

**SOUTHEASTERN REGIONAL MEDICAL CENTER
AND RELATED ORGANIZATIONS**

Financial Statements

**For the Years Ended
September 30, 2017 and 2016**

Southeastern Regional Medical Center and Related Organizations
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September 30, 2017 and 2016

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S. Preston Douglas & Associates, LLP

CERTIFIED PUBLIC ACCOUNTANTS

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Independent Auditor's Report

To the Board of Trustees
Southeastern Regional Medical Center
and Related Organizations
Lumberton, North Carolina

We have audited the accompanying combined financial statements of Southeastern Regional Medical Center and Related Organizations (a North Carolina nonprofit health care corporation) which comprise the combined balance sheets as of September 30, 2017 and 2016, and the related combined statements of operations, combined statements of changes in net assets, combined statements of cash flows for the years then ended, and the related notes to the combined financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standard* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Southeastern Regional Medical Center and Related Organizations as of September 30, 2017 and 2016, and the results of its operations, changes in net assets, and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Other Matters

Other Information

Our audits were conducted for the purpose of forming an opinion on the financial statements as a whole. The accompanying schedule of expenditures of federal awards, as required by Title 2 U.S. *Code of Federal Regulations* Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards*, is presented for purposes of additional analysis and is not a required part of the 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 financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated, in all material respects, in relation to the financial statements as a whole.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated January 5, 2018, on our consideration of Southeastern Regional Medical Center and Related Organizations' internal over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is solely to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the effectiveness of Southeastern Regional Medical Center and Related Organizations' internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering Southeastern Regional Medical Center and Related Organizations' internal control over financial reporting and compliance.



Lumberton, North Carolina
January 5, 2018

Southeastern Regional Medical Center and Related Organizations
Combined Balance Sheets
September 30, 2017 and 2016

	2017	2016
Assets		
Current assets		
Cash and cash equivalents	\$ 23,852,652	\$ 11,826,284
Current portion of assets limited as to use	8,359,627	8,892,120
Patient accounts receivable, net of allowance for doubtful accounts of \$103,492,388 in 2017 and \$106,854,972 in 2016	45,867,761	50,247,799
Other receivables	5,996,329	9,058,357
Inventories	7,542,705	7,820,191
Prepaid expenses	1,969,608	1,975,425
Total current assets	93,588,682	89,820,176
Property and equipment, net	200,043,742	177,292,785
Other assets		
Investments, assets limited as to use, net of current portion	118,790,701	117,520,988
Long-term investments	1,591,617	1,712,872
Total other assets	120,382,318	119,233,860
Total assets	\$ 414,014,742	\$ 386,346,821
Liabilities and Net Assets		
Current liabilities		
Current portion of long-term debt and capital leases	\$ 4,050,488	\$ 3,941,116
Line of credit	10,000,000	-
Accounts payable	4,786,274	5,723,364
Accrued expenses	15,982,288	23,675,651
Estimated third-party payer settlements	3,635,422	6,564,065
Total current liabilities	38,454,472	39,904,196
Long-term liabilities, net of current portion:		
Long-term debt and capital leases	47,957,999	51,906,092
Line of credit - non revolving	27,471,733	-
Accrued pension expense	17,938,038	22,150,977
Share of deficiency in assets of Southeastern Ambulatory Surgery Center, LLC	3,387,308	1,887,308
Total long-term liabilities, net of current portion	96,755,078	75,944,377
Total liabilities	135,209,550	115,848,573
Net assets		
Unrestricted	275,001,475	267,032,811
Temporarily restricted	1,042,139	954,440
Permanently restricted	2,761,578	2,510,997
Total net assets	278,805,192	270,498,248
Total liabilities and net assets	\$ 414,014,742	\$ 386,346,821

See accompanying notes.

Southeastern Regional Medical Center and Related Organizations
Combined Statements of Operations
For the Years Ended September 30, 2017 and 2016

	<u>2017</u>	<u>2016</u>
Unrestricted revenue and other support		
Net patient service revenue	\$ 366,020,935	\$ 378,851,839
Provision for bad debts	(86,163,627)	(74,484,760)
Net patient service revenue less provision for bad debts	<u>279,857,308</u>	<u>304,367,079</u>
Other revenue	<u>12,887,932</u>	<u>12,533,202</u>
Total unrestricted revenue and other support	292,745,240	316,900,281
Operating expenses		
Salaries and benefits	158,894,223	168,700,548
Medical supplies and drugs	52,365,589	57,462,252
Insurance	2,179,338	1,234,403
Depreciation and amortization	19,127,872	19,040,204
Interest expense	1,926,314	1,791,493
Other expenses	68,926,958	65,440,265
Total operating expenses	<u>303,420,294</u>	<u>313,669,165</u>
Operating income	<u>(10,675,054)</u>	<u>3,231,116</u>
Nonoperating gains (losses)		
Interest and dividends	4,108,734	4,811,839
Realized gains (losses)	4,633,404	1,752,821
Unrealized gains (losses)	4,550,363	2,481,080
Investment fees	(495,732)	(546,959)
Total nonoperating gains	<u>12,796,769</u>	<u>8,498,781</u>
Excess of unrestricted revenue and other support over expenses	<u>\$ 2,121,715</u>	<u>\$ 11,729,897</u>

See accompanying notes.

Southeastern Regional Medical Center and Related Organizations
Combined Statements of Changes in Net Assets
For the Years Ended September 30, 2017 and 2016

	2017	2016
Unrestricted net assets		
Excess of unrestricted revenue and other support over expenses	\$ 2,121,715	\$ 11,729,897
Pension adjustment	5,753,864	(1,486,440)
Net assets released from restrictions	93,085	3,404
Increase (decrease) in unrestricted net assets	7,968,664	10,246,861
Temporarily restricted net assets		
Contributions	888,335	764,900
Net assets released from restrictions - operations	(707,551)	(709,235)
Net assets released from restrictions - property and equipment	(93,085)	(3,404)
Increase (decrease) in temporarily restricted net assets	87,699	52,261
Permanently restricted net assets		
Restricted contributions, net of expenses	38,211	6,676
Investment income	212,370	143,275
Increase (decrease) in permanently restricted net assets	250,581	149,951
Increase (decrease) in net assets	8,306,944	10,449,073
Net assets, beginning of year	270,498,248	260,049,175
Net assets, end of year	\$ 278,805,192	\$ 270,498,248

See accompanying notes.

Southeastern Regional Medical Center and Related Organizations
Combined Statements of Cash Flows
For the Years Ended September 30, 2017 and 2016

	2017	2016
Cash flows from operating activities		
Increase (decrease) in net assets	\$ 8,306,944	\$ 10,449,073
Adjustments to reconcile change in net assets to net cash provided (used) by operating activities:		
Depreciation and amortization	19,127,872	19,040,204
Provision for bad debts	86,163,627	74,484,760
Net realized and unrealized gains on investments	(9,183,767)	(4,233,901)
Amortization of original issue discount, premium and bond issue costs	(100,105)	(100,105)
Equity earnings in affiliate	1,500,000	1,550,679
Cash flows from (increase) decrease in:		
Receivables	(78,721,561)	(87,367,533)
Inventories	277,486	(559,586)
Prepaid expenses	5,817	(494,331)
Cash flows from increase (decrease) in:		
Accounts payable	(937,090)	604,825
Accrued expenses	(7,693,361)	(1,581,128)
Accrued pension expense	(4,212,939)	576,170
Third-party payer settlement	(2,928,643)	(5,322,472)
Net cash provided (used) by operating activities	11,604,280	7,046,655
Cash flows from investing activities		
Purchase of property and equipment	(41,878,829)	(23,778,986)
(Increase) decrease in assets limited as to use	8,446,547	14,569,402
(Increase) decrease in other long-term investments	121,255	1,723,721
Net cash provided (used) by investing activities	(33,311,027)	(7,485,863)
Cash flows from financing activities		
Net borrowing on line of credit	10,000,000	-
Borrowing on non-revolving line of credit	27,471,733	-
Principal payments on capital lease obligations	(1,573,618)	(3,668,990)
Principal payments on long-term debt	(2,165,000)	(2,100,000)
Net cash provided (used) by financing activities	33,733,115	(5,768,990)
Net increase (decrease) in cash and cash equivalents	12,026,368	(6,208,198)
Cash and cash equivalents, beginning of year	11,826,284	18,034,482
Cash and cash equivalents, end of year	\$ 23,852,652	\$ 11,826,284

Cash paid for interest in 2017 and 2016 was \$1,854,743 and \$1,714,679, respectively.

See accompanying notes.

Southeastern Regional Medical Center and Related Organizations
Notes to Financial Statements
September 30, 2017 and 2016

Note A - Organization and Summary of Significant Accounting Policies

Organization

Southeastern Regional Medical Center and Related Organizations (the Hospital) is a not-for-profit health care corporation, exempt from federal income tax under Section 501(a) of the Internal Revenue Code (the Code) as an organization described in Section 501(c)(3) whereby only unrelated business income as defined by Section 512(a)(1) of the Code, is subject to federal income tax. The Hospital, located in Lumberton, North Carolina, provides inpatient, outpatient, and emergency care services through acute care as well as primary and specialty care services for residents of southeastern North Carolina.

Combination Policy

The accompanying combined balance sheets, statements of operations, statements of changes in net assets, and statements of cash flows, referred to as "Southeastern Regional Medical Center and Related Organizations," include the accounts of Southeastern Regional Medical Center, Health Horizons, Inc., Southeastern Regional Medical Center Foundation, and Southeastern Regional Physician Services, all of which are under common management. Intercompany balances and transactions have been eliminated in the combination.

Controlled Affiliates of the Hospital

The following entities are controlled affiliates of the Hospital:

Health Horizons, Inc. is a 501(c)(3) not-for-profit corporation. Health Horizons, Inc. includes Southeastern Home Care Services which offers a complete range of skilled nursing care along with physical, occupational, and speech therapy services, as well as case management for eligible people in their homes; Southeastern Home Health which provides services after hospitalization; Southeastern Home Medical Equipment which provides medical, respiratory, and rehabilitation equipment and supplies and Southeastern Hospice which offers medical care and comfort for patients. The Hospital is the sole shareholder of Health Horizons, Inc.

Southeastern Regional Medical Center Foundation (the Foundation) is a 501(c)(3) not-for-profit corporation. The purpose of the Foundation is to: (a) receive grants, bequests, donations, and contributions on behalf of; (b) provide fund-raising and other support to; and (c) make contributions to the Hospital and its related tax-exempt corporations. The Hospital is the sole shareholder of the Foundation.

Southeastern Regional Physician Services (Physician Services) is a 501(c)(3) not-for-profit corporation. The purpose of Physician Services is to operate primary care, specialty, and urgent care clinics throughout Robeson, Bladen, Cumberland, and Scotland counties. The Hospital is the sole shareholder of Physician Services.

Executive Credit Collections is an inactive corporation.

Other Affiliates of the Hospital

The following entity is an affiliate of the Hospital, but is not controlled and is, therefore, not included within these combined financial statements.

Southeastern Ambulatory Surgery Center, LLC (ASC) was formed to operate an ambulatory surgery center focused on providing same-day surgical care, including diagnostic and preventive procedures to patients and is owned jointly by the Hospital and physicians practicing in the Lumberton area.

Use of Estimates

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

Cash and Cash Equivalents

Cash and cash equivalents include certain investments in highly liquid debt instruments with a maturity of three months or less, excluding amounts whose use is limited by board designation or other arrangements under trust agreements or with third-party payers.

Southeastern Regional Medical Center and Related Organizations
Notes to Financial Statements
September 30, 2017 and 2016

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

Cash and Cash Equivalents (continued)

The Hospital maintains cash and cash equivalents on deposit at financial institutions, which at times exceed the limits insured by the Federal Deposit Insurance Corporation. This exposes the Hospital to potential risk of loss in the event the financial institution becomes insolvent.

Patient Accounts Receivable, Allowance for Doubtful Accounts, Provision for Bad Debts

Patient accounts receivable are carried at the original charge less an estimate for doubtful accounts. The Hospital records an allowance for doubtful accounts and bad debt expense for estimated losses resulting from non-payment for accounts receivable for services from patients. The Hospital accounts for uncollectible accounts receivable balances from third-party commercial insurers as reductions to net patient service revenue rather than bad debt expense. Management routinely evaluates account collection history, economic conditions, and trends in health care coverage in determining the sufficiency of the allowance for doubtful accounts and provision for bad debts. Accounts receivable are written off against the allowance for doubtful accounts when management determines that recovery is unlikely.

Assets Limited as to Use and Investments

Assets limited as to use are limited principally to certain funds established to be held and invested by a trustee. These funds are related to the issuance of the Hospital's Revenue Bonds, investments for capital improvements set aside by the Board of Trustees (the Board) over which the Board retains control and may at its discretion subsequently use for other purposes, self-insurance arrangements, and certain permanently restricted endowment assets.

The fair values of individual investments are based on quoted market prices of individual securities or investments or estimated amounts using quoted market prices of similar investments. Realized and unrealized investment returns from all unrestricted investments and assets limited as to use are included in the combined statements of operations as part of nonoperating gains and losses. Investment income (loss) on investments of temporarily or permanently restricted assets is added to or deducted from the appropriate restricted fund balance if the income is restricted. The cost of securities sold is based on the specific-identification method. Investments are classified as either current or noncurrent based on maturity dates and availability for current operations.

Substantially all investments are classified as trading securities, with unrealized gains and losses included in excess of unrestricted revenue and other support in excess of expenses.

Investment Risk and Uncertainties

The Hospital invests in professionally managed portfolios that contain corporate bonds, United States Government obligations, municipal obligations, asset-backed securities, marketable equity securities, and money market funds. Such investments are exposed to various risks, such as interest rate, market, and credit. Due to the level of risk associated with such investments and the level of uncertainty related to changes in the value of such investments, it is at least reasonably possible that changes in risks in the near term would materially affect investment balances and the amounts reported in the financial statements.

Inventories

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

Property and Equipment

Property and equipment acquisitions are recorded at cost. Items acquired by gift are recorded at fair value at the time of acquisition. Depreciation is provided over the estimated useful life of each class of depreciable asset and is computed on the straight-line method.

Asset Impairment

The Hospital considers whether indicators of impairment are present and performs the necessary tests to determine if the carrying value of an asset is appropriate. Impairment write-downs are recognized in operating income at the time the impairment is identified. There was no impairment of long-lived assets in 2017 or 2016.

Southeastern Regional Medical Center and Related Organizations
Notes to Financial Statements
September 30, 2017 and 2016

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

Premiums, Discounts and Deferred Financing Costs on Long-Term Debt

Premiums and discounts arising from the original issuance of long-term debt are amortized on the straight-line basis, which approximates the effective interest method, over the life of the debt. The unamortized portion of these premiums and discounts are included in long-term debt on the combining balance sheets. Deferred financing costs represent costs incurred in conjunction with the issuance of the Hospital's long-term debt. These costs are amortized on a straight-line basis, which approximates the effective interest method, over the life of the debt. The amortization expense of deferred debt issue costs was \$102,394 and \$102,394 for the years ended September 30, 2017 and 2016, respectively.

Net Assets

Resources are classified for reporting purposes into three net asset categories as permanently restricted, temporarily restricted, and unrestricted according to the absence or existence of board designations or donor-imposed restrictions. Permanently restricted net assets have been restricted by donors to be maintained by the Hospital in perpetuity to provide a permanent source of income. Temporarily restricted net assets are those assets whose use by the Hospital has been limited by donors to a specific time period or purpose.

Net Patient Service Revenue

The Hospital has agreements with third-party payers that provide for payments to the Hospital for patient services 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 payers, and others for services rendered, including estimated adjustments under reimbursement agreements with third-party payers. Estimated adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods, as final settlements are determined.

The Hospital's revenues may be subject to adjustment as a result of examination by government agencies or contractors and as a result of differing interpretation of government regulations, medical diagnosis, charge coding, medical necessity, or other contract terms. The resolution of these matters, if any, often is not finalized until subsequent to the period during which the services were rendered.

Financial Assistance and Community Benefits

In support of its mission, the Hospital provides charity care to patients who lack financial resources and are deemed to be medically indigent. Policies have been established that define financial assistance and provide guidelines for assessing a patient's ability to pay. Evaluation procedures for financial assistance qualification have been established for those situations when previously unknown financial circumstances are revealed or when incurred charges are significant when compared to the individual patient's income and/or net assets. Because the Hospital does not pursue collection of amounts determined to qualify as financial assistance, they are not reported as revenue in the accompanying combined statements of operations and changes in net assets.

In addition, the Hospital provides services to other medically indigent patients under various state Medicaid programs that pay providers amounts less than the costs incurred for the services provided to recipients.

Under current accounting standards, the Hospital is required to report the cost of providing financial assistance. The cost of financial assistance provided by the Hospital is based on the Hospital's aggregate cost to charge ratio and totaled \$9,474,457 and \$9,086,253 in 2017 and 2016, respectively.

In addition to its Financial Assistance policy, the Hospital has a long-standing commitment of supporting the community through the provision of outreach services designed to address identified health and social issues. Specifically, the Hospital provides a variety of screening and early detection tests, wellness activities, social support services and educational seminars. A majority of these services are provided at either nominal or no cost to community members.

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

Southeastern Regional Medical Center and Related Organizations
Notes to Financial Statements
September 30, 2017 and 2016

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

is received. The gifts are reported as either temporarily or permanently restricted support if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified to unrestricted net assets if restricted for capital or reported in the statements of operations as net assets released from restrictions if restricted for operating purposes. Donations received with no restrictions and donor-restricted contributions whose restrictions are met within the same year as received are reported as unrestricted contributions in the accompanying combined statements of operations as other operating revenues.

Unconditional promises to give cash or other assets are reported as other receivables and contributions with the appropriate net asset category. An allowance for uncollectible pledges receivable is estimated based on historical experience and other collection indicators.

Excess of Unrestricted Revenue and other Support over Expenses

The accompanying combined statements of operations and changes in net assets include the excess of revenue over expenses. Changes in unrestricted net assets, which are excluded from the excess of revenue over expenses, consistent with industry practice, include contributions of long-lived assets (including assets acquired using contributions, which, by donor restriction, are to be used for the purposes of acquiring such assets) and changes in pension liabilities.

Recent Accounting Pronouncements

Revenue Recognition - In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2014-09, *Revenue from Contracts with Customers (Topic 606)*. This ASU establishes principles for reporting useful information to users of financial statements about the nature, amount, timing, and uncertainty of revenue and cash flows arising from the entity's contracts and customers. Particularly, that an entity recognizes revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for goods or services. ASU 2014-09 is effective for fiscal year 2019, and early adoption is permitted beginning in fiscal year 2018. The Hospital expects to record a decrease in net patient service revenue related to self-pay patients and a corresponding decrease in bad debt expense upon the adoption of this standard.

Debt Issuance Costs - In April 2015, the FASB issued ASU No. 2015-03, *Interest-Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs*. The amendments in this ASU require that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. This guidance was effective for fiscal year 2017. ASU 2015-3 mandates that an entity should apply the new guidance on a retrospective basis, wherein the balance sheet of each individual period presented should be adjusted to reflect the period-specific effects of applying the new guidance. The Hospital modified its presentation of debt issuance costs as described above.

Leases - In February 2016, the FASB issued SSU No. 2016-02, *Leases (ASU 2016-02)*. This ASU amends the existing accounting standards for lease accounting, including requiring lessees to recognize most leases on their balance sheets. The adoption of ASU 2016-02 is effective in fiscal year 2020, and will require application of the new guidance at the beginning of the earliest comparable period presented. Early adoption is permitted. The Hospital is currently assessing the impact of the adoption of ASU No. 2016-02, which is expected to increase the Hospital's assets and liabilities but not have a significant impact on the results of operations.

Not-for-Profit Reporting - The FASB issued ASU No. 2016-14, *Not-for-Profit Entities (ASU 2016-14)*, which amends the requirements for financial statements and notes in Topic 958, Not-for-Profit Entities (NFP), and requires a NFP to:

- Reduce the number of net asset classes presented from three to two, with donor restrictions and without donor restrictions;
- Require all NFP's to present expenses by their functional and their natural classifications in one location in the financial statements;
- Require NFP's to provide quantitative and qualitative information about management of liquid resources and availability of financial assets to meet cash needs within one year of the balance sheet date.

Southeastern Regional Medical Center and Related Organizations
Notes to Financial Statements
September 30, 2017 and 2016

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

Recent Accounting Pronouncements (continued)

Not-for-Profit Reporting – (continued)

The adoption of ASU 2016-14 is effective in fiscal year 2019, and is applied retrospectively in the year of adoption. The Hospital does not anticipate that the adoption of this ASU will have a material impact on its financial position and results of operations.

Note B – Investments and Assets Limited as to Use

Assets measured at fair value are presented in the accompanying combined balance sheet under the following classifications:

	<u>2017</u>	<u>2016</u>
Assets limited as to use, current	\$ 8,359,627	\$ 8,892,120
Assets limited as to use, noncurrent	118,790,701	117,520,988
Long-term investments	<u>1,591,617</u>	<u>1,712,872</u>
	<u>\$ 128,741,945</u>	<u>\$ 128,125,980</u>

Current and long- term assets whose use is limited for 2017 and 2016 are classified as follows:

	<u>2017</u>	<u>2016</u>
Board designated assets, primarily construction and capital	\$ 102,358,720	\$ 101,053,613
Board designated assets, Epic escrow	14,083,501	14,132,476
Bond indenture agreement assets restricted by trustees	2,348,480	2,334,899
Self-insurance assets board designated	<u>8,359,627</u>	<u>8,892,120</u>
	<u>\$ 127,150,328</u>	<u>\$ 126,413,108</u>

Assets Limited as to Use

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

	<u>2017</u>	<u>2016</u>
By board for capital improvements:		
Cash and short-term investments	\$ 2,008,130	\$ 1,231,618
Corporate bonds and other fixed income	52,619,265	54,757,407
Equity securities	35,593,797	36,889,163
Mutual funds	<u>26,221,029</u>	<u>22,307,901</u>
	<u>116,442,221</u>	<u>115,186,089</u>
Held by trustee:		
Cash and short-term investments	<u>2,348,480</u>	<u>2,334,899</u>
Self-insurance program:		
Cash and short-term investments	237,446	111,917
Equity securities	3,915,811	4,234,794
Corporate bonds and other fixed income	<u>4,206,370</u>	<u>4,545,409</u>
	<u>8,359,627</u>	<u>8,892,120</u>
Total investments, assets limited as to use	<u>\$ 127,150,328</u>	<u>\$ 126,413,108</u>

Investment income and gains for assets limited as to use and other investments, including temporarily and permanently restricted assets, are comprised of the following for the years ending September 30:

	<u>2017</u>	<u>2016</u>
Interest, dividends, and gains (losses) permanently restricted	\$ 212,370	\$ 143,275
Interest and dividend income	4,108,734	4,811,839
Realized gains (losses) on trading securities	4,633,404	1,752,821
Unrealized gains (losses) on trading securities	<u>4,550,363</u>	<u>2,481,080</u>
Totals	<u>\$ 13,504,871</u>	<u>\$ 9,189,015</u>

Southeastern Regional Medical Center and Related Organizations
Notes to Financial Statements
September 30, 2017 and 2016

Note C – Equity Method Investments

Southeastern Regional Medical Center and Related Organizations use the equity method to account for their financial interest in Southeastern Ambulatory Surgical Center, LLC (ASC). The operating agreement stipulates that ASC is to have Class A Members, which includes physicians practicing in the Lumberton area and Class B Members, which is the Hospital. ASC is managed by a Board of Managers, which is comprised of three representatives of the Class A Members and three representatives of the Class B Members, each entitled to one vote. ASC files an income tax return as a partnership. As of December 31, 2016, the Hospital owned 172 of the 198 outstanding ASC member units or 86.87%.

The Hospital is a guarantor on the indebtedness of ASC, therefore, the negative investment balance is shown in long-term liabilities on the balance sheet as “Share of Deficiency in Assets of Southeastern Ambulatory Surgery Center, LLC.”

Summarized financial information for ASC, accounted for under the equity method, as of September 30, 2017 and 2016, consists of the following:

	<u>2017</u>	<u>2016</u>
Total assets	\$ 2,848,923	\$ 3,682,939
Total liabilities	<u>6,484,609</u>	<u>5,775,724</u>
Members’ equity	<u>\$ (3,635,686)</u>	<u>\$ (2,092,785)</u>
Net patient revenue	\$ 2,659,121	\$ 2,969,344
Expenses before depreciation and interest expense	<u>3,450,180</u>	<u>3,805,554</u>
Net operating income	\$ (791,059)	\$ (836,210)
Depreciation and interest expense	<u>751,843</u>	<u>733,589</u>
Net income (loss)	<u>\$ (1,542,902)</u>	<u>\$ (1,569,799)</u>
Hospital’s share of deficiency in assets of ASC	<u>\$ (3,387,308)</u>	<u>\$ (1,887,308)</u>

Note D – Fair Value Measurements

The Hospital follows the requirements of ASC 820 in regards to measuring the fair value of certain assets and liabilities as well as disclosures about fair value measurements. ASC 820 defines fair value as the price that would be received for an asset or paid for a transfer of a liability in an orderly transaction on the measurement date.

The methodologies used to determine fair value of assets and liabilities reflect market participant objectives and are based on the applications of a three-level valuation hierarchy that prioritizes observable market inputs over unobservable inputs. The three levels are defined as follows:

- Level 1 – Inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities in active markets.
- Level 2 – Inputs other than Level 1 that are observable, either directly or indirectly, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the same term of the assets or liabilities.
- Level 3 – Inputs are unobservable inputs for the assets or liabilities, which are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

A financial instrument’s categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value instrument.

Southeastern Regional Medical Center and Related Organizations
Notes to Financial Statements
September 30, 2017 and 2016

Note D – Fair Value Measurements (continued)

The following tables present the financial instruments measured at fair value on a recurring basis as of September 30, 2017 and 2016:

	Fair Value as of September 30, 2017			
	Level 1	Level 2	Level 3	Total
Assets:				
Cash and cash equivalents	\$ 23,852,651	\$ -	\$ -	\$ 23,852,651
Trading securities and other assets whose use is limited:				
Cash and cash equivalents	4,594,058	-	-	4,594,058
Corporate bonds and other fixed income	-	56,825,635	-	56,825,635
Equity securities	39,509,608	-	-	39,509,608
Mutual funds	26,221,028	-	-	26,221,028
Other	-	-	1,591,617	1,591,617
Total	<u>\$ 94,177,345</u>	<u>\$ 56,825,635</u>	<u>\$ 1,591,617</u>	<u>\$ 152,594,597</u>

	Fair Value as of September 30, 2016			
	Level 1	Level 2	Level 3	Total
Cash and cash equivalents	\$ 11,826,284	\$ -	\$ -	\$ 11,826,284
Trading securities and other assets whose use is limited:				
Cash and cash equivalents	3,678,434	-	-	3,678,434
Corporate bonds and other fixed income	-	59,302,816	-	59,302,816
Equity securities	41,123,957	-	-	41,123,957
Mutual funds	22,307,901	-	-	22,307,901
Other	-	-	1,712,872	1,712,872
Total	<u>\$ 78,936,576</u>	<u>\$ 59,302,816</u>	<u>\$ 1,712,872</u>	<u>\$ 139,952,264</u>

Valuation Techniques and Inputs

Investments - The fair value of Level 1 investments, which primarily includes equity securities, corporate bonds, mutual funds, and cash, is based on quoted market prices that are valued on a daily basis. Level 2 investments consist of U.S. government securities, corporate bonds and other fixed income investments. The fair value of the U.S. government securities and corporate bonds is established based on values obtained from nationally recognized pricing services that value the investments based on similar securities and matrix pricing of similar quality and maturity securities. Level 3 investments are valued at cost.

The carrying values of cash and cash equivalents, accounts receivable, accounts payable, accrued expenses, and short-term borrowings are reasonable estimates of their fair values due to the short-term nature.

The estimated fair value of the Revenue Bonds, including the current portion, was \$52,002,473 and \$54,369,971 at September 30, 2017 and 2016, respectively. The fair value of this Level 2 liability is based on quoted market prices for the same or similar issues and the relationship of those bond yields with various market indices.

The fair value of pledges receivable, a Level 2 asset, is based on discounted cash flow analysis and approximated the carrying value of \$170,477 and \$303,984 at September 30, 2017 and 2016, respectively.

Southeastern Regional Medical Center and Related Organizations
Notes to Financial Statements
September 30, 2017 and 2016

Note E - Property and Equipment

A summary of property and equipment at September 30 follows:

	2017	2016
Land	\$ 5,854,286	\$ 5,306,117
Land improvements	4,119,781	4,119,781
Buildings and improvements	186,037,792	171,900,088
Furniture and fixtures	23,834,041	23,827,119
Fixed equipment	20,991,262	17,251,719
Moveable equipment	148,896,540	148,269,724
Automobiles	2,111,997	1,874,538
Rental equipment	2,647,539	2,365,502
	394,493,238	374,914,588
Less - Accumulated depreciation and amortization	229,549,700	210,696,314
	164,943,538	164,218,274
Construction in progress	35,100,204	13,074,511
Property and equipment, net	\$ 200,043,742	\$ 177,292,785

Construction in progress consists of building construction and renovations and costs associated with a new system for integrated electronic health records. As these projects are completed, the related assets are transferred out of construction in progress and into the appropriate asset category and are depreciated over the applicable useful lives.

Depreciation expense for the years ended September 30, 2017 and 2016 amounted to \$19,127,872 and \$19,040,204, respectively.

Note F – Self-Insurance Liabilities and Related Insurance Recoverables

The Hospital retains certain levels of professional and general liability risks. For those risks, the Hospital has established trust funds to pay claims and related costs. The Hospital is required to maintain cash and investments sufficient to fund actuarially determined tail liabilities. There are known claims and incidents that may result in the assertion of additional claims, as well as claims from unknown incidents that may be asserted arising from services provided to patients. The Hospital has employed independent actuaries to estimate the ultimate costs, if any, of the settlement of such claims. Accrued provision for malpractice losses in the amount of \$6,008,783 and \$6,165,285 for 2017 and 2016, respectively, are included in current liabilities to cover the Hospital’s malpractice exposure.

Note G – Debt Obligations

Series 2005

On September 15, 2005, North Carolina Medical Care Commission issued Bonds on behalf of Southeastern Regional Medical Center with a face amount of \$20,000,000. The proceeds were used for the acquisition and construction of the heart center and the 7th floor of the bed tower.

Series 2012

In October 2012, the North Carolina Medical Care Commission issued Series 2012 Revenue Refunding Bonds on behalf of Southeastern Regional Medical Center with a face amount of \$40,210,000. The proceeds of the 2012 Bonds were used to refund the Series 1999 Revenue Bonds and the Series 2002 Revenue Bonds and to pay certain expenses incurred in connection with the issuance and sale of the 2012 Bonds. The 2012 Bonds were issued with a premium of \$4,049,963, which is being amortized over the life of the bonds. The accumulated amortization was \$1,012,490 and \$809,992 at September 30, 2017 and September 30, 2016, respectively.

Capital Leases

The Hospital has entered into various lease agreements with Winthrop Resource Corporation to secure information technology equipment dating from 2012 through 2015. The leases are payable over periods of 44 to 60 monthly payments. The total annual payment is approximately \$1,628,714, including interest imputed at 7.1%. The equipment is included in property and equipment on the combined balance sheets and the depreciation of the assets is included in depreciation expense in the amount of \$1,510,858, for the year ended September 30, 2017 and \$1,641,772, for the year ended September 30, 2016.

Southeastern Regional Medical Center and Related Organizations
Notes to Financial Statements
September 30, 2017 and 2016

Note G – Debt Obligations (continued)

Line of Credit

On October 4, 2016, the Hospital entered into a \$10,000,000 line of credit with Branch Bank & Trust “Bank” for the purpose of providing short-term working capital needs. The line of credit bears interest at the adjusted LIBOR rate plus 1.75%. The obligation was set to expire on October 4, 2017. On September 26, 2017, the line of credit was modified with payment terms remaining the same, expiration date set as October 4, 2019. The line of credit includes terms, conditions, and covenants as executed between the Bank and the Hospital on September 1, 2005 Letter of Credit and Reimbursement Agreement, as amended. As of September 30, 2017, the line of credit has a balance of \$10,000,000.

Line of Credit – Non Revolving

On August 31, 2017, the Hospital entered into a non-revolving line of credit in the amount of \$42,160,000 with Branch Bank & Trust “Bank”. Interest is payable monthly, beginning on October 5, 2017, at the adjusted LIBOR rate plus .90%. The obligation matures on February 28, 2018. The purpose of the line of credit is to finance, on an interim basis, the cost of capital projects. The indebtedness outstanding under this line of credit is intended to be refinanced by tax-exempt bonds to be issued by the North Carolina Medical Care Commission for the benefit of the hospital. The line of credit includes terms, conditions, and covenants as executed between the Bank and the Hospital on September 1, 2005 Letter of Credit and Reimbursement Agreement, as amended. As of September 30, 2017, the line of credit has a balance of \$27,471,733.

Long-term debt and capital leases as shown on the balance sheets consisted of the following at September 30:

	<u>2017</u>	<u>2016</u>
Series 2005 Hospital Revenue Bonds; principal maturing in varying annual amounts ranging from \$600,000 to \$1,085,000; interest rate variable, controlled by 91-day Treasury Bill rate	\$ 17,000,000	\$ 17,635,000
Series 2012 Hospital Revenue Refunding Bonds; principal maturing in varying annual amounts ranging from \$1,440,000 to \$2,860,000; interest rates ranging from 2% to 5%	31,965,000	33,495,000
Unamortized premium, net	3,037,473	3,239,971
	<u>35,002,473</u>	<u>36,734,971</u>
Capital leases	1,602,990	3,176,608
Totals	53,605,463	57,546,579
Current portion bond principle and capital leases	(3,847,990)	(3,738,618)
Current portion bond premium amortization	(202,498)	(202,498)
Unamortized cost of issuance	(1,596,976)	(1,699,371)
Long-term portion	<u>\$ 47,957,999</u>	<u>\$ 51,906,092</u>

Scheduled principal and interest repayments on long-term debt and lease obligations, excluding premium, for the next five years are as follows:

	<u>Capital Lease</u>		<u>Long-term debt</u>	
	<u>Principal</u>	<u>Interest</u>	<u>Principal</u>	<u>Interest</u>
2018	\$ 1,602,990	\$ 43,880	\$ 2,245,000	\$ 1,679,462
2019	-	-	2,320,000	1,605,588
2020	-	-	2,400,000	1,529,648
2021	-	-	2,495,000	1,449,437
2022	-	-	2,555,000	1,396,985

Under the terms of the Bond Indenture, the Hospital is required to maintain certain deposits with a trustee. Such deposits are included with assets whose use is limited in the financial statements. The provisions under the Bond Indenture require the Hospital to maintain reporting, financial, and other covenants. The Hospital was in compliance with these provisions at September 30, 2017.

Southeastern Regional Medical Center and Related Organizations
Notes to Financial Statements
September 30, 2017 and 2016

Note H - Pension Benefits

The Hospital has a defined benefit plan that covers substantially all of its employees. The plan benefits are based on years of service and the employees' compensation during the last five years of covered employment. Contributions are intended to provide not only for benefits attributed to service to date but also for those expected to be earned in the future. The plan was amended, effective January 1, 2005, so that no eligible employee hired or rehired on or after January 1, 2005 can become a participant in the plan or accrue any benefits under the plan. Effective December 31, 2009, the plan was amended to cease benefit accruals.

The following table sets forth the changes in benefit obligations, changes in plan assets, and components of net periodic benefit cost for the years ended September 30:

	<u>2017</u>	<u>2016</u>
Change in benefit obligation:		
Benefit obligation at beginning of year	\$ 108,934,388	\$ 103,654,015
Service cost	-	-
Interest cost	4,050,845	4,596,670
Actuarial (gain) loss	(2,153,883)	7,911,087
Benefits paid	<u>(4,422,701)</u>	<u>(7,227,384)</u>
Projected benefit obligation at end of year	<u>\$ 106,408,649</u>	<u>\$ 108,934,388</u>
Change in plan assets:		
Fair value of plan assets at beginning of year	\$ 86,783,411	\$ 82,079,208
Actual return on plan assets	6,109,901	8,931,587
Employer contributions	0	3,000,000
Benefits paid	<u>(4,422,701)</u>	<u>(7,227,384)</u>
Fair value of plan assets at end of year	<u>88,470,611</u>	<u>86,783,411</u>
Funded status	<u>\$ (17,938,038)</u>	<u>\$ (22,150,977)</u>
Amounts recognized in the balance sheet:		
Non-current liabilities	<u>(17,938,038)</u>	<u>(21,150,977)</u>
Total Asset/ (Liability)	<u>\$ (17,938,038)</u>	<u>\$ (22,150,977)</u>
Amounts recognized in Accumulated Other Comprehensive Income:		
Net transition (obligation)/ asset	\$ -	\$ -
Prior service (cost)/ credit	-	-
Net actuarial gain/ (loss)	<u>(29,877,318)</u>	<u>(35,631,182)</u>
Total	<u>\$ (29,877,318)</u>	<u>\$ (35,631,182)</u>

The accumulated benefit obligation for the plan was \$106,408,649 and \$108,934,388 at September 30, 2017 and 2016, respectively.

Components of Net Periodic Benefit Cost and Other Amounts Recognized in Other Comprehensive Income:

	<u>2017</u>	<u>2016</u>
Net Periodic Benefit Cost:		
Service costs	\$ -	\$ -
Interest cost in projected benefit obligation	4,050,845	4,596,670
Expected return on assets	(5,292,967)	(5,107,689)
Amortization of transition obligation (asset)	-	-
Amortization of prior service cost	-	-
Amortization of net (gain) loss	2,783,047	2,600,749
Curtailement expense	-	-
Net periodic benefit cost	<u>\$ 1,540,925</u>	<u>\$ 2,089,730</u>

The net transition obligation (asset), prior service cost (credit), and estimated net loss (gain) for the plan that are expected to be amortized from accumulated other comprehensive income into net periodic benefit cost over the next fiscal year are \$0, \$0, and \$2,936,640, respectively.

Southeastern Regional Medical Center and Related Organizations
Notes to Financial Statements
September 30, 2017 and 2016

Note H - Pension Benefits (continued)

Assumptions:	2017	2016
Weighted-average assumptions used to determine benefit obligation at September 30		
Discount rate	3.92%	3.80%
Expected long-term rate of return	6.00%	6.00%
Rate of compensation increase	N/A	N/A
Weighted-average assumptions used to determine net periodic benefit cost for years ended September 30		
Discount rate	3.80%	4.53%
Expected long-term return on plan assets	6.00%	6.00%
Rate of compensation increase	N/A	N/A

Plan assets have been invested in equities, fixed income, real estate, and money markets. The composition of plan assets for the past two years is shown below. The expected long-term rate of return of 6% has been determined by use of Aon Hewitt Investment Consulting's expectations of returns for various asset classes applied to the asset allocation listed below. Six percent is at the high end of the acceptable range. The intent of the investment policy is to add more liability-hedging assets over time, which will lead to a lower expected return over time. This will be monitored each year and the expectation is that the expected long-term rate of return will decline in future years.

Plan Assets

The composition of plan assets is as follows:

	Target Allocation	Percentage of Plan Assets September 30	
		2017	2016
Return-seeking securities	32-42%	36.8%	41.5%
Liability-hedging securities	68-58%	63.2%	58.5%

Investment policy guidelines for the Plan include a portfolio that will provide liquidity to meet the Plan's benefit payments and expenses payable from the Plan under ERISA, offer a reasonable probability of achieving a growth of assets that will assist in closing the Plan funding gap, and manage the Plan's assets in a liability framework. The mix of growth and liability matching assets is determined by the acceptable level of risk to the funded status.

The following table presents the Plan's financial instruments as of September 30, 2017 and 2016 measured at fair value on a recurring basis by the valuation hierarchy described in Note C:

	Plan Assets at Fair Value as of September 30, 2017			
	Level 1	Level 2	Level 3	Total
Cash and cash equivalents	\$ 1,046,444	\$ -	\$ -	\$ 1,046,444
Mutual funds	-	87,422,794	-	87,422,794
	\$ 1,046,444	\$ 87,422,794	\$ -	\$ 88,469,238
	Plan Assets at Fair Value as of September 30, 2016			
	Level 1	Level 2	Level 3	Total
Cash and cash equivalents	\$ 925,497	\$ -	\$ -	\$ 925,497
Mutual funds	-	85,823,491	-	85,823,491
	\$ 925,497	\$ 85,823,491	\$ -	\$ 86,748,988

The fair value of Level 1 investments, which consists of equity securities and certain mutual funds, is based on quoted market prices and are value on a daily basis. Level 2 investments consist of U.S. government securities, corporate bonds and fixed income instruments. The fair value of the U.S. government securities and corporate bonds is established based on values obtained from nationally recognized pricing services that value the investments based on similar securities and matrix pricing of similar quality and maturity services. Level 3 investments consist of limited partnership interests in real estate and are based on net asset value.

Southeastern Regional Medical Center and Related Organizations
Notes to Financial Statements
September 30, 2017 and 2016

Note H - Pension Benefits (continued)

Cash Flows

Contributions - The Hospital is not required to make a contribution to its pension plan in 2018.

Estimated Future Benefit Payments – The following benefit payments, which reflect future service, as appropriate, are expected to be paid:

2018	\$ 4,936,000
2019	5,393,000
2020	5,506,000
2021	5,704,000
2022	5,798,000
Years 2023 - 2027	31,053,000

Defined Contribution Plan

The Hospital has a defined contribution plan qualified under Internal Revenue Code Section 403(b) covering all employees. For employees hired before January 1, 2005, the Hospital matches 25% of the first 4% of compensation deferred by the employee, subject to Internal Revenue Service limitations.

For employees hired or rehired on or after January 1, 2005, there is a new enhanced 403 (b) plan. Effective January 1, 2010, all employees hired prior to January 1, 2005 became covered under the new enhanced 403(b) plan. After a one year waiting period, the Hospital contributes 2% of each eligible employee’s annual compensation to the plan, subject to a 3 year vesting period. In addition, the Hospital will match a percentage of the first 4% of compensation deferred by the employee based on years of service as of the immediately preceding December 31st, subject to Internal Revenue Service limitations. The percentages are 25% for the first 5 years of service, 50% for the next 5 years of service and 100% for each year of service thereafter. The amount of the contribution made by the Hospital is within its discretion and may vary. The Hospital’s contributions to the 403(b) plans were \$1,990,051 and \$1,941,293 for 2017 and 2016, respectively.

Note I – Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets are available for the following purposes at September 30, 2017 and 2016:

	2017	2016
Healthcare services:		
Purchase of property and equipment	\$ 212,296	\$ 130,415
Operating expenses and charity care	829,843	824,025
	\$ 1,042,139	\$ 954,440

Permanently restricted net assets, the income from which is expendable to support research, education and other expenses, was \$2,761,578 and \$2,510,997 for September 30, 2017 and 2016, respectively.

Note J - Net Patient Service Revenue

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

Medicare - Inpatient acute care services and outpatient services rendered to Medicare program beneficiaries are paid at prospectively determined rates. These rates vary according to a patient classification system that is based on clinical, diagnostic, and other factors. Inpatient non-acute services and defined capital and medical education costs related to medicare beneficiaries are paid based on a cost reimbursement methodology. 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 Medicare fiscal intermediary has audited the Hospital's Medicare cost reports through September 30, 2013.

Medicaid - Inpatient and 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

Southeastern Regional Medical Center and Related Organizations
Notes to Financial Statements
September 30, 2017 and 2016

Note J - Net Patient Service Revenue (continued)

submission of annual cost reports by the Hospital and audits thereof by the Medicaid fiscal intermediary. The Medicaid fiscal intermediary has audited the Hospital's Medicaid cost reports through September 30, 2014.

Revenue from the Medicare and Medicaid programs accounted for approximately 48.0% and 21.3%, respectively, of the hospital's net patient revenue for the year ended 2017, and 48.2% and 21.5%, respectively, of the hospital's net patient revenue for the year ended 2016. 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.

The Hospital also has entered into payment agreements with certain commercial insurance carriers, HMO's, and preferred provider organizations. The basis for payment to the Hospital under these agreements includes prospectively determined rates per discharge, discounts from established covered charges, and prospectively determined daily rates.

The Hospital grants credit without collateral to its patients, most of who are local residents and are insured under third party payer agreements. The mix of receivables from patients and third party payers consisted of the following at September 30:

	2017	2016
Medicare	29.3%	28.4%
Medicaid	16.3%	23.6%
Other third party payers	34.8%	32.8%
Self pay patients	19.6%	15.2%
	100.0%	100.0%

Note K - Functional Expenses

The Hospital provides general healthcare services primarily to residents within its geographic location. For the years ended September 30, 2017 and 2016, expenses related to providing these services were as follows:

	2017	2016
Healthcare services	\$ 277,769,142	\$ 289,244,929
Research and education	1,188,283	1,077,839
Fund-raising	321,259	339,609
General, administrative, and other	24,141,610	23,006,788
	\$ 303,420,294	\$ 313,669,165

Note L - Reclassifications

Certain amounts in the prior-year financial statements have been reclassified for comparative purposes to conform to the presentation in the current-year financial statements.

Note M - Commitments and Contingencies

Construction commitments. The Hospital has approved contracts for uncompleted construction and renovation with outstanding balances of \$8,564,055 and \$1,739,707 for the years ending September 30, 2017 and 2016, respectively.

Contract commitment. The Hospital selected Epic for a single, integrated electronic health record (EHR) and revenue cycle management (RCM) system. The new system replaced the Hospital's two EHRs and various legacy systems previously in use, and is a foundation for the system's clinical and financial operations over the next decade. Implementation began in May, 2016 and the system went live on November 5, 2017. Management plans to fund this project with excess cash flow, unrestricted reserves and a new debt issuance. The total project capital cost is estimated to be approximately \$56 million dollars, of which \$29,270,063 has been spent as of September 30, 2017.

Operating leases. The Hospital leases various equipment and facilities under operating leases expiring at various dates. Total rental expense in 2017 and 2016 for all operating leases was approximately \$317,163 and \$732,020, respectively.

Southeastern Regional Medical Center and Related Organizations
Notes to Financial Statements
September 30, 2017 and 2016

Note M - Commitments and Contingencies (continued)

Operating leases (continued)

The following is a schedule by year of future minimum lease payments under operating leases as of September 30, 2017, that have initial or remaining lease terms in excess of one year.

Year Ending September 30	Amount
2018	\$ 206,673
2019	3,267
2020	-
2021	-
2022	-

Litigation. The Hospital is involved in litigation and regulatory investigations arising in the ordinary course of business. After consultation with legal counsel, management estimates that these matters will be resolved without material adverse effect on the Hospital's future financial position or results from operations.

Note N – Related Party Transactions

The Hospital leases office space to Southeastern Ambulatory Center, LLC (ASC). The terms of the lease are for twenty years a base rent of \$38,772 per month, plus actual common area maintenance charges. At September 30, 2017 the ASC owed the Hospital \$1,648,223 for services rendered.

Note O– Subsequent Events

Management evaluation. Management has evaluated subsequent events through January 5, 2018, the date that the financial statements were available for issue.

Series 2017 A & B Bond Issuance. On December 21, 2017, the Hospital issued North Carolina Medical Care Commission Hospital Revenue Bonds Series 2017A and Hospital Revenue Refunding Bonds Series 2017B, pursuant to their respective Trust Agreements dated as of December 1, 2017.

Series 2017A - \$42,160,000 – The proceeds of these bonds were used to repay the interim non-revolving line of credit with Branch Bank and Trust, which had a balance of \$27,471,733 at the time of closing. The balance of these funds will be used to reimburse the cost of ongoing capital projects.

Series 2017B - \$15,780,000 – The proceeds of these bonds, along with the Release of Bond Funds held by trustees were used to refund the Series 2005 Hospital Revenue Bonds in the amount of \$17,000,000.

Note P – Other Information

Hurricane Matthew. On October 8, 2016, Hurricane Matthew devastated the City of Lumberton, Robeson County, and many surrounding counties. The Hospital estimates incremental costs associated with the hurricane in excess of \$7 million dollars. As of September 30, 2017, a total of \$2.8 million dollars has been received to offset these costs from FEMA, insurance proceeds, and a grant from the Kate B. Reynolds Charitable Trust.

Compliance Section

S. Preston Douglas & Associates, LLP

CERTIFIED PUBLIC ACCOUNTANTS

MEMBERS

American Institute of CPAs

N. C. Association of CPAs

Report On Internal Control Over Financial Reporting And On Compliance and Other Matters Based On An Audit Of Financial Statements Performed In Accordance With *Government Auditing Standards*

To the Board of Trustees
Southeastern Regional Medical Center
and Related Organizations
Lumberton, North Carolina

We have audited, in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, the accompanying financial statements of Southeastern Regional Medical Center and Related Organizations (the Hospital), as of and for the year ended September 30, 2017, and the related notes to the financial statements and have issued our report thereon dated January 5, 2018.

Internal Control over Financial Reporting

In planning and performing our audit of the financial statements, we considered Southeastern Regional Medical Center and Related Organizations' internal control over financial reporting to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Hospital's internal control. Accordingly, we do not express an opinion on the effectiveness of the Hospital's internal control.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider material weaknesses. However, material weaknesses may exist that were not identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Hospital's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Stanton Douglas & Associates, LLP

Lumberton, North Carolina
January 5, 2018

S. Preston Douglas & Associates, LLP

CERTIFIED PUBLIC ACCOUNTANTS

MEMBERS

American Institute of CPAs

N. C. Association of CPAs

Report on Compliance for Each Major Program; Report on Internal Control Over Compliance; With OMB Uniform Guidance

To the Board of Trustees
Southeastern Regional Medical Center and Related Organizations
Lumberton, North Carolina

Report on Compliance for Each Major Federal Program

We have audited Southeastern Regional Medical Center and Related Organizations' compliance with the types of compliance requirements described in the *OMB Compliance Supplement* that could have a direct and material effect on each of Southeastern Regional Medical Center and Related Organizations' major federal programs for the year ended September 30, 2017. Southeastern Regional Medical Center and Related Organizations' major federal program is identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs.

Management's Responsibility

Management is responsible for compliance with the requirements of laws, regulations, contracts, and grants applicable to its federal programs.

Auditor's Responsibility

Our responsibility is to express an opinion on compliance for each of Southeastern Regional Medical Center and Related Organizations' major federal program based on our audit of the types of compliance requirements referred to above. We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States and the audit requirements of Title 2 U.S. Code of Federal Regulations Part 200, Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards (Uniform Guidance). Those standards and the Uniform Guidance require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about Southeastern Regional Medical Center and Related Organizations' compliance with those requirements and performing such other procedures as we considered necessary in the circumstances.

We believe that our audit provides a reasonable basis for our opinion on compliance for each major federal program. However, our audit does not provide a legal determination of Southeastern Regional Medical Center and Related Organizations' compliance.

Opinion on Each Major Federal Program

In our opinion, Southeastern Regional Medical Center and Related Organizations complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended September 30, 2017.

Report on Internal Control over Compliance

Management of Southeastern Regional Medical Center and Related Organizations is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered Southeastern Regional Medical Center and Related Organizations' internal control over compliance with the types of requirements that could have a direct and material effect on each major federal program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for each major federal program and to test and report on internal control over compliance in accordance with the Uniform Guidance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of Southeastern Regional Medical Center and Related Organizations' internal control over compliance.

A deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct,

noncompliance with a type of compliance requirement of a federal program on a timely basis. A material weakness in internal control over compliance is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis. A significant deficiency in internal control over compliance is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of the Uniform Guidance. Accordingly, this report is not suitable for any other purpose.

Stanton Douglas + Associates, LLP

Lumberton, North Carolina
January 5, 2018

**Southeastern Regional Medical Center and Related Organizations
Schedule of Findings and Questioned Costs
For the Year Ended September 30, 2017**

Section I. Summary of Auditor's Results
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Financial Statements

Type of auditor's report issued:	Unmodified
Internal control over financial reporting:	
• Material weakness(es) identified?	_____ yes <u> X </u> no
• Significant deficiency(s) identified that are not considered to be material weaknesses	_____ yes <u> X </u> none reported
• Noncompliance material to financial statements	_____ yes <u> X </u> no

• ***Federal Awards***

Type of auditor's report issued on compliance for major federal programs:	Unmodified
Internal control over major federal programs:	
• Material weakness(es) identified?	_____ yes <u> X </u> no
• Significant deficiency(s) identified that are not considered to be material weaknesses	_____ yes <u> X </u> none reported
• Noncompliance material to federal awards	_____ yes <u> X </u> no
• Any audit findings disclosed that are required to be reported in accordance with 2 CFR 200.516 (a)	_____ yes <u> X </u> no

Identification of major federal programs:

CFDA Numbers

97.036

Names of Federal Program or Cluster

Disaster Grants – Public Assistance
(Presidentially Declared Disasters)

Dollar Threshold used to distinguish between Type A and Type B programs

\$750,000

Auditee qualified as low-risk auditee?

_____ yes X no

Southeastern Regional Medical Center and Related Organizations
Schedule of Findings and Questioned Costs (continued)
For the Year Ended September 30, 2017

Section II. Financial Statement Findings

None reported

Section III. Federal Award Findings and Questioned Costs

None reported

**Southeastern Regional Medical Center and Related Organizations
Corrective Action Plan
For the Year Ended September 30, 2017**

Section II. Financial Statement Findings

None reported

Section III. Federal Award Findings and Questioned Costs

None reported

**Southeastern Regional Medical Center and Related Organizations
Schedule of Prior Year Findings
For the Year Ended September 30, 2017**

There were no prior year findings.

Southeastern Regional Medical Center and Related Organizations
Schedule of Expenditures of Federal and State Awards
For the Fiscal Year Ended September 30, 2017

<u>Grantor/Pass - through Grant/Program Title</u>	<u>Federal CFDA Number</u>	<u>Award number/State Pass-through Grantor's Number</u>	<u>Federal (Direct Pass- through) Expenditures</u>	<u>State Expenditures</u>
Federal Grants:				
Cash Assistance:				
Major Programs				
<u>U.S. Department of Homeland Security</u>				
Passed through NC Dept of Public Safety				
Disaster Grants - Public Assistance				
(Presidentially Declared Disasters)				
	97.036		\$ 1,814,741	\$ -
Total federal and State awards			<u>\$ 1,814,741</u>	<u>\$ -</u>

Notes to the Schedule of Expenditures of federal and State Awards:

The schedule of expenditures of federal and State awards includes the federal and State grant activity of Southeastern Regional Medical Center and Related Organizations, and is presented on the modified accrual basis of accounting. The information in this schedule is presented in accordance with the requirements of Title 2 U.S. Code of Federal Regulations Part 200, Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal awards (Uniform Guidance). Therefore, some amounts presented in this schedule may differ from amounts presented in, or used in the preparation of the financial statements.

Southeastern Regional Medical Center and Related Organizations has elected not to use the 10-percent de minimis indirect rate as allowed under the Uniform Guidance.