construction-in-progress	<u>650,758</u>	<u>585,623</u>
	<u>\$ 59,214,369</u>	<u>\$ 62,304,049</u>
Property and equipment, net		

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 Ventures

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. The Hospital contributed an additional \$950,000 to Alleghany during the year ended September 30, 2019.

Income or loss from joint ventures is reported on a consistent basis with the Hospital's reporting. The Hospital's portion of income or loss of the Hospice and Alleghany is reported as income from investment in joint venture in nonoperating revenues and expenses. The Hospital's income(loss) from investment in joint venture for the years ended September 30, 2019 and 2018, was approximately \$(1,066,000) and \$829,000, respectively. The total investment at September 30, 2019 and 2018, was approximately \$8,285,000 and \$8,405,000, respectively.

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

9. Long-Term Debt

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

	<u>2019</u>	<u>2018</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%	\$ 20,545,000	\$ 22,195,000
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>39,160,000</u>	<u>39,975,000</u>
	59,705,000	62,170,000
Less: current portion	(2,495,000)	(2,465,000)
Less: unamortized debt issuance costs	(139,310)	(188,747)
Long-term debt, net of current portion	<u>\$ 57,070,690</u>	<u>\$ 59,516,253</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, 2019 and 2018, interest on the bonds was for 3.58% and 3.52%, 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 \$6,878,000 and \$2,422,000 at September 30, 2019 and 2018, respectively.

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

The Hospital manages the interest rate risk of its debt portfolio by utilizing interest rate swap agreements. The following table summarizes the general terms for each of the outstanding agreements as of September 30:

Description	Obligator	Fixed Rate Paid	Variable Rate Received	Final Maturity	Notional 2019	Notional 2018
2008 Fixed-interest rate swap agreement A	Wells Fargo	3.148%	64.05% of LIBOR	10/1/2038	\$ 19,580,000	\$ 19,987,500
2008 Fixed-interest rate swap agreement B	Wells Fargo	2.510%	64.05% of LIBOR	10/1/2038	\$ 19,580,000	\$ 19,987,500

	2019 Fair Value	2019 Net Loss	2018 Fair Value	2018 Net Gain
2008A rate swap	\$ 4,181,818	\$ 2,256,442	\$ 1,925,376	\$ 1,366,453
2008B rate swap	<u>2,696,149</u>	<u>2,199,518</u>	<u>496,631</u>	<u>1,180,983</u>
	<u>\$ 6,877,967</u>	<u>\$ 4,455,960</u>	<u>\$ 2,422,007</u>	<u>\$ 2,547,436</u>

On December 1, 2015, the Hospital refinanced the 2003 series bonds through issuance of revenue Series 2015 bonds. The original principal amount of the Series 2003 bonds was \$40,000,000, of which \$25,895,000 was outstanding prior to the refinance. The Series 2015 bonds have an aggregate principal amount of \$25,495,000 and is payable through annual installment through October 1, 2030.

The Series 2008 and Series 2015 bond obligations have been secured by a first lien on substantially all of the assets of the Hospital.

The master trust indenture, reimbursement agreement, continuing covenant agreements, and loan agreements relating to the Series 2008 and 2015 bonds contain certain restrictive covenants. As of September 30, 2019, the Hospital was in compliance with the requirements.

The future debt service requirements of long-term debt based upon the prevailing interest rate at September 30, 2019, are as follows:

	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2020	\$ 2,495,000	\$ 2,323,695	\$ 4,818,695
2021	2,530,000	2,233,636	4,763,636
2022	2,570,000	2,142,074	4,712,074
2023	2,695,000	2,047,248	4,742,248
2024	2,730,000	1,949,666	4,679,666
Thereafter	<u>46,685,000</u>	<u>16,941,165</u>	<u>63,626,165</u>
	<u>\$ 59,705,000</u>	<u>\$ 27,637,484</u>	<u>\$ 87,342,484</u>

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

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:

2020	\$	92,313
2021		91,654
2022		80,122
2023		47,936
2024		<u>29,098</u>
Total minimum lease payments		341,123
Less interest		<u>(39,454)</u>
		301,669
Less current portion		<u>(76,828)</u>
Noncurrent portion	\$	<u>224,841</u>

As of September 30, 2019 and 2018, depreciable capital assets on the consolidated balance sheet included \$293,379 and \$161,887, respectively of equipment under capital leases, net of accumulated depreciation of \$90,435 and \$37,241, respectively. Amortization of property under capital leases is included in depreciation and amortization expense.

11. Net Assets with Donor Restrictions

Net assets with donor restrictions are available for the following purposes at September 30:

	<u>2019</u>	<u>2018</u>
Capital campaign	\$ 3,715,581	\$ 3,562,990
Other	<u>314,003</u>	<u>347,001</u>
	<u>\$ 4,029,584</u>	<u>\$ 3,909,991</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 without restriction. 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

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, 2019

	<u>Without Donor Restriction</u>	<u>With Donor Restriction</u>	<u>Total</u>
Endowment funds:			
Board-restricted	\$ 618,674	\$ -	\$ 618,674

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

	<u>Without Donor Restriction</u>	<u>With Donor Restriction</u>	<u>Total</u>
Endowment funds:			
Board-restricted	\$ 618,674	\$ -	\$ 618,674

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. The Foundation expects current spending will allow the endowment to retain the original fair value of the gifts. There are no underwater funds at September 30, 2019 or 2018.

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, 2019 and 2018, was approximately \$7,269,000 and \$7,098,000 respectively. The Hospital's liability for claims payable of approximately \$825,000 and \$736,000 at September 30, 2019 and 2018, 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 \$671,000 and \$587,000 for the years ended September 30, 2019 and 2018, 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, 2019 and 2018, the Hospital has recorded a liability for potential unasserted claims in the amount of approximately \$1,641,000 and \$2,300,000 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

Management believes the Hospital is in compliance with fraud and abuse laws 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 \$1,191,000 for the years ended September 30, 2019 and 2018. The contract ended June 30, 2019 and was auto-renewed through June 30, 2020.

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 \$993,000 and \$1,430,000 at September 30, 2019 and 2018, respectively, over periods of one to two years. The payments are forgiven over the two- to five-year contract periods.

As of September 30, 2019 and 2018, the Hospital had paid approximately \$834,000 and \$1,253,000, 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 \$155,000 and \$177,000, respectively. During the years ended September 30, 2019 and 2018, approximately \$90,000 and \$152,000, 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 year ended September 30, 2018, the management fees were approximately \$35,000. The amount of salary and fringe benefit expense related to the agreement was approximately \$39,000 for the year ended September 30, 2018.

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, 2019 and 2018, the shared service fees were approximately \$68,000.

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, 2019 and 2018, 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, 2019 and 2018. 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, 2019

	<u>(Level 1)</u>	<u>(Level 2)</u>	<u>(Level 3)</u>
Assets:			
Mutual funds	\$ 17,676,880	\$ -	\$ -
Marketable equity securities			
Domestic equity securities	84,592,454	-	-
International equity securities	288,944	-	-
U.S. government securities			
FNMA notes	5,820,926	-	-
U.S. Treasury notes	10,087,500	-	-
U.S. Treasury bonds	1,904,971	-	-
Federal farm credit obligations	994,260	-	-
Corporate bonds	<u>20,004,365</u>	<u>-</u>	<u>-</u>
Total assets	<u>\$141,370,300</u>	<u>\$ -</u>	<u>\$ -</u>
Liabilities:			
Interest rate swaps	<u>\$ -</u>	<u>\$ 6,877,967</u>	<u>\$ -</u>

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	1,321,137	-	-
Corporate bonds	<u>18,593,233</u>	<u>-</u>	<u>-</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>

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

There was no Level 3 activity during the years ended September 30, 2019 and 2018.

The Hospital has approximately \$11,407,000 and \$7,716,000 of cash and cash equivalents and \$230,000 and \$254,000 of accrued interest included in assets limited as to use and investments as of September 30, 2019 and 2018, 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 \$30,000 and \$34,000 for the years ended September 30, 2019 and 2018, respectively. In addition, at September 30, 2019 and 2018, Hospice owed balances of approximately \$1,000 related to these supplies and services.

The Hospital has sold supplies and provided other services to Alleghany. Total supplies and services amounted to approximately \$16,000 and \$7,000 for the years ended September 30, 2019 and 2018, respectively. In addition, at September 30, 2019 and 2018, Alleghany owed a balance of approximately \$22,000 and \$4,000 related to these supplies and services, respectively.

19. Functional Expenses

The Hospital provides inpatient, outpatient, emergency care services, and long-term care primarily for residents of the Elkin, North Carolina area. Expenses related to providing these services for the year ended September 30, 2019 are approximately:

	<u>Healthcare Services</u>	<u>General & Administrative</u>	<u>Total</u>
Salaries and benefits	\$ 52,440,886	\$ 6,468,219	\$ 58,909,105
Other operating expenses	32,084,539	3,957,406	36,041,945
Depreciation	5,241,134	646,458	5,887,592
Interest	<u>2,276,375</u>	<u>280,775</u>	<u>2,557,150</u>
Total operating expenses	<u>\$ 92,042,934</u>	<u>\$ 11,352,858</u>	<u>\$ 103,395,792</u>

Expenses related to providing these services for the year ended September 30, 2018 are approximately:

	<u>Healthcare Services</u>	<u>General & Administrative</u>	<u>Total</u>
Salaries and benefits	\$ 49,128,455	\$ 5,598,575	\$ 54,727,030
Other operating expenses	30,860,459	3,516,793	34,377,252
Depreciation	5,465,395	622,825	6,088,220
Interest	<u>2,346,064</u>	<u>267,353</u>	<u>2,613,417</u>
Total operating expenses	<u>\$ 87,800,373</u>	<u>\$ 10,005,546</u>	<u>\$ 97,805,919</u>

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

20. Liquidity and Availability of Resources

Financial assets available for general expenditure, without donor or other restrictions limiting their use, within one year of the consolidated balance sheet date are reflected in the balance sheets as current assets and include the following balances at September 30:

	<u>2019</u>	<u>2018</u>
Financial assets at year end:		
Cash and cash equivalents	\$ 4,210,932	\$ 8,283,303
Accounts receivable:		
Patient accounts, net	11,157,378	10,573,712
Other	<u>1,108,631</u>	<u>635,503</u>
Financial assets available to meet general expenditures over the next twelve months	<u>\$ 16,476,941</u>	<u>\$ 19,492,518</u>

The Hospital funds its operations primarily through services charged to patients.

Supplementary Information

Hugh Chatham Memorial Hospital, Inc. and Affiliates
Consolidating Balance Sheet Information
September 30, 2019

	Hospital	Foundation	Auxiliary	Eliminations	Consolidated
ASSETS					
Cash and cash equivalents	\$ 3,399,925	\$ 627,951	\$ 183,056	\$ -	\$ 4,210,932
Assets limited as to use	4,100,521	-	-	-	4,100,521
Patient accounts receivable, net	11,157,378	-	-	-	11,157,378
Other receivables	1,209,029	7,600	-	(107,998)	1,108,631
Unconditional promises to give, current	-	168,518	-	(168,518)	-
Supplies	814,446	-	13,272	-	827,718
Prepaid expenses	1,976,820	-	29	-	1,976,849
Total current assets	22,658,119	804,069	196,357	(276,516)	23,382,029
Assets limited as to use, net of current portion	1,024,620	-	-	-	1,024,620
Investments	146,516,414	1,366,498	-	-	147,882,912
Property and equipment, net	59,214,369	-	-	-	59,214,369
Investment in joint ventures	8,284,529	-	-	-	8,284,529
Intangible assets and goodwill, net	1,303,099	-	-	-	1,303,099
Other assets	-	81,290	-	-	81,290
Total assets	\$ 239,001,150	\$ 2,251,857	\$ 196,357	\$ (276,516)	\$ 241,172,848
LIABILITIES AND NET ASSETS					
Current liabilities:					
Current portion of capital lease obligations	\$ 76,828	\$ -	\$ -	\$ -	\$ 76,828
Current portion of long-term debt	2,495,000	-	-	-	2,495,000
Interest payable	440,898	-	-	-	440,898
Accounts payable	2,683,877	-	8,338	-	2,692,215
Accrued expenses	8,720,494	107,998	130,000	(237,998)	8,720,494
Resident trust funds	73,882	-	-	-	73,882
Physician recruitment guarantee	154,753	-	-	-	154,753
Estimated third-party payor settlements payable	865,782	-	-	-	865,782
Total current liabilities	15,511,514	107,998	138,338	(237,998)	15,519,852
Interest rate swaps	6,877,967	-	-	-	6,877,967
Capital lease obligations, less current portion	224,841	-	-	-	224,841
Long-term debt, less current portion	57,070,690	-	-	-	57,070,690
	79,685,012	107,998	138,338	(237,998)	79,693,350
Net assets:					
Without donor restrictions	156,171,226	1,259,187	58,019	(38,518)	157,449,914
With donor restrictions	3,144,912	884,672	-	-	4,029,584
	159,316,138	2,143,859	58,019	(38,518)	161,479,498
Total liabilities and net assets	\$ 239,001,150	\$ 2,251,857	\$ 196,357	\$ (276,516)	\$ 241,172,848

Hugh Chatham Memorial Hospital, Inc. and Affiliates
Consolidating Statement of Operations Information
Year Ended September 30, 2019

	<u>Hospital</u>	<u>Foundation</u>	<u>Auxiliary</u>	<u>Eliminations</u>	<u>Consolidated</u>
Unrestricted revenues:					
Net patient service revenue	\$ 101,926,149	\$ -	\$ -	\$ -	\$ 101,926,149
Other operating revenue	1,964,036	-	117,272	(38,518)	2,042,790
Net assets released from restriction	66,263	-	-	-	66,263
Total unrestricted revenues	103,956,448	-	117,272	(38,518)	104,035,202
Expenses:					
Salaries and wages	46,139,003	81,881	15,482	-	46,236,366
Employee benefits	12,666,539	6,200	-	-	12,672,739
Medical supplies and other expenses	35,948,365	40,709	52,871	-	36,041,945
Depreciation and amortization	5,887,489	103	-	-	5,887,592
Interest expense	2,557,150	-	-	-	2,557,150
Total expenses	103,198,546	128,893	68,353	-	103,395,792
Operating income (loss)	757,902	(128,893)	48,919	(38,518)	639,410
Nonoperating revenues and expenses:					
Investment income, net	8,810,329	92,942	-	-	8,903,271
Loss from investment in joint venture	(1,065,920)	-	-	-	(1,065,920)
Change in value of interest rate swaps	(4,455,960)	-	-	-	(4,455,960)
Recognized losses on other than temporarily impaired investments	(2,572,524)	-	-	-	(2,572,524)
Total net nonoperating revenues and expenses	715,925	92,942	-	-	808,867
Excess of revenues over (under) expenses	1,473,827	(35,951)	48,919	(38,518)	1,448,277
Change in net unrealized losses on investments	(1,409,096)	(97,717)	-	-	(1,506,813)
Increase (decrease) in net assets without donor restrictions	\$ 64,731	\$ (133,668)	\$ 48,919	\$ (38,518)	\$ (58,536)