

**SOUTHEASTERN REGIONAL MEDICAL CENTER
AND RELATED ORGANIZATIONS**

Financial Statements

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

Southeastern Regional Medical Center and Related Organizations
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September 30, 2018 and 2017

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S. Preston Douglas & Associates, LLP

CERTIFIED PUBLIC ACCOUNTANTS

MEMBERS

American Institute of CPAs

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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, 2018 and 2017, 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. 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, 2018 and 2017, 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.



Lumberton, North Carolina

January 24, 2019

Southeastern Regional Medical Center and Related Organizations
Combined Balance Sheets
September 30, 2018 and 2017

	2018	Restated 2017
	<u> </u>	<u> </u>
Assets		
Current assets		
Cash and cash equivalents	\$ 3,583,771	\$ 23,852,652
Current portion of assets limited as to use	8,072,566	8,359,627
Patient accounts receivable, net of allowance for doubtful accounts of \$120,348,389 in 2018 and \$103,492,3889 in 2017	40,197,042	37,623,054
Other receivables	6,282,655	6,541,328
Inventories	7,617,029	7,542,646
Prepaid expenses	2,181,105	1,969,608
Total current assets	<u>67,934,168</u>	<u>85,888,915</u>
Property and equipment, net	<u>233,858,352</u>	<u>200,043,742</u>
Other assets		
Investments, assets limited as to use, net of current portion	86,713,216	118,790,701
Long-term investments	2,391,516	1,591,617
Total other assets	<u>89,104,732</u>	<u>120,382,318</u>
Total assets	<u>\$ 390,897,252</u>	<u>\$ 406,314,975</u>
 Liabilities and Net Assets		
Current liabilities		
Current portion of long-term debt and capital leases	\$ 2,522,498	\$ 4,050,488
Line of credit	-	10,000,000
Accounts payable	8,551,738	4,786,274
Accrued expenses	17,889,057	15,982,231
Estimated third-party payer settlements	4,058,104	3,635,422
Total current liabilities	<u>33,021,397</u>	<u>38,454,415</u>
Long-term liabilities, net of current portion:		
Long-term debt and capital leases	86,403,711	47,957,999
Line of credit - non revolving	-	27,471,733
Accrued pension expense	15,140,432	17,938,038
Share of deficiency in assets of Southeastern Ambulatory Surgery Center, LLC	5,161,373	3,387,308
Total long-term liabilities, net of current portion	<u>106,705,516</u>	<u>96,755,078</u>
Total liabilities	<u>139,726,913</u>	<u>135,209,493</u>
Net assets		
Unrestricted	247,194,546	267,301,765
Temporarily restricted	1,079,094	1,042,139
Permanently restricted	2,896,699	2,761,578
Total net assets	<u>251,170,339</u>	<u>271,105,482</u>
Total liabilities and net assets	<u>\$ 390,897,252</u>	<u>\$ 406,314,975</u>

See accompanying notes.

Southeastern Regional Medical Center and Related Organizations
Combined Statements of Operations
For the Years Ended September 30, 2018 and 2017

	2018	Restated 2017
Unrestricted revenue and other support		
Net patient service revenue	\$ 340,586,097	\$ 357,128,499
Provision for bad debts	<u>(63,055,896)</u>	<u>(86,151,942)</u>
Net patient service revenue less provision for bad debts	277,530,201	270,976,557
Other revenue	<u>22,761,996</u>	<u>21,774,678</u>
Total unrestricted revenue and other support	300,292,197	292,751,235
Operating expenses		
Salaries and benefits	173,224,095	158,894,223
Medical supplies and drugs	50,165,719	52,368,933
Insurance	2,199,946	2,179,338
Depreciation and amortization	23,001,304	19,130,523
Interest expense	3,472,998	1,926,314
Other expenses	79,480,336	68,926,958
Total operating expenses	<u>331,544,398</u>	<u>303,426,289</u>
Operating income	<u>(31,252,201)</u>	<u>(10,675,054)</u>
Nonoperating gains (losses)		
Loss on extinguishment of debt	(274,822)	-
Interest and dividends	4,149,000	4,108,734
Realized gains (losses)	7,804,592	4,633,404
Unrealized gains (losses)	(5,383,788)	4,550,363
Investment fees	(467,704)	(495,732)
Total nonoperating gains	<u>5,827,278</u>	<u>12,796,769</u>
Excess of unrestricted revenue and other support over expenses	<u>\$ (25,424,923)</u>	<u>\$ 2,121,715</u>

See accompanying notes.

Southeastern Regional Medical Center and Related Organizations
Combined Statements of Changes in Net Assets
For the Years Ended September 30, 2018 and 2017

	<u>2018</u>	<u>Restated 2017</u>
Unrestricted net assets		
Excess of unrestricted revenue and other support over expenses	\$ (25,424,923)	\$ 2,121,715
Pension adjustment	5,318,939	5,753,864
Net assets released from restrictions	<u>36,955</u>	<u>93,085</u>
 Increase (decrease) in unrestricted net assets	 <u>(20,069,029)</u>	 <u>7,968,664</u>
Temporarily restricted net assets		
Contributions	818,712	888,335
Net assets released from restrictions - operations	(781,757)	(707,551)
Net assets released from restrictions - property and equipment	<u>(36,955)</u>	<u>(93,085)</u>
 Increase (decrease) in temporarily restricted net assets	 <u>-</u>	 <u>87,699</u>
Permanently restricted net assets		
Restricted contributions, net of expenses	8,099	38,211
Investment income	<u>125,787</u>	<u>212,370</u>
 Increase (decrease) in permanently restricted net assets	 <u>133,886</u>	 <u>250,581</u>
 Increase (decrease) in net assets	 (19,935,143)	 8,306,944
Net assets, beginning of year	271,105,482	270,498,248
 Restatement (Note O)	 <u>-</u>	 <u>(7,699,710)</u>
 Net assets, beginning of year, restated	 271,105,482	 262,798,538
 Net assets, end of year	 <u>\$ 251,170,339</u>	 <u>\$ 271,105,482</u>

See accompanying notes.

Southeastern Regional Medical Center and Related Organizations
Combined Statements of Cash Flows
For the Years Ended September 30, 2018 and 2017

	2018	Restated 2017
Cash flows from operating activities		
Increase (decrease) in net assets	\$ (19,935,143)	\$ 8,306,944
Adjustments to reconcile change in net assets to net cash provided (used) by operating activities:		
Depreciation and amortization	23,001,304	19,130,523
Provision for bad debts	63,555,896	86,151,942
Net realized and unrealized gains on investments	(2,420,804)	(9,183,767)
Amortization of original issue discount, premium and bond issue costs	163,267	(100,105)
Equity earnings in affiliate	1,774,065	1,500,000
Cash flows from (increase) decrease in:		
Receivables	(65,871,212)	(78,712,586)
Inventories	(74,383)	277,545
Prepaid expenses	(211,497)	5,817
Cash flows from increase (decrease) in:		
Accounts payable	3,765,464	(937,090)
Accrued expenses	1,906,826	(7,693,361)
Accrued pension expense	(2,797,606)	(4,212,939)
Third-party payer settlement	422,682	(2,928,643)
Net cash provided (used) by operating activities	3,278,859	11,604,280
Cash flows from investing activities		
Purchase of property and equipment	(56,815,914)	(41,878,829)
(Increase) decrease in assets limited as to use	34,785,350	8,446,547
(Increase) decrease in other long-term investments	(799,899)	121,255
Net cash provided (used) by investing activities	(22,830,463)	(33,311,027)
Cash flows from financing activities		
Payment on line of credit	(10,000,000)	10,000,000
Payment on non-revolving line of credit	(27,471,733)	27,471,733
Principal payments on capital lease obligations	(1,602,990)	(1,573,618)
Issuance of long-term debt	57,335,000	-
Bond issuance costs	(382,554)	-
Redemption of bonds	(17,000,000)	-
Principal payments on long-term debt	(1,595,000)	(2,165,000)
Net cash provided (used) by financing activities	(717,277)	33,733,115
Net increase (decrease) in cash and cash equivalents	(20,268,881)	12,026,368
Cash and cash equivalents, beginning of year	23,852,652	11,826,284
Cash and cash equivalents, end of year	\$ 3,583,771	\$ 23,852,652

Cash paid for interest in 2018 and 2017 was \$3,373,719 and \$1,854,743, respectively.

See accompanying notes.

Southeastern Regional Medical Center and Related Organizations
Notes to Financial Statements
September 30, 2018 and 2017

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, 2018 and 2017

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 2018 or 2017.

Southeastern Regional Medical Center and Related Organizations
Notes to Financial Statements
September 30, 2018 and 2017

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.

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 \$11,295,704 and \$6,334,623 in 2018 and 2017, 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, 2018 and 2017

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

Donor-Restricted Gifts (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, 2018 and 2017

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>2018</u>	<u>2017</u>
Assets limited as to use, current	\$ 8,072,566	\$ 8,359,627
Assets limited as to use, noncurrent	86,713,217	118,790,701
Long-term investments	<u>2,391,516</u>	<u>1,591,617</u>
	<u>\$ 97,177,299</u>	<u>\$ 128,741,945</u>

Current and long- term assets whose use is limited for 2018 and 2017 are classified as follows:

	<u>2018</u>	<u>2017</u>
Board designated assets, primarily construction and capital	\$ 79,700,199	\$ 102,358,720
Board designated assets, Epic escrow	3,665,511	14,083,501
Bond indenture agreement assets restricted by trustees	3,347,506	2,348,480
Self-insurance assets board designated	<u>8,072,566</u>	<u>8,359,627</u>
	<u>\$ 94,785,782</u>	<u>\$ 127,150,328</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>2018</u>	<u>2017</u>
By board for capital improvements:		
Cash and short-term investments	\$ 2,712,789	\$ 2,008,130
Corporate bonds and other fixed income	32,451,877	52,619,265
Equity securities	29,916,220	35,593,797
Mutual funds	<u>18,284,824</u>	<u>26,221,029</u>
	<u>83,365,710</u>	<u>116,442,221</u>
Held by trustee:		
Cash and short-term investments	<u>3,347,506</u>	<u>2,348,480</u>
Self-insurance program:		
Cash and short-term investments	169,901	237,446
Equity securities	3,914,948	3,915,811
Corporate bonds and other fixed income	<u>3,987,717</u>	<u>4,206,370</u>
	<u>8,072,566</u>	<u>8,359,627</u>
Total investments, assets limited as to use	<u>\$ 94,785,782</u>	<u>\$ 127,150,328</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>2018</u>	<u>2017</u>
Interest, dividends, and gains (losses) permanently restricted	\$ 125,787	\$ 212,370
Interest and dividend income	4,149,000	4,108,734
Realized gains (losses) on trading securities	7,804,592	4,633,404
Unrealized gains (losses) on trading securities	<u>(5,383,788)</u>	<u>4,550,363</u>
Totals	<u>\$ 6,695,591</u>	<u>\$ 13,504,871</u>

Southeastern Regional Medical Center and Related Organizations
Notes to Financial Statements
September 30, 2018 and 2017

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, 2017, the Hospital owned 172 of the 190 outstanding ASC member units or 90.53%.

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, 2018 and 2017, consists of the following:

	<u>2018</u>	<u>2017</u>
Total assets	\$ 1,892,290	\$ 2,848,923
Total liabilities	<u>7,860,453</u>	<u>6,484,609</u>
Members' equity	<u>\$ (5,968,163)</u>	<u>\$ (3,635,686)</u>
Net patient revenue	\$ 2,256,355	\$ 2,659,121
Expenses before depreciation and interest expense	<u>3,428,320</u>	<u>3,450,180</u>
Net operating income	\$ (1,171,965)	\$ (791,059)
Depreciation and interest expense	<u>777,568</u>	<u>751,843</u>
Net income (loss)	<u>\$ (1,949,533)</u>	<u>\$ (1,542,902)</u>
Hospital's share of deficiency in assets of ASC	<u>\$ (5,161,373)</u>	<u>\$ (3,387,308)</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, 2018 and 2017

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, 2018 and 2017:

	<u>Fair Value as of September 30, 2018</u>			
	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Assets:				
Cash and cash equivalents	\$ 3,583,771	\$ -	\$ -	\$ 3,583,771
Trading securities and other assets whose use is limited:				
Cash and cash equivalents	6,230,196	-	-	6,230,196
Corporate bonds and other fixed income	-	36,439,594	-	36,439,594
Equity securities	33,831,168	-	-	33,831,168
Mutual funds	18,284,824	-	-	18,284,824
Other	1,985,999	-	405,517	2,391,516
Total	<u>\$ 63,915,958</u>	<u>\$ 36,439,594</u>	<u>\$ 405,517</u>	<u>\$ 100,761,069</u>

	<u>Fair Value as of September 30, 2017</u>			
	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Cash and cash equivalents	\$ 23,852,652	\$ -	\$ -	\$ 23,852,652
Trading securities and other assets whose use is limited:				
Cash and cash equivalents	4,594,057	-	-	4,594,057
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	1,247,159	-	344,458	1,591,617
Total	<u>\$ 95,424,504</u>	<u>\$ 56,825,635</u>	<u>\$ 344,458</u>	<u>\$ 152,594,597</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 \$90,539,975 and \$52,002,473 at September 30, 2018 and 2017, 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 \$32,101 and \$170,477 at September 30, 2018 and 2017, respectively.

Southeastern Regional Medical Center and Related Organizations
Notes to Financial Statements
September 30, 2018 and 2017

Note E - Property and Equipment

A summary of property and equipment at September 30 follows:

	<u>2018</u>	<u>2017</u>
Land	\$ 5,954,286	\$ 5,854,286
Land improvements	4,119,781	4,119,781
Buildings and improvements	191,064,349	186,037,792
Furniture and fixtures	23,837,363	23,834,041
Fixed equipment	22,053,669	20,991,262
Moveable equipment	211,848,499	148,896,540
Automobiles	2,274,074	2,111,997
Rental equipment	<u>2,704,061</u>	<u>2,647,539</u>
	463,856,082	394,493,238
Less - Accumulated depreciation and amortization	<u>252,681,814</u>	<u>229,549,700</u>
	211,174,268	164,943,538
Construction in progress	<u>22,684,084</u>	<u>35,100,204</u>
Property and equipment, net	<u>\$ 233,858,352</u>	<u>\$ 200,043,742</u>

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, 2018 and 2017 amounted to \$23,001,304 and \$19,130,523, 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 \$6,477,489 and \$6,008,783 for 2018 and 2017, 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. These bonds were refunded on December 21, 2017 with the issuance of Series 2017B Hospital Revenue Refunding Bonds.

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 \$1,214,988 and \$1,012,490 at September 30, 2018 and September 30, 2017, respectively.

Southeastern Regional Medical Center and Related Organizations
Notes to Financial Statements
September 30, 2018 and 2017

Note G – Debt Obligations (continued)

Series 2017A

In December 2017, the North Carolina Medical Care Commission issued Series 2017A Hospital Revenue Bonds on behalf of Southeastern Regional Medical Center with a face amount of \$42,160,000. The proceeds of the 2017A Bonds, net of issuance expense and fund amounts deposited to cover interest payments on a portion of the bonds, are to be used to finance ongoing capital projects, and to repay an interim non-revolving line of credit with Branch Bank and Trust used to finance certain costs of ongoing capital projects.

Series 2017B

In December 2017, the North Carolina Medical Care Commission issued Series 2017B Hospital Revenue Refunding Bonds on behalf of Southeastern Regional Medical Center with a face amount of \$15,780,000. The proceeds of the 2017B Bonds and release of fund amounts deposited in the amount of \$1,341,160 net of issuance expense, were used to refund \$17,000,000 of outstanding debt related to the Series 2005 Hospital Revenue Bonds.

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 \$747,417, for the year ended September 30, 2018 and \$1,510,858, for the year ended September 30, 2017.

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, 2018, the line of credit has a balance of \$0.

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 was 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, 2018 and September 30, 2017, the line of credit balance of was \$0 and \$27,471,733, respectively.

Southeastern Regional Medical Center and Related Organizations
Notes to Financial Statements
September 30, 2018 and 2017

Note G – Debt Obligations (continued)

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

	<u>2018</u>	<u>2017</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
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%	30,370,000	31,965,000
Unamortized premium, net	<u>2,834,975</u>	<u>3,037,473</u>
	<u>33,204,975</u>	<u>35,002,473</u>
Series 2017A Hospital Revenue Bonds: principal maturing in varying annual amounts ranging from \$50,000 to \$3,230,000; interest rate 2.78%	<u>42,160,000</u>	<u>-</u>
Series 2017B Hospital Revenue Bonds; principal maturing in varying annual amounts ranging from \$605,000 to 1,005,000; interest rates variable based on LIBOR index rate	<u>15,175,000</u>	<u>-</u>
Capital leases	<u>-</u>	<u>1,602,990</u>
Totals	90,539,975	53,605,463
Current portion bond principle and capital leases	(2,320,000)	(3,847,990)
Current portion bond premium amortization	(202,498)	(202,498)
Unamortized cost of issuance	<u>(1,613,766)</u>	<u>(1,596,976)</u>
Long-term portion	<u>\$ 86,403,711</u>	<u>\$ 47,957,999</u>

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

	<u>Long-term debt</u>	
	<u>Principal</u>	<u>Interest</u>
2019	\$ 2,320,000	\$ 2,996,015
2020	2,650,000	2,907,645
2021	2,815,000	2,804,783
2022	2,890,000	2,731,468
2023	2,955,000	2,653,988

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, 2018.

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.

Southeastern Regional Medical Center and Related Organizations
Notes to Financial Statements
September 30, 2018 and 2017

Note H - Pension Benefits (continued)

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:

	2018	2017
Change in benefit obligation:		
Benefit obligation at beginning of year	\$ 106,408,649	\$ 108,934,388
Service cost	-	-
Interest cost	4,075,403	4,050,845
Actuarial (gain) loss	(6,018,495)	(2,153,883)
Benefits paid	<u>(4,673,190)</u>	<u>(4,422,701)</u>
Projected benefit obligation at end of year	<u>\$ 99,792,367</u>	<u>\$ 106,408,649</u>
Change in plan assets:		
Fair value of plan assets at beginning of year	\$ 88,470,611	\$ 86,783,411
Actual return on plan assets	1,385,107	6,109,901
Employer contributions	-	-
Expenses paid	(530,593)	-
Benefits paid	<u>(4,673,190)</u>	<u>(4,422,701)</u>
Fair value of plan assets at end of year	<u>84,651,935</u>	<u>88,470,611</u>
Funded status	<u>\$ (15,140,432)</u>	<u>\$ (17,938,038)</u>
Amounts recognized in the balance sheet:		
Non-current liabilities	<u>(15,140,432)</u>	<u>(17,938,038)</u>
Total Asset/ (Liability)	<u>\$ (15,140,432)</u>	<u>\$ (17,938,038)</u>
Amounts recognized in Accumulated Other Comprehensive Income:		
Net transition (obligation)/ asset	\$ -	\$ -
Prior service (cost)/ credit	-	-
Net actuarial gain/ (loss)	<u>(24,558,379)</u>	<u>(29,877,318)</u>
Total	<u>\$ (24,558,379)</u>	<u>\$ (29,877,318)</u>

The accumulated benefit obligation for the plan was \$99,792,367 and \$106,408,649 at September 30, 2018 and 2017, respectively.

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

	2018	2017
Net Periodic Benefit Cost:		
Service costs	\$ -	\$ -
Interest cost in projected benefit obligation	4,075,403	4,050,845
Expected return on assets	(5,021,303)	(5,292,967)
Expected administrative expenses	530,593	-
Amortization of transition obligation (asset)	-	-
Amortization of prior service cost	-	-
Amortization of net (gain) loss	2,936,640	2,783,047
Curtailment expense	-	-
Net periodic benefit cost	<u>\$ 2,521,333</u>	<u>\$ 1,540,925</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 \$1,827,502 respectively.

Southeastern Regional Medical Center and Related Organizations
Notes to Financial Statements
September 30, 2018 and 2017

Note H - Pension Benefits (continued)

Assumptions:	2018	2017
Weighted-average assumptions used to determine benefit obligation at September 30		
Discount rate	4.32%	3.92%
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	3.92%	3.80%
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	
		2018	2017
Return-seeking securities	32-42%	41.5%	36.8%
Liability-hedging securities	68-58%	58.5%	63.2%

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, 2018 and 2017 measured at fair value on a recurring basis by the valuation hierarchy described in Note D:

	Plan Assets at Fair Value as of September 30, 2018			
	Level 1	Level 2	Level 3	Total
Cash and cash equivalents	\$ 1,626,155	\$ -	\$ -	\$ 1,626,155
Mutual funds	-	83,025,780	-	83,025,780
	\$ 1,626,155	\$ 83,025,780	\$ -	\$ 84,651,935
	Plan Assets at Fair Value as of September 30, 2017			
	Level 1	Level 2	Level 3	Total
Cash and cash equivalents	\$ 1,047,817	\$ -	\$ -	\$ 1,047,817
Mutual funds	-	87,422,794	-	87,422,794
	\$ 1,047,817	\$ 87,422,794	\$ -	\$ 88,470,611

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, 2018 and 2017

Note H - Pension Benefits (continued)

Cash Flows

Contributions - The Hospital is not required to make a contribution to its pension plan in 2019.

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

2019	\$ 5,148,000
2020	5,345,000
2021	5,492,000
2022	5,713,000
2023	5,814,000
Years 2024 - 2028	31,015,000

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 \$2,015,186 and \$1,990,051 for 2018 and 2017, respectively.

Note I – Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets are available for the following purposes at September 30, 2018 and 2017:

	2018	2017
Healthcare services:		
Purchase of property and equipment	\$ 308,679	\$ 212,296
Operating expenses and charity care	770,415	829,843
	\$ 1,079,094	\$ 1,042,139

Permanently restricted net assets, the income from which is expendable to support research, education and other expenses, was \$2,896,699 and \$2,761,578 for September 30, 2018 and 2017, 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.

Southeastern Regional Medical Center and Related Organizations
Notes to Financial Statements
September 30, 2018 and 2017

Note J - Net Patient Service Revenue (continued)

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 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, 2013.

Revenue from the Medicare and Medicaid programs accounted for approximately 49.5% and 20.7%, respectively, of the hospital's net patient revenue for the year ended 2018, and 48.0% and 21.3%, respectively, of the hospital's net patient revenue for the year ended 2017. 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:

	2018	2017
Medicare	28.8%	29.3%
Medicaid	12.6%	16.3%
Other third party payers	30.8%	34.8%
Self pay patients	27.8%	19.6%
	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, 2018 and 2017, expenses related to providing these services were as follows:

	2018	2017
Healthcare services	\$ 304,487,654	\$ 277,769,142
Research and education	872,334	1,188,283
Fund-raising	413,617	321,259
General, administrative, and other	26,045,615	24,147,605
	\$ 331,819,220	\$ 303,426,289

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 \$1,491,213 and \$8,564,055 for the years ending September 30, 2018 and 2017, respectively.

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 and utilities. At September 30, 2018 the ASC owed the Hospital \$3,576,236 for services rendered.

Southeastern Regional Medical Center and Related Organizations
Notes to Financial Statements
September 30, 2018 and 2017

Note O – Restatement

Prior Period Adjustment

Management has determined that an error was made in the calculation of the allowance for doubtful accounts for the year ended September 30, 2016, due to the effects of Hurricane Matthew and its aftermath on the collectability of the Hospital's accounts receivable. The error caused an understatement of the allowance in the amount of \$7,699,710, and is reflected as an adjustment to unrestricted net assets as of the beginning of fiscal year ended September 30, 2017. The comparative financial information for the year ended September 30, 2017, has been restated to reflect this change.

Note P – Subsequent Events

Management evaluation. Management has evaluated subsequent events through January 24, 2019, the date that the financial statements were available for issue.

Note Q – Other Information

Federally Declared Disaster Area

The City of Lumberton, Robeson County and many surrounding counties have been declared Federal Disaster Areas twice in less than two years. First Hurricane Matthew devastated the area with massive flooding in early October of 2016; then, Hurricane Florence struck the area on September 14, 2018, dumping in excess of 20 inches of rain on the region causing massive flooding for a second time. Many residents in the area have lost their homes and a significant number have moved out of the area. The financial impact on the Hospital over the last two years has been significant but difficult to quantify.