

Spartanburg Regional Health Services District, Inc.

Combined Financial Statements

Years Ended September 30, 2018 and 2017

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Independent Auditors' Report

Board of Directors
Spartanburg Regional Health Services District, Inc.
Spartanburg, South Carolina

We have audited the accompanying combined financial statements of Spartanburg Regional Health Services District, Inc. (the "District"), which comprise the combined balance sheets as of September 30, 2018 and 2017, and the related combined statements of revenues, expenses, and changes in net position, and cash flows for the years then ended, and the related notes to the combined financial statements.

Management's Responsibility for the Combined Financial Statements

Management is responsible for the preparation and fair presentation of these combined 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 combined financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the combined financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the combined 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 combined 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 District'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 combined 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 combined financial statements referred to above present fairly, in all material respects, the financial position of Spartanburg Regional Health Services District, Inc. as of September 30, 2018 and 2017, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.



Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that management's discussion and analysis on pages 3 through 9 be presented to supplement the basic combined financial statements. Additionally, accounting principles generally accepted in the United States of America require that the schedule of proportionate share of net pension liability and schedule of contributions on pages 38 and 39 be presented to supplement the basic combined financial statements. Such information, although not a part of the basic combined financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic combined financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic combined financial statements, and other knowledge we obtained during our audit of the basic combined financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Dixon Hughes Goodman LLP

**Charlotte, North Carolina
March 29, 2019**

Spartanburg Regional Health Services District, Inc. Management's Discussion and Analysis

This section of Spartanburg Regional Health Services District, Inc.'s (the "District") combined financial statements presents management's analysis of the District's financial performance during the fiscal year that ended on September 30, 2018. Please read it in conjunction with the combined financial statements, which follow this section.

Financial Highlights

Some highlights of the District's financial performance in fiscal year 2018 include:

- Net patient service revenues increased from fiscal year 2017 to 2018 by approximately \$82.4 million or 7.9% primarily due to increases in outpatient volumes and contract rate increases.
- Net nonoperating expenses decreased by approximately \$17.8 million from fiscal year 2017 to fiscal year 2018. In 2017, costs of approximately \$13.0 million were incurred in connection with the resolution of various legal matters. In addition, also in 2017, costs of \$7.5 million were incurred due to the final year of District support of Guardian Research Network (GRN). There were no expenditures of this nature in 2018.
- Operating expenses increased from fiscal year 2017 to fiscal year 2018 by \$35.6 million or 3.3%. Salary expense increased approximately \$32.7 million due to the addition of full time employees, wage merit increases, and market adjustments. Benefits decreased \$13.7 million primarily due to application of GASB 68, which caused pension plan expense to decrease by \$24.1 million, offset by an increase of \$6.3 million in retirement related expenses and \$3.8 million in health insurance expense. Supplies expense increased \$17.4 million due primarily to a 9.0% increase in pharmaceutical pricing and a 14.6% increase in surgical supplies due to volume.
- From fiscal year 2017 to fiscal year 2018, the District's cash and cash equivalents, short term investments, and board designated cash and investments increased by approximately \$67.2 million or 17.8% due to an increase in cash from operations and the issuance of Hospital Revenue and Refunding bonds. Proceeds from the 2017 bond issuance will be used for capital expenditures in connection with the clinical expansion at Pelham Medical Center Campus.

Overview of the Combined Financial Statements

The combined financial statements consist of two parts: Management's Discussion and Analysis and the Required Basic Combined Financial Statements. The required basic combined financial statements also include notes that explain in more detail some of the information in the combined financial statements.

Required Basic Combined Financial Statements

The District is reported as an enterprise fund under GASB pronouncements and therefore uses accounting methods similar to those used by private sector companies. These combined financial statements offer short-term and long-term financial information about its activities. The Combined Balance Sheets include all of the District's assets and liabilities and provide information about the nature and amounts of investments in resources (assets) and the obligations to District creditors (liabilities). The assets and liabilities are presented in a classified format, which distinguishes between current and long-term assets and liabilities. These combined financial statements also provide the bases for computing rate of return, evaluating the capital structure of the District, and assessing the liquidity and financial flexibility of the District.

All of the current year's revenues and expenses are accounted for in the Combined Statements of Revenues, Expenses, and Changes in Net Position. These combined statements measure the performance of the District's operations for the years ended September 30, 2018 and 2017.

The final required statements are the Combined Statements of Cash Flows. The primary purpose of these combined statements is to provide information about the District's cash receipts and cash payments during the reporting period. The statements report cash receipts, cash payments, and net changes in cash resulting from

Spartanburg Regional Health Services District, Inc.
Management's Discussion and Analysis

operating, investing, noncapital financing, and capital and related financing activities and information concerning sources and uses of cash.

Financial Analysis

Table A-1

Condensed Combined Balance Sheets (In Thousands of Dollars)

	Fiscal Year 2018	Fiscal Year 2017	Dollar Increase (Decrease)	Percentage Increase (Decrease)
Current assets	\$ 431,468	\$ 367,673	\$ 63,795	17.35%
Capital assets, net	545,027	510,409	34,618	6.78%
Other long-term assets	241,014	232,635	8,379	3.60%
Total assets	1,217,509	1,110,717	106,792	9.61%
Deferred outflows	49,075	75,484	(26,409)	(34.99)%
Total assets & deferred outflows	\$ 1,266,584	\$ 1,186,201	\$ 80,383	6.78%
Current liabilities	\$ 193,462	\$ 196,342	\$ (2,880)	(1.47)%
Long-term liabilities	995,807	975,864	19,943	2.04%
Total liabilities	1,189,269	1,172,206	17,063	1.46%
Deferred inflows	45,759	11,203	34,556	308.45%
Total liabilities & deferred inflows	1,235,028	1,183,409	51,619	4.36%
Net investment in capital assets	144,180	180,980	(36,800)	(20.33)%
Restricted	27,907	6,087	21,820	358.47%
Unrestricted	(140,531)	(184,275)	43,744	23.74%
Total net position	31,556	2,792	28,764	1030.23%
Total liabilities & net position	\$ 1,266,584	\$ 1,186,201	\$ 80,383	6.78%

- Net position increased \$28.8 million to \$31.6 million in fiscal year 2018 due to operating income of \$29.3 million as well as a nonoperating net expense of \$0.5 million.
- Current assets increased \$63.8 million primarily due to short term investments. Short term investments increased \$62.9 million due to an increase in operating cash generated from the issuance of Hospital Revenue and Refunding bonds in December 2017.
- Net capital assets increased \$34.6 million due to the net activity of additions, deductions and depreciation. Additions primarily relate to capitalizing costs for the master facility renovation plan and expansion projects.
- Other long-term assets increased \$8.4 million due to the remaining proceeds acquired from the issuance of Hospital Revenue and Refunding bonds in December 2017 held in a project fund by the Bond Trustee.
- Total deferred outflows decreased by \$26.4 million as a result of pension asset activity related to the District's share of employer allocations of the South Carolina Retirement System ("SCRS"), in accordance with Statement No. 68 of the Governmental Accounting Standards Board.
- Long-term liabilities increased \$19.9 million primarily due to the issuance of Hospital Revenue and Refunding bonds in December 2017 offset by a \$57.0 million decrease in the District's share of the SCRS net pension liability, in accordance with GASB 68.
- Total deferred inflows increased by \$34.6 million as a result of pension deferral activity related to the District's share of employer allocations of the SCRS, in accordance with GASB 68.

**Spartanburg Regional Health Services District, Inc.
Management's Discussion and Analysis**

Financial Analysis

Table A-2

Condensed Combined Balance Sheets (In Thousands of Dollars)

	Fiscal Year 2017	Fiscal Year 2016	Dollar Increase (Decrease)	Percentage Increase (Decrease)
Current assets	\$ 367,673	\$ 353,353	\$ 14,320	4.05%
Capital assets, net	510,409	499,004	11,405	2.29%
Other long-term assets	232,635	262,617	(29,982)	(11.42)%
Total assets	1,110,717	1,114,974	(4,257)	(0.38)%
Deferred outflows	75,484	95,134	(19,650)	(20.66)%
Total assets & deferred outflows	\$ 1,186,201	\$ 1,210,108	\$ (23,907)	(1.98)%
Current liabilities	\$ 196,342	\$ 180,942	\$ 15,400	8.51%
Long-term liabilities	975,864	951,348	24,516	2.58%
Total liabilities	1,172,206	1,132,290	39,916	3.53%
Deferred inflows	11,203	38,405	\$ (27,202)	(70.83)%
Total liabilities & deferred inflows	1,183,409	1,170,695	12,714	1.09%
Net investment in capital assets	180,980	157,515	23,465	14.90%
Restricted	6,087	6,104	(17)	(0.28)%
Unrestricted	(184,275)	(124,206)	(60,069)	48.36%
Total net position	2,792	39,413	(36,621)	(92.92)%
Total liabilities & net position	\$ 1,186,201	\$ 1,210,108	\$ (23,907)	(1.98)%

- Net position decreased \$36.6 million to \$2.8 million in fiscal year 2017 due to an operating loss of \$18.3 million as well as a nonoperating net expense of \$18.3 million.
- Current assets increased \$14.3 million primarily due to patient accounts receivable. Patient accounts receivable increased \$30.5 million due to accounts receivable growth as a result of volume increases.
- Net capital assets increased \$11.4 million due to the net activity of additions, deductions and depreciation. Additions primarily relate to capitalizing costs for the master facility renovation plan and expansion projects.
- Other long-term assets decreased \$30.0 million due to increased spending of cash internally restricted for capital asset purchases including those discussed above.
- Total deferred outflows decreased by \$19.7 million as a result of pension asset activity related to the District's share of employer allocations of the South Carolina Retirement System ("SCRS"), in accordance with Statement No. 68 of the Governmental Accounting Standards Board.
- Current liabilities increased by \$15.4 million over the prior year primarily due to increased payables to suppliers and employees.
- Long-term liabilities increased \$24.5 million primarily due to a \$35.7 million increase in the District's share of the SCRS net pension liability, in accordance with GASB 68.
- Total deferred inflows decreased by \$27.2 million as a result of pension deferral activity related to the District's share of employer allocations of the SCRS, in accordance with GASB 68.

**Spartanburg Regional Health Services District, Inc.
Management's Discussion and Analysis**

Table A-3

Condensed Combined Statements of Revenues, Expenses, and Changes in Net position (In Thousands of Dollars)

	Fiscal Year 2018	Fiscal Year 2017	Dollar Increase (Decrease)	Percentage Increase (Decrease)
Net patient service revenues	\$ 1,113,320	\$ 1,030,954	\$ 82,366	7.99%
Premium revenues	-	3,207	(3,207)	(100.00)%
Other revenues	34,235	30,234	4,001	13.23%
Total operating revenues	1,147,555	1,064,395	83,160	7.81%
Salaries, temporary personnel, and benefit expenses	657,762	638,734	19,028	2.98%
Supply expenses	201,839	184,460	17,379	9.42%
Other expenses	258,656	259,480	(824)	(0.32)%
Total operating expenses	1,118,257	1,082,674	35,583	3.29%
			47,577	260.28%
Operating income (loss)	29,298	(18,279)		
Net nonoperating revenues (expenses)	(534)	(18,342)	17,808	97.09%
Increase (decrease) in net position	28,764	(36,621)	65,385	178.55%
Beginning net position	2,792	39,413	(36,621)	(92.92)%
Ending net position	\$ 31,556	\$ 2,792	\$ 28,764	1030.23%

- Total operating revenues increased by approximately \$83.2 million due to an increase of net patient service revenue of \$82.4 million, a decrease of premium revenues of \$3.2 million, and increase in other revenue of \$4.0 million.
- The increase of net patient service revenues is due to Outpatient volume increases, Medicaid payments for treating a disproportionate share of low income patients, and Medicaid payments under the Upper Payment Limit program.
- During 2016 the District sold the rights to provide services to the health plans operated by Advicare. The District received trailing premium revenues in 2017 of \$3.2 million.
- Other revenues increased \$4 million due to an increase in recognition of payor incentives earned and revenue from physicians leased to other healthcare systems.
- Total operating expenses increased by approximately \$35.6 million primarily due to a \$19.0 million increase in salaries, temporary personnel, and benefit expenses and a \$17.4 million increase in supply expenses.
- Salaries and benefit expenses increased approximately \$19.0 million. Salaries increased \$32.7 million due to the addition of full time employees, market adjustments, an annual merit wage increase. Benefits decreased \$13.7 million due to a decrease in pension plan cost of \$24.1 million due to application of GASB 68, offset by increases in retirement related expenses and health insurance expense.
- Supply expenses increased \$17.4 million primarily due to pharmaceutical pricing and an increase in surgical supplies due to volume.
- Net nonoperating expenses decreased by \$17.8 million compared to the prior year primarily due to costs incurred in 2017 of approximately \$13.0 million in connection with the resolution of various legal matters. In addition, also in 2017, costs were incurred of \$7.5 million due to the final year of District support of GRN. There were no expenditures of this nature in 2018.

**Spartanburg Regional Health Services District, Inc.
Management's Discussion and Analysis**

Table A-4

Condensed Combined Statements of Revenues, Expenses, and Changes in Net position (In Thousands of Dollars)

	Fiscal Year 2017	Fiscal Year 2016	Dollar Increase (Decrease)	Percentage Increase (Decrease)
Net patient service revenues	\$ 1,030,954	\$ 1,016,925	\$ 14,029	1.38%
Premium revenues	3,207	109,007	(105,800)	(97.06)%
Other revenues	30,234	34,620	(4,386)	(12.67)%
Total operating revenues	1,064,395	1,160,552	(96,157)	(8.29)%
Salaries, temporary personnel, and benefit expenses	638,734	599,970	38,764	6.46%
Supply expenses	184,460	186,026	(1,566)	(0.84)%
Other expenses	259,480	371,917	(112,437)	(30.23)%
Total operating expenses	1,082,674	1,157,913	(75,239)	(6.50)%
Operating income	(18,279)	2,639	(20,918)	(792.65)%
Net nonoperating revenues (expenses)	(18,342)	9,846	(28,188)	(286.29)%
Increase (decrease) in net position	(36,621)	12,485	(49,106)	(393.32)%
Beginning net position	39,413	26,928	12,485	46.36%
Ending net position	\$ 2,792	\$ 39,413	\$ (36,621)	(92.92)%

- Total operating revenues decreased by approximately \$96.2 million primarily due to an increase of net patient service revenue of \$14.0 million, a decrease of premium revenues of \$105.8 million, and decrease in other revenue of \$4.4 million.
- The increase of net patient service revenues is due to volume increases, new services, and managed care contract changes.
- During 2016 the District sold the rights to provide services to the health plans operated by Advicare causing premium revenues to decrease by approximately \$105.8 million from fiscal year 2016 to 2017.
- Total operating expenses decreased by approximately \$75.2 million primarily due to a \$112.3 million decrease in other expenses.
- Salaries and benefit expenses increased approximately \$38.8 million primarily due to the addition of full time employees, market adjustments, an annual merit wage increase, increased health insurance expenses over the prior year and additional pension plan cost of \$10.4 million due to application of GASB 68.
- Other expenses decreased approximately \$112.4 million from 2016 to 2017 due to the divestiture of the health plans operated by Advicare which reduced medical claims by \$89.8 million. In addition, the expense related to the Upper Payment Limit program increased by approximately \$6.2 million and fees and purchased services decreased by approximately \$12.8 million.
- Net nonoperating revenues decreased by \$28.2 million compared to the prior year primarily due to costs incurred of approximately \$13.0 million in connection with the resolution of various legal matters. In addition, costs were incurred of \$7.5 million due to the final year of District support of GRN in 2017.

**Spartanburg Regional Health Services District, Inc.
Management's Discussion and Analysis**

Capital Assets and Long-Term Debt

Capital Assets

Table A-5

Capital Assets (In Thousands of Dollars)

	Fiscal Year 2018	Fiscal Year 2017
Land and land improvements	\$ 69,726	\$ 68,301
Building and building fixtures	380,210	339,310
Equipment	749,063	721,913
Construction-in-progress	68,610	51,407
Equipment under capital lease obligations	12,084	12,367
Total capital assets	<u>1,279,693</u>	<u>1,193,298</u>
Less accumulated depreciation	<u>734,666</u>	<u>682,889</u>
Net capital assets	<u>\$ 545,027</u>	<u>\$ 510,409</u>

As of September 30, 2018, the District had approximately \$545.0 million invested in capital assets, as reflected in Table A-5, which represents a net increase (additions, deductions and depreciation) of approximately \$34.6 million or 6.78% from the end of last year.

Table A-6

Capital Assets (In Thousands of Dollars)

	Fiscal Year 2017	Fiscal Year 2016
Land and land improvements	\$ 68,301	\$ 68,161
Building and building fixtures	339,310	326,502
Equipment	721,913	651,453
Construction-in-progress	51,407	73,762
Equipment under capital lease obligations	12,367	12,367
Total capital assets	<u>1,193,298</u>	<u>1,132,245</u>
Less accumulated depreciation	<u>682,889</u>	<u>633,241</u>
Net capital assets	<u>\$ 510,409</u>	<u>\$ 499,004</u>

As of September 30, 2017, the District had approximately \$510.4 million invested in capital assets, as reflected in Table A-5, which represents a net increase (additions, deductions and depreciation) of approximately \$11.4 million or 2.3% from the end of last year.

Long-Term Debt

As of September 30, 2018, the District had approximately \$396.5 million in outstanding long-term debt, less current portion, and as of September 30, 2017, the District had approximately \$319.5 million in outstanding long-term debt, less current portion. This represents a net increase of approximately \$77.0 million, primarily due to the issuance of Hospital Revenue and Refunding bonds in December 2017.

For more detailed information regarding the District's capital assets and long-term debt, refer to the accompanying notes to the combined financial statements.

**Spartanburg Regional Health Services District, Inc.
Management's Discussion and Analysis**

Future Outlook

The Board of Directors and management believe that the District is well positioned to improve its strong financial condition and continue to provide excellent health care services to its service area. Increases in volume are expected to continue as the District continues to add new services, expand existing services, and increase its market share. To further this goal, the District entered into a purchase agreement to acquire the assets of the Mary Black Health system hospitals and clinics as of December 31, 2018. The acquisition includes two hospitals with combined beds of 332 and 20 physician practices.

In addition, due to the District's ownership of a diverse selection of physician practices (Medical Group of the Carolinas), advanced information technology, medical staff and employee leadership, growth of cancer research, and relationship with Regional Health Plus, LLC, management believes that the District is well positioned to address the challenges and opportunities of health care reform. The District's prudent use of financial resources, cost-control efforts, and increases in patient volume will ensure that the District will continue as the primary provider of health care service in the area.

Requests for Information

This financial report is designed to provide a general overview of the District's finances for all those with an interest in the District's finances. Questions concerning any of the information provided in this report or requests for additional information should be addressed to the District at 101 East Wood Street, Spartanburg, South Carolina 29303.

Spartanburg Regional Health Services District, Inc.
Combined Balance Sheets
September 30, 2018 and 2017

	<u>2018</u>	<u>2017</u>
	<i>(In Thousands)</i>	
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 119,980	\$ 124,249
Short term investments	91,276	28,338
Patient accounts receivable, net of allowance for uncollectible accounts of approximately \$103,993 (2018) and \$127,737 (2017)	154,079	169,146
Drugs and supplies	10,381	9,135
Other current assets	55,752	36,805
Total current assets	<u>431,468</u>	<u>367,673</u>
Assets whose use is limited:		
Board designated cash and investments	205,376	218,737
Board designated other assets	928	887
Funds held by trustee	27,907	6,087
Total assets whose use is limited	<u>234,211</u>	<u>225,711</u>
Capital assets, net	545,027	510,409
Other assets	6,803	6,924
Total assets	<u>1,217,509</u>	<u>1,110,717</u>
DEFERRED OUTFLOWS		
Deferred loss on defeased debt, net	4,717	5,716
Pension deferrals	44,358	69,768
Total deferred outflows	<u>49,075</u>	<u>75,484</u>
Total assets and deferred outflows	<u>\$ 1,266,584</u>	<u>\$ 1,186,201</u>

See accompanying notes.

Spartanburg Regional Health Services District, Inc.
Combined Balance Sheets
September 30, 2018 and 2017

Continued

	<u>2018</u>	<u>2017</u>
	<i>(In Thousands)</i>	
LIABILITIES		
Current liabilities:		
Accounts payable	\$ 88,977	\$ 87,476
Accrued expenses	93,541	91,201
Estimated third-party payor settlements	6,621	7,822
Current portion of obligations under capital leases	221	895
Current portion of long-term debt	4,102	8,948
	<hr/>	<hr/>
Total current liabilities	193,462	196,342
Net pension liability	599,283	656,278
Long-term debt, less current portion	396,524	319,531
Long-term obligations under capital leases, less current portion	-	55
	<hr/>	<hr/>
Total liabilities	1,189,269	1,172,206
 DEFERRED INFLOWS		
Pension deferrals	45,759	11,203
	<hr/>	<hr/>
Total liabilities and deferred inflows	1,235,028	1,183,409
 NET POSITION		
Net investment in capital assets	144,180	180,980
Restricted- Expendable for debt service	27,907	6,087
Unrestricted	(140,531)	(184,275)
	<hr/>	<hr/>
Total net position	31,556	2,792
 <hr/>		
Total liabilities, deferred inflows and net position	\$ 1,266,584	\$ 1,186,201
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See accompanying notes.

Spartanburg Regional Health Services District, Inc.
Combined Statements of Revenues, Expenses, and Changes in Net Position
September 30, 2018 and 2017

	<u>2018</u>	<u>2017</u>
	<i>(In Thousands)</i>	
Operating revenues:		
Net patient service revenues, net of provision for bad debts of approximately \$131,548 (2018) and \$135,817 (2017)	\$ 1,113,320	\$ 1,030,954
Premium revenues	-	3,207
Other operating revenues	<u>34,235</u>	<u>30,234</u>
Total operating revenues	<u>1,147,555</u>	<u>1,064,395</u>
Operating expenses:		
Salaries	524,887	492,181
Benefits	132,875	146,553
Supplies	201,839	184,460
Fees and purchased services	108,260	110,901
Depreciation	55,496	54,809
Other	<u>94,900</u>	<u>93,770</u>
Total operating expenses	<u>1,118,257</u>	<u>1,082,674</u>
Operating income (loss)	29,298	(18,279)
Non-operating revenues (expenses):		
Interest expense	(12,713)	(11,088)
Net investment expense	(1,857)	(57)
Non-capital grants and contributions	10,974	11,584
Other gain (loss)	<u>3,062</u>	<u>(18,781)</u>
Net non-operating expenses	<u>(534)</u>	<u>(18,342)</u>
Excess (deficit) of revenues over expenses	28,764	(36,621)
Net position at beginning of year	<u>2,792</u>	<u>39,413</u>
Net position at end of year	<u>\$ 31,556</u>	<u>\$ 2,792</u>

See accompanying notes.

Spartanburg Regional Health Services District, Inc.
Combined Statements of Cash Flows
September 30, 2018 and 2017

	<u>2018</u>	<u>2017</u>
	<i>(In Thousands)</i>	
Cash flows from operating activities:		
Receipts from patients	\$ 1,127,185	\$ 1,002,356
Payments to vendors	(399,246)	(387,565)
Claims and self-insurance payments	(33,081)	(27,625)
Payments for salaries and benefits	(646,413)	(597,068)
Other receipts from operations	40,620	62,886
	<u>89,065</u>	<u>52,984</u>
Net cash provided by operating activities		
Cash flows from non-capital financing activities:		
Non-capital grants and contributions	10,974	11,584
Payment of unconditional pledges to give	-	(1,000)
Other	3,062	(18,781)
	<u>14,036</u>	<u>(8,197)</u>
Net cash provided by (used in) non-capital financing activities		
Cash flows from capital and related financing activities:		
Purchase and construction of capital assets	(94,205)	(59,312)
Proceeds from sale of capital assets	158	197
Proceeds from issuance on long-term debt	263,056	-
Principal payments on long-term debt, net	(189,763)	(8,630)
Interest payments on long-term debt	(12,713)	(11,088)
Principal payments on capital lease obligations	(729)	(3,003)
	<u>(34,196)</u>	<u>(81,836)</u>
Net cash used in capital and related financing activities		
Cash flows from investing activities:		
Net change in investments	(62,938)	214
Net change in assets whose use is limited	39,210	922
Net investment income (loss)	(1,857)	(57)
Net change in investments in joint ventures	121	1,186
	<u>(25,464)</u>	<u>2,265</u>
Net cash provided by (used in) investing activities		
Net increase (decrease) in cash and cash equivalents	43,441	(34,784)
Cash and cash equivalents at beginning of year	<u>132,826</u>	<u>167,610</u>
Cash and cash equivalents at end of year	<u>\$ 176,267</u>	<u>\$ 132,826</u>

See accompanying notes.

Spartanburg Regional Health Services District, Inc.
Combined Statements of Cash Flows
September 30, 2018 and 2017

(Continued)

	<u>2018</u>	<u>2017</u>
	<i>(In Thousands)</i>	
Reconciliation of cash and cash equivalents:		
Cash and cash equivalents on the balance sheet	\$ 119,980	\$ 124,249
Cash and cash equivalents in assets whose use is limited	<u>56,287</u>	<u>8,577</u>
Total cash and cash equivalents	<u>\$ 176,267</u>	<u>\$ 132,826</u>
Reconciliation of operating income (loss) to net cash provided by operating activities:		
Operating income (loss)	\$ 29,298	\$ (18,279)
Adjustments to reconcile operating income (loss) to net cash provided by operating activities:		
Amortization of bond premium	(1,146)	(427)
Provision for bad debts	131,548	135,817
Depreciation	55,496	54,809
Loss (Gain) on sale of capital assets	1,021	(213)
Changes in operating assets and liabilities:		
Patient accounts receivable	(116,481)	(166,312)
Drugs and supplies	(1,246)	(751)
Other current assets	(17,948)	11,893
Accounts payable	4,413	(1,028)
Deferred outflows- pension deferrals	25,410	18,571
Estimated third-party payor settlements	(1,201)	1,898
Accrued expenses	2,340	9,415
Net pension liability	(56,995)	35,685
Supplemental executive retirement plan liability	-	(892)
Deferred inflows- pension	<u>34,556</u>	<u>(27,202)</u>
Net cash provided by operating activities	<u>\$ 89,065</u>	<u>\$ 52,984</u>
Supplemental non-cash information:		
Capital assets included in accounts payable	<u>\$ 4,986</u>	<u>\$ 7,898</u>
Receivable on sale of capital assets	<u>\$ -</u>	<u>\$ 1,012</u>
Net unrealized loss	<u>\$ (4,165)</u>	<u>\$ (3,399)</u>
Net realized loss	<u>\$ (2,377)</u>	<u>\$ (939)</u>

See accompanying notes.

Notes to the Combined Financial Statements

1. Description Of Reporting Entity And Summary Of Significant Accounting Policies

Reporting entity

Spartanburg Regional Health Services District, Inc. (the "District") is a statutory public hospital corporation and a political subdivision of the state of South Carolina, and, as such, is exempt from federal and state income tax. The District is governed by a Board of Directors (the "Board") appointed by the Spartanburg County Council, the primary government.

The District operates an integrated health care delivery system in Spartanburg and Union Counties consisting of Spartanburg Medical Center ("SMC"), Spartanburg Hospital for Restorative Care ("SHRC"), Pelham Medical Center ("PMC"), Union Medical Center ("UMC"), Ellen Sagar Nursing Center ("ESNC"), and Woodruff Manor ("Woodruff"). The District includes a network of physician practices, the Medical Group of the Carolinas ("MGC") that offer an array of medical services in the Upstate Region of South Carolina. In addition, the District owns SMC Ventures, LLC ("Ventures") and Greer Group, LLC ("Greer Group"), which are organized as limited liability companies under South Carolina limited liability company statutes, as well as NC Network, Inc. ("NC Network"), which is organized as a North Carolina corporation. The District operates Advicare Corp. ("Advicare"), a Medicaid managed care organization and Palmetto Physician Connections, LLC ("PPC"), a previous Medicaid medical home network that converted its covered lives to Advicare in fiscal year 2014. Advicare had no active members during fiscal years 2018 and 2017. Guardian Research Network, Inc. ("GRN") is a research collaborative incorporated as a private not-for-profit entity which received support from the District under the terms of a management agreement until August 1, 2017, when the agreement was terminated.

Ventures holds investments in joint ventures as further described in this note under "Investments in Joint Ventures".

During fiscal year 2017, the District entered into a five-year Management Services Agreement (the "MSA") with Apella Health management, Inc. ("Apella"), a South Carolina nonprofit corporation, to provide executive management services for the District. The MSA was amended to a ten-year term during fiscal year 2018. Under the terms of the MSA, the District pays Apella an annual management fee. The District continues to be the licensed owner and provider of healthcare services, and retains ultimate control over assets and critical strategic, quality, and operations matters. The District also provides certain administrative services to Apella under an Administrative Services Agreement and leases certain employees from Apella under an Employee Lease Agreement. The net amount of payments from the District to Apella during fiscal years 2018 and 2018 was approximately \$72.3 million and \$12.2 million, respectively.

The combined financial statements of the District include the accounts of SMC, PMC, SHRC, UMC, ESNC, Woodruff, MGC, Ventures, Greer Group, NC Network, Advicare, and PPC. These affiliated entities are reported as blended component units of the District. Ventures, Greer Group, Advicare, and PPC operate on a calendar year end. All intercompany transactions have been eliminated in the combined financial statements.

Accounting standards and methods

The District qualifies as a governmental organization and is subject to the pronouncements of the Governmental Accounting Standards Board ("GASB"). The District is reported as an enterprise fund under GASB pronouncements. The proprietary fund method of accounting is used whereby revenues and expenses are recognized on the accrual basis.

Spartanburg Regional Health Services District, Inc.
Notes to the Combined Financial Statements

Use of estimates

The preparation of combined 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 combined financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Cash and cash equivalents

Cash and cash equivalents include investments in highly liquid debt instruments with an original maturity of three months or less when purchased.

At various times throughout the year, the District maintains deposits at financial institutions in excess of amounts covered by the Federal Deposit Insurance Corporation ("FDIC") limits. Management believes the credit risk associated with these deposits is minimal.

Patient accounts receivable

Patient accounts receivable are carried at net realizable value. The allowance is based upon a review of the outstanding balances aged by financial class. For patient receivables associated with services provided to patients who have third-party coverage, the District analyzes contractually due amounts and provides an allowance for contractual adjustments. Management uses collection percentages based upon historical collection experience to determine collectability. Management also reviews troubled, aged accounts to determine collection potential. Patient accounts receivable are written off when deemed uncollectible. Recoveries of accounts previously written off are recorded as a reduction to provision for bad debts when received. Interest is not charged on patient accounts receivable.

Drugs and supplies

Drugs and supplies are stated at the lower of cost, determined using the first-in, first-out method, or net realizable value.

Investments

Short term and long term investments consist principally of certificates of deposit and debt securities. Investments in debt securities are reported at fair value. Interest, dividends and gains and losses, both realized and unrealized, on investments in debt securities are included in nonoperating revenues when earned.

Assets whose use is limited

Assets whose use is limited primarily includes assets designated by the Board for future capital improvements, over which the Board retains control and may at its discretion subsequently use for other purposes, and amounts held by Bond Trustees in accordance with indenture agreements.

Capital assets

Capital assets are stated at cost, including interest costs incurred during construction. Contributed property is recorded at its fair value at date of donation. Depreciation is computed using the straight-line method over the estimated useful lives of the assets as determined by industry standards. Routine maintenance, repairs, and replacements are charged to expense. The District capitalizes all assets purchased individually that have a useful life of three or more years and a cost of \$2,500. Items purchased as a group are capitalized if the purchase is for the same item, the individual item cost is equal to or exceeds \$500, the total cost of the group purchase is equal to or exceeds \$25,000, and the purchase occurs at one time.

The amortization of assets under capital leases is included in depreciation expense. Assets are amortized over the shorter of the lease term or asset life.

Spartanburg Regional Health Services District, Inc.
Notes to the Combined Financial Statements

When properties are retired or otherwise disposed of, the cost of the assets and related allowances for depreciation are removed from the accounts, and any resulting gain or loss is recognized as a non-operating activity in the combined Statements of Revenues, Expenses and Changes in Net Position.

Interest costs incurred during the period of construction of qualifying capital assets are capitalized as a component of the cost of these assets and amortized over the life of the asset.

Investments in joint ventures

Regional HealthPlus, LLC (“RHP”) is a limited liability company formed to organize a collaborative network of health care providers and execute and manage various contracts with third-party payors. RHP is owned 50% by SMC Ventures, LLC and 50% by area physicians. The District accounts for the investment in RHP using the equity method.

The Ambulatory Surgery Center of Spartanburg, LLC (“ASCS, LLC”) is a limited liability company formed to assist the District in serving the ambulatory surgical needs of Spartanburg County residents. ASCS, LLC is owned 50% by SMC Ventures, LLC and 50% by area physicians. The District accounts for the investment in ASCS, LLC using the equity method.

The Ambulatory Surgery Center of Pelham, LLC (“ASC Pelham, LLC”) is a limited liability company formed to assist the District in serving the ambulatory surgical needs of Spartanburg County residents. ASC Pelham, LLC is owned 50% by SMC Ventures, LLC and 50% by area physicians. The District accounts for the investment in ASC Pelham, LLC using the equity method.

The District’s investments in joint ventures included in other assets as of September 30, are as follows, in thousands:

	<u>2018</u>	<u>2017</u>
Regional HealthPlus, LLC	\$ 4,064	\$ 3,742
Ambulatory Surgery Center of Spartanburg, LLC	1,221	1,573
Ambulatory Surgery Center of Pelham, LLC	<u>1,518</u>	<u>1,609</u>
	<u>\$ 6,803</u>	<u>\$ 6,924</u>

Net position

Net position of the District classified as net investment in capital assets consist of capital assets, net of accumulated depreciation, reduced by the current balances of any outstanding borrowings used to finance the purchase or construction of those assets. Restricted components of net position include amounts deposited with trustees as required by revenue bond indentures. Unrestricted components of net position are remaining net position that do not meet the definition of net investment in capital assets or restricted.

Net patient service revenues

Net patient service revenues are reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors. Third-party contractual revenue adjustments are accrued on an estimated basis in the period the related services are rendered. Such amounts are subject to audit by governmental agencies. Adjustments, if any, are included in contractual revenue adjustments in the year of determination. In compliance with governmental accounting standards, net patient service revenues have been reduced by the amount of bad debt expense incurred by the District.

Spartanburg Regional Health Services District, Inc.
Notes to the Combined Financial Statements

The District's policy does not require collateral or other security for patient accounts receivable. The District routinely accepts assignment of, or is otherwise entitled to receive, patient benefits payable under health insurance programs, plans or policies such as those related to Medicare, Medicaid, Blue Cross, health maintenance organizations and commercial insurance carriers.

Charity care

The District accepts all patients regardless of their ability to pay. A patient is classified as a charity patient by reference to certain established policies of the District. Essentially, these policies define charity services as those services for which no payment is anticipated. In assessing a patient's inability to pay, the District utilizes the generally recognized poverty income levels of South Carolina, and also includes certain cases where incurred charges are significant when compared to the patient's income. Patients that qualify for the state Medically Indigent Act Program are a component of charity care. The District receives no reimbursement for services provided to these patients. Charity care is not reflected in net patient service revenues. The gross amount of charges written off to charity care under these policies for the year ended September 30, 2018 and 2017 were approximately \$78.9 million and \$53.6 million, respectively. The net cost of charity care provided was approximately \$21.6 million in 2018 and \$16.3 million in 2017. The District uses the cost to charge ratio to estimate the cost of charity care.

Operating revenues and expenses

The District's combined statements of revenues, expenses, and changes in net position distinguishes between operating and nonoperating revenues and expenses. Operating revenues result from exchange transactions associated with providing health care services – the District's principal activity. Nonexchange revenues, including grants, and contributions received for purposes other than capital asset acquisition, are reported as nonoperating revenues. Operating expenses are all expenses incurred to provide health care services, other than financing costs. Investment income on proceeds of borrowings that are held by a trustee, to the extent not capitalized, is reported as other revenues.

Grants and contributions

From time to time, the District receives grants from Spartanburg County, the State of SC, and the Federal Government as well as contributions from individuals and private organizations. Revenues from grants and contributions (including contributions of capital assets) are recognized when all eligibility requirements, including time requirements are met. Grants and contributions may be restricted for either specific operating purposes or for capital purposes. Amounts that are unrestricted or that are restricted to a specific operating purpose are reported as nonoperating revenues. Amounts restricted to capital acquisitions are reported after nonoperating revenues and expenses.

Income taxes

The District is a political subdivision of the State of South Carolina and also has been granted exemption from income taxes as an organization described in Section 115 of the Internal Revenue Code. Limited liability companies combined with the District are treated as a partnerships for Federal and state income tax purposes and are not taxed at the entity level. Advicare is a corporation with a tax year-end of December 31. Advicare files tax returns with appropriate Federal and state taxing authorities in compliance with Internal Revenue Service and state provisions and is current on all tax payments. The District has determined that it does not have any material unrecognized tax benefits or obligations as of September 30, 2018.

Risk management

The District is exposed to various risks of loss from torts; theft of, damage to, and destruction of assets; business interruption; errors and omissions; employee injuries and illnesses; and, natural disasters; medical malpractice claims and judgments; and employee health, dental and accident benefits. Insurance coverage is purchased to cover the majority of claims arising from such matters. The District is self-insured for amounts up to a specified level for health and medical coverages for its employees and medical malpractice claims. The estimated liability is

Spartanburg Regional Health Services District, Inc.
Notes to the Combined Financial Statements

the total estimated amount to be paid for all known claims or incidents and a reserve for incurred but not reported claims.

2. Cash, Investments, and Assets Whose Use is Limited

At September 30, 2018 and 2017, the District had cash on hand and deposits as follows, in thousands:

	<u>2018</u>	<u>2017</u>
Insured (FDIC) or collateralized with securities held by the District	\$ 2,431	\$ 1,844
Collateralized by securities held by the pledging financial institution's trust department, but not in the District's name	<u>117,549</u>	<u>122,405</u>
Total	<u>\$ 119,980</u>	<u>\$ 124,249</u>

The types of securities which are permitted investments for District funds are established by the District's Investment Policy in accordance with South Carolina Statutes. As of September 30, 2018, the District's funds are permitted to be invested in certain principal protected investment vehicles. The District's investments maintain a target allocation of one-third corporate bonds, one-third U.S. Intermediate Term Treasuries, and one-third Treasury Inflation Protected Securities as established by the District's Investment Policy.

Custodial Credit Risk - The District's deposits are exposed to custodial credit risk if they are not covered by depository insurance and the deposits are uncollateralized or are collateralized with securities held by the pledging financial institution's trust department or agent but not in the depositor-government's name. The District's investment securities are exposed to custodial credit risk if the securities are uninsured, are not registered in the name of the District, and are held by either the counterparty or the counterparty's trust department or agent but not in the District's name. The deposit risk is that, in the event of the failure of a depository financial institution, the District will not be able to recover deposits or will not be able to recover collateral securities that are in the possession of an outside party.

Concentration of Credit Risk - This is the risk associated with the amount of investments the District has with any one issuer that exceeds 5% or more of its total investments and assets whose use is limited. Investments issued or explicitly guaranteed by the U.S. government and investments in mutual funds, external investment pools, and other pooled investments are excluded from this requirement. The District's investment policy states that not more than 10% of a manager's portfolio may be invested in the securities of any one issuer, with the exception of the U.S. Government or its agencies and other sovereign government issuers.

Credit Risk - This is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. The District's investment policy provides guidelines for its fund managers and lists specific allowable investments. The policy provides for the utilization of varying styles of managers so that portfolio diversification is maximized and total portfolio efficiency is enhanced.

Spartanburg Regional Health Services District, Inc.
Notes to the Combined Financial Statements

The credit risk profile of the District's investments and assets whose use is limited as of September 30, 2018 and 2017 is as follows, in thousands:

<u>Investment Type</u>	<u>September 30, 2018</u>	<u>Rating</u>	
		<u>AAA-BBB</u>	<u>N/A</u>
Cash and cash equivalents	\$ 56,287	\$ -	\$ 56,287
Corporate obligations	43,839	43,839	-
Foreign obligations	21,578	21,578	-
U.S. Treasury obligations	125,296	-	125,296
Certificates of deposit	2,000	-	2,000
U.S. agency obligations	75,833	-	75,833
Municipal	654	654	-
Total	<u>\$ 325,487</u>	<u>\$ 66,071</u>	<u>\$ 259,416</u>

<u>Investment Type</u>	<u>September 30, 2017</u>	<u>Rating</u>	
		<u>AAA-BBB</u>	<u>N/A</u>
Cash and cash equivalents	\$ 6,577	\$ -	\$ 6,577
Corporate obligations	45,513	45,513	-
Foreign obligations	19,093	19,093	-
U.S. Treasury obligations	101,394	-	101,394
Certificates of deposit	2,000	-	2,000
U.S. agency obligations	78,728	-	78,728
Municipal	715	715	-
Alternative investments	29	-	29
Total	<u>\$ 254,049</u>	<u>\$ 65,321</u>	<u>\$ 188,728</u>

Interest Rate Risk – This is the risk that changes in interest rates will adversely affect the fair value of an investment. The District's investment policy authorizes a strategic asset allocation that is designed to provide an optimal return over the District's investment horizon and within the District's risk tolerance and cash requirements.

The distribution of the District's investments and assets whose use is limited by maturity as of September 30, 2018 and 2017 is as follows (in thousands):

<u>Investment Type</u>	<u>September 30 2018</u>	<u>Remaining Maturity (In Months)</u>				
		<u>Twelve Months to 24 Months</u>	<u>13 Months to 60 Months</u>	<u>25 Months to 60 Months</u>	<u>Greater Than 60 Months</u>	<u>N/A</u>
Cash and cash equivalents	\$ 56,287	\$ 56,287	\$ -	\$ -	\$ -	\$ -
Corporate obligations	43,839	2,141	6,251	18,413	17,034	-
Foreign obligations	21,578	1,550	2,323	10,104	7,601	-
U.S. Treasury obligations	125,296	34,259	16,609	43,303	31,125	-
Certificates of deposit	2,000	2,000	-	-	-	-
U.S. agency obligations	75,833	2,244	2,255	9,350	61,984	-
Municipal	654	-	-	329	325	-
Total	<u>\$ 325,487</u>	<u>\$ 98,481</u>	<u>\$ 27,438</u>	<u>\$ 81,499</u>	<u>\$ 118,069</u>	<u>\$ -</u>

Spartanburg Regional Health Services District, Inc.
Notes to the Combined Financial Statements

Investment Type	September 30 2017	Remaining Maturity (In Months)				N/A
		Twelve Months to 24 Months	13 Months to 60 Months	25 Months to 60 Months	Greater Than 60 Months	
Cash and cash equivalents	\$ 6,577	\$ 6,577	\$ -	\$ -	-	\$ -
Corporate obligations	45,513	1,763	4,724	16,231	22,795	-
Foreign obligations	19,093	1,371	1,777	8,433	7,512	-
U.S. Treasury obligations	101,394	11,018	9,150	52,890	28,336	-
Certificates of deposit	2,000	2,000	-	-	-	-
U.S. agency obligations	78,728	1,526	2,314	9,602	65,286	-
Municipal	715	150	-	121	444	-
Alternative investments	29	-	-	-	-	29
Total	\$ 254,049	\$ 24,405	\$ 17,965	\$ 87,277	\$ 124,373	\$ 29

The carrying amount of investments and assets whose use is limited is included in the District's combined balance sheets as follows, in thousands:

	<u>2018</u>	<u>2017</u>
Short term investments	\$ 91,276	\$ 28,338
Assets whose use is limited	<u>234,211</u>	<u>225,711</u>
	<u>\$ 325,487</u>	<u>\$ 254,049</u>

For the years ended September 30, 2018 and 2017, net investment income (loss) is comprised of the following:

	<u>2018</u>	<u>2017</u>
Interest and dividends, net of fees	\$ 4,685	\$ 4,281
Net unrealized loss	(4,165)	(3,399)
Net realized loss	<u>(2,377)</u>	<u>(939)</u>
	<u>\$ (1,857)</u>	<u>\$ (57)</u>

3. Fair Value of Financial Instruments

The Fair Value Measurements and Application Standard addresses accounting and financial reporting issues related to fair value measurements. The standard describes fair value as an exit price. The definition of fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. This statement provides guidance for determining a fair value measurement for financial reporting purposes. This statement also provides guidance for applying fair value to certain investments and disclosures related to all fair value measurements.

The statement establishes a three-level hierarchy of inputs to valuation techniques used to measure fair value. Level 1 inputs are quoted prices in active markets for identical assets or liabilities. Level 2 inputs are quoted prices for similar assets or liabilities, inputs that are observable for the asset or liability, and market-corroborated inputs. Level 3 inputs are unobservable inputs and take into account all information about market participant assumptions that are reasonably available. The System categorizes its fair value measurements within the fair value hierarchy established by this standard.

Spartanburg Regional Health Services District, Inc.
Notes to the Combined Financial Statements

For assets carried at fair value, the following table provides fair value information as of September 30, in thousands:

	Assets at Fair Value as of September 30, 2018			
	Level 1	Level 2	Level 3	Total
Corporate obligations	\$ -	\$ 43,839	\$ -	\$ 43,839
Foreign obligations	-	21,578	-	21,578
U.S. Treasury obligations	125,296	-	-	125,296
U.S. agency obligations	-	75,833	-	75,833
Municipal	-	654	-	654
Investments at fair value	<u>\$ 125,296</u>	<u>\$ 141,904</u>	<u>\$ -</u>	<u>\$ 267,200</u>

	Assets at Fair Value as of September 30, 2017			
	Level 1	Level 2	Level 3	Total
Corporate obligations	\$ -	\$ 45,513	\$ -	\$ 45,513
Foreign obligations	-	19,093	-	19,093
U.S. Treasury obligations	101,394	-	-	101,394
U.S. agency obligations	-	78,728	-	78,728
Municipal	-	715	-	715
Alternative investments	-	29	-	29
Investments at fair value	<u>\$ 101,394</u>	<u>\$ 144,078</u>	<u>\$ -</u>	<u>\$ 245,472</u>

The District has approximately \$58.3 million and \$8.6 million of cash and cash equivalents included in assets limited as to use as of September 30, 2018 and 2017, respectively, which were not classified as a level.

The District recognizes transfers between the levels as of the actual date of the event or change in circumstances that caused the transfer. There were no gross transfers between the levels for the years ended September 30, 2018 and 2017.

4. Accounts Receivable and Payable

Patient accounts receivable and accounts payable (including accrued expenses) reported as current assets and liabilities by the District at September 30, 2018 and 2017 consisted of these amounts, in thousands:

Patient Accounts Receivable

	2018	2017
Receivable from patients and their insurance carriers	\$ 182,031	\$ 207,229
Receivable from Medicare	56,749	68,526
Receivable from Medicaid	<u>19,292</u>	<u>21,128</u>
Total patient accounts receivable	258,072	296,883
Less: allowance for uncollectible amounts	<u>(103,993)</u>	<u>(127,737)</u>
Patient accounts receivable, net	<u>\$ 154,079</u>	<u>\$ 169,146</u>

Spartanburg Regional Health Services District, Inc.
Notes to the Combined Financial Statements

Accounts Payable and Accrued Expenses

	<u>2018</u>	<u>2017</u>
Payable to employees (including payroll taxes)	\$ 63,122	\$ 62,250
Payable to suppliers	66,913	63,587
Payable for Medicaid Upper Payment Limit program	7,270	5,987
Payable for Advicare medical claims	259	223
Other	<u>44,954</u>	<u>46,630</u>
Total accounts payable and accrued expenses	<u>\$ 182,518</u>	<u>\$ 178,677</u>

5. Capital Assets

A summary of capital assets and the related accumulated depreciation for 2018 and 2017 is as follows, in thousands:

	<u>Balance September 30 2017</u>	<u>Additions</u>	<u>Transfers</u>	<u>Disposals</u>	<u>Balance September 30, 2018</u>
Land and land improvements	\$ 68,301	\$ 702	\$ 732	\$ (9)	\$ 69,726
Buildings and building fixtures	339,310	2,048	38,852	-	380,210
Fixed equipment	280,512	-	1,050	(1,024)	280,538
Major movable equipment	441,401	-	30,706	(3,582)	468,525
Equipment under capital lease obligations	12,367	-	-	(283)	12,084
Construction-in-progress	<u>51,407</u>	<u>88,543</u>	<u>(71,340)</u>	<u>-</u>	<u>68,610</u>
	1,193,298	91,293	-	(4,898)	1,279,693
Less accumulated depreciation	<u>(682,889)</u>	<u>(55,496)</u>	<u>-</u>	<u>3,719</u>	<u>(734,666)</u>
Capital assets, net	<u>\$ 510,409</u>	<u>\$ 35,797</u>	<u>\$ -</u>	<u>\$ (1,179)</u>	<u>\$ 545,027</u>

	<u>Balance September 30 2016</u>	<u>Additions</u>	<u>Transfers</u>	<u>Disposals</u>	<u>Balance September 30, 2017</u>
Land and land improvements	\$ 68,161	\$ 12	\$ 128	\$ -	\$ 68,301
Buildings and building fixtures	326,502	927	11,881	-	339,310
Fixed equipment	279,524	-	988	-	280,512
Major movable equipment	371,929	59	75,655	(6,242)	441,401
Equipment under capital lease obligations	12,367	-	-	-	12,367
Construction-in-progress	<u>73,762</u>	<u>66,297</u>	<u>(88,652)</u>	<u>-</u>	<u>51,407</u>
	1,132,245	67,295	-	(6,242)	1,193,298
Less accumulated depreciation	<u>(633,241)</u>	<u>(54,809)</u>	<u>-</u>	<u>5,161</u>	<u>(682,889)</u>
Capital assets, net	<u>\$ 499,004</u>	<u>\$ 12,486</u>	<u>\$ -</u>	<u>\$ (1,081)</u>	<u>\$ 510,409</u>

Spartanburg Regional Health Services District, Inc.
Notes to the Combined Financial Statements

Construction commitments at September 30, 2018 consisted of remaining project costs relating to the clinical expansion and renovations of the Pelham Medical Center and the Gibbs Cancer Center of approximately \$54,509,000 to the project contractor.

6. Long-Term Debt and Capital Lease Obligations

Series 2017A

Hospital Revenue and Refunding bonds, Series 2017A were issued on December 21, 2017 in the amount of \$192.5 million consisting of: (i) \$19.0 million of term bonds with an interest rate of 3.63% maturing in 2039; (ii) \$69.2 million of term bonds with an interest rate of 4.0% due in 2043; and (iii) \$52.0 million of term bonds with an interest rate of 4.0% due in 2048 and (iv) \$52.3 million of term bonds with an interest rate of 5.0% due in 2048. Interest is payable semi-annually on October 15 and April 15. The bonds are secured by a pledge of the revenues of the District. The term bonds maturing in 2039 are subject to mandatory sinking fund redemption from 2038 to 2039 ranging in amounts from approximately \$3.4 million to \$15.7 million. The term bonds maturing in 2043 are subject to mandatory sinking fund redemption from 2040 to 2043 ranging in amounts from approximately \$16.3 million to \$18.3 million. The term bonds maturing in 2048 and bearing interest at 4% are subject to mandatory sinking fund redemption from 2044 to 2048 ranging in amounts from approximately \$9.6 million to \$11.2 million. The term bonds maturing in 2048 and bearing interest at 5% are subject to mandatory sinking fund redemption from 2044 to 2048 ranging in amounts from approximately \$9.5 million to \$11.5 million.

The Series 2017A Bonds were issued with a premium of approximately \$9.3 million of which approximately \$9.1 million remains unamortized at September 30, 2018.

The refunding of the Series 2008A and Series 2008D bonds from the issuance of Series 2017A Bonds resulted in losses on refunding of approximately \$1.8 million and \$0.7 million, respectively. This difference, reported in the combined balance sheets as a deferred outflow of resources, is being charged as a component of interest expense through the years 2022 and 2025 using the straight line method, which approximates the effective interest method. At September 30, 2018, the total unamortized loss on refunding is approximately \$2.1 million.

As a result of the advance refunding of a portion of the Series 2008A and the Series 2008D Bonds, the difference between the future cash flows of the refunded debt of approximately \$52.0 million and the future cash flows of the replacement debt of approximately \$80.4 million totals future cash outflows of approximately \$28.4 million. The economic gain on the refunding, which represents the difference between the present values of the refunded debt service requirements and the replacement debt service requirements, discounted at the effective interest rate and adjusted for additional cash paid, total approximately \$4.1 million.

Series 2017B

Hospital Revenue and Refunding bonds, Series 2017B were issued on December 21, 2017 in the amount of \$57.3 million consisting of: (i) \$25.5 million of serial bonds with interest rates ranging from 3.2% to 3.7% maturing in 2027; (ii) \$31.8 million of term bonds with an interest rate of 4.23% due in 2038. Interest is payable semi-annually on October 15 and April 15. The bonds are secured by a pledge of the revenues of the District. The term bonds maturing in 2038 are subject to mandatory sinking fund redemption from 2032 to 2038 ranging in amounts from approximately \$3.1 million to \$11.7 million.

As a result of the advance refunding of a portion of the Series 2008A, the difference between the future cash flows of the refunded debt of approximately \$18.8 million and the future cash flows of the replacement debt of approximately \$21.8 million totals future cash outflows of approximately \$3.0 million. The economic gain on the refunding, which represents the difference between the present values of the refunded debt service requirements and the replacement debt service requirements, discounted at the effective interest rate and adjusted for additional cash paid, total approximately \$1.3 million.

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Series 2012A

Hospital Revenue and Refunding bonds, Series 2012A were issued on July 19, 2012 in the amount of \$132.5 million consisting of: (i) \$27.8 million of serial bonds with interest rates ranging from 2.0% to 5.0% maturing in 2027; (ii) \$55.9 million of term bonds with an interest rate of 5.0% due in 2032; and (iii) \$48.8 million of term bonds with an interest rate of 5.0% due in 2037. Interest is payable semi-annually on October 15 and April 15. The bonds are secured by a pledge of the revenues of the District. The term bonds maturing in 2032 are subject to mandatory sinking fund redemption from 2028 to 2032 ranging in amounts from approximately \$8.3 million to \$12.7 million. The term bonds maturing in 2037 are subject to mandatory sinking fund redemption from 2033 to 2037 ranging in amounts from approximately \$8.9 million to \$10.7 million.

The Series 2012A Bonds were issued with a premium of approximately \$8.5 million of which approximately \$6.3 million remains unamortized at September 30, 2018.

The advance refunding of the Series 2008B and Series 2002 bonds from the issuance of Series 2012A Bonds resulted in losses on refunding of approximately \$4.5 million and \$0.9 million, respectively. This difference, reported in the combined balance sheets as a deferred outflow of resources, is being charged as a component of interest expense through the years 2022 and 2032 using the straight line method, which approximates the effective interest method. At September 30, 2018, the total unamortized loss on refunding is approximately \$2.3 million.

On February 12, 2018, in order to remediate the Series 2012A bonds, the District irrevocably deposited from its general unrestricted funds approximately \$1.4 million for the sole purpose of providing resources to purchase United States Obligations that will produce total matured principal and interest in the amount of approximately \$1.6 million in order to partially defease Series 2012A. As a result, the Series 2012A bonds are considered between the amount placed into trust and the amount of the defeased bonds, approximately \$0.01 million, is recognized as a loss. After this partial defeasement, the remaining balance of this debt as of September 30, 2018 is approximately \$120.9 million.

Series 2012B

Hospital Revenue and Refunding bonds, Series 2012B were issued on July 19, 2012 in the amount of \$20.0 million. Interest is payable monthly at an annual fixed rate of 1.93%, commencing on August 15, 2012. Principal is paid annually on April 15, commencing on April 15, 2013. The bonds are secured by a pledge of the revenues of the District. The Series 2012B bonds mature on April 15, 2023.

The advance refunding of the Series 2008C from the issuance of the Series 2012B Bonds resulted in a loss on refunding of approximately \$0.4 million. This difference, reported in the combined balance sheets as a deferred outflow of resources, is being charged as a component of interest expense through the year 2023 using the straight line method, which approximates the effective interest method. At September 30, 2018, the unamortized loss on refunding is approximately \$0.2 million.

Series 2009

Hospital Revenue bonds, Series 2009 were issued on May 21, 2009 in the amount of \$15.0 million. The Series 2009 bonds are term bonds bearing interest at an annual rate of 4.11%. Principal and interest installments are payable semi-annually on October 15 and April 15, commencing October 15, 2009. The bonds are secured by a pledge of the revenues of the District. The Series 2009 bonds were refunded with the issuance of the Series 2017B bonds.

Series 2008A

Hospital Revenue and Refunding bonds, Series 2008A were issued on June 25, 2008 in the amount of \$49.5 million consisting of: (i) \$23.3 million of serial bonds with interest rates ranging from 4.0% to 5.25% maturing in 2022; (ii) \$10.3 million of term bonds with an interest rate of 5.25% due in 2025; and (iii) \$15.9 million of term bonds with an interest rate of 4.5% due in 2027. Interest is payable semi-annually on October 15 and April 15.

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The bonds are secured by a pledge of the revenues of the District. The term bonds maturing in 2025 are subject to mandatory sinking fund redemption from 2023 to 2025 ranging in amounts from approximately \$1.1 million to \$4.7 million. The term bonds maturing in 2027 are subject to mandatory sinking fund redemption for 2026 and 2027 in the amount of approximately \$7.8 million and \$8.1 million, respectively. The Series 2008A bonds were refunded with the issuance of the Series 2017A bonds and the Series 2017B bonds.

Series 2008B

Hospital Revenue and Refunding bonds, Series 2008B were issued on June 25, 2008 in the amount of \$90.8 million. The Series 2008B are variable rate bonds initially bearing interest determined weekly by the remarketing agent under prevailing market conditions. In accordance with the Series 2008B bond indenture, the District converted the weekly interest rate to a long-term variable interest rate as defined by the bond indenture and interest is payable semi-annually on October 15 and April 15. The bonds are secured by a pledge of the revenues of the District and are subject to mandatory sinking fund redemption annually from 2010 to 2037 ranging in amounts from approximately \$0.1 million to \$8.9 million. The Series 2008B Bonds were refunded with the issuance of the Series 2012A Bonds.

A portion of the proceeds from the issuance of the Series 2008B bonds refunded in advance of their maturity approximately \$18.9 million of the Series 2002 bonds. The partial advance refunding of the Series 2002 bonds resulted in a loss on refunding of approximately \$0.2 million. This difference, reported in the combined balance sheets as a deferred outflow of resources, is being charged as a component of interest expense through the year 2032 using the straight line method, which approximates the effective interest method. At September 30, 2018, the unamortized loss on refunding is approximately \$0.05 million.

Series 2008C

Hospital Revenue and Refunding bonds, Series 2008C, were issued in the amount of \$20.0 million on June 25, 2008. The Series 2008C are variable rate bonds initially bearing interest determined weekly by the remarketing agent under prevailing market conditions. In accordance with the Series 2008C bond indenture, the District converted the weekly interest rate to a long-term variable interest rate as defined by the bond indenture and interest is payable semi-annually on October 15 and April 15. The bonds are secured by a pledge of the revenues of the District and are subject to mandatory sinking fund redemption annually from 2009 to 2023 ranging in amounts from approximately \$0.6 million to \$4.8 million. The Series 2008C Bonds were refunded with the issuance of the Series 2012B Bonds.

A portion of the proceeds of the Series 2008C bonds was deposited in an irrevocable trust with an escrow agent to provide future debt service payments on the Series 1998 bonds. The advance refunding of the Series 1998 bonds resulted in a loss on refunding of approximately \$0.4 million. This difference, reported in the combined balance sheets as a deferred outflow of resources, is being charged as a component of interest expense through the year 2023 using the straight-line method, which approximates the effective interest method. At September 30, 2018, the unamortized loss on refunding is approximately \$0.1 million.

Series 2008D

Hospital Revenue and Refunding bonds, Series 2008D in the amount of \$32.6 million were issued on July 30, 2008 consisting of: (i) \$16.4 million of serial bonds with interest rates ranging from 4.0% to 5.0% maturing in 2018; (ii) \$4.0 million of term bonds with an interest rate of 5.25% due in 2020; (iii) \$4.5 million of term bonds with an interest rate of 5.25% due in 2022; and (iv) \$7.7 million of term bonds with an interest rate of 4.5% due in 2025. Interest is payable semi-annually on October 15 and April 15. The bonds are secured by a pledge of the revenues of the District. The term bonds maturing in 2020 are subject to mandatory sinking fund redemption for 2019 and 2020 in the amount of \$2.0 million and \$2.2 million, respectively. The term bonds maturing in 2022 are subject to mandatory sinking fund redemption for 2021 and 2022 in the amount of approximately \$2.2 million and \$2.3 million, respectively. The Series 2008D bonds were refunded with the issuance of the Series 2017A bonds.

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Series 2002

Hospital Revenue and Refunding Bonds, Series 2002 in the amount of \$49.5 million were issued on May 15, 2002, consisting of: (i) \$19.8 million of serial bonds with interest rates ranging from 3.5% to 5.5% maturing in 2022; (ii) \$2.2 million of term bonds with an interest rate of 5.25% due in 2027; and (iii) \$27.5 million of term bonds with an interest rate of 5.25% due in 2032. Interest is payable semi-annually on October 15 and April 15. The Series 2002 are secured by a pledge of revenues of the District. The Series 2002 Bonds were refunded with the issuance of the Series 2012A Bonds.

Trust agreements for Series 2017 A and B and Series 2012 A and B contain certain restrictive covenants which, among other matters, require the District to maintain its rates, fees and charges to the extent necessary in order for the District to maintain certain earnings levels as defined.

Lines of Credit Agreements

On June 17, 2014, the District entered into a revolving line of credit agreement, with a financial institution. Under the revolving line of credit agreement, the District can borrow up to \$75 million with an adjusted LIBOR rate equal to one-month LIBOR plus 0.55%. The line of credit was modified various times during the years ended September 30, 2016 and 2015 to adjust the commitment amounts. The line of credit was modified on May 5, 2015, with a decrease to the revolving A commitment to \$25 million and an increase to the revolving B commitment to \$50 million, for a total commitment of \$75 million. The line of credit was modified on November 20, 2015, with an increase in the revolving A commitment to \$35 million and a decrease in the revolving B commitment to \$40 million, for a total commitment of \$75 million. The line of credit was modified on March 24, 2016, with an increase in the revolving A commitment to \$66.5 million and a decrease in the revolving B commitment to \$8.5 million, for a total commitment of \$75 million. The line of credit was modified on September 19, 2016, with an increase in the revolving A commitment to approximately \$68.4 million and a decrease in the revolving B commitment to approximately \$6.6 million, for a total commitment of \$75 million. June 17, 2019 was the original maturity date of both commitments. With the issuance of the Series 2017A and 2017B bonds, the revolving line of credit was paid in full and retired on December 21, 2017.

On September 17, 2015, the District entered into a revolving line of credit agreement, with a financial institution. Under the revolving line of credit agreement, the District can borrow up to \$50 million with an adjusted LIBOR rate equal to one-month LIBOR plus 0.65%. On December 21, 2017, the revolving line of credit was paid in full with the issuance of the Series 2017A and Series 2017B bonds.

On February 15, 2018, the District entered into a revolving line of credit agreement, with a financial institution. Under the revolving line of credit agreement, the District can borrow up to \$50 million with an adjusted LIBOR rate equal to one-month LIBOR plus 0.65%. The line of credit matures on February 15, 2021. As of September 30, 2018, the District had not drawn on the revolving line of credit.

Loan Agreements

On October 1, 2017, the District entered into a promissory note agreement with Caman Group, Inc. for \$3.9 million with a fixed interest rate of 3.00%. The note is unsecured. The proceeds of the note were used to purchase the real property and furniture, fixtures and equipment of Woodruff Manor skilled nursing facility. After the initial payment to the lender of \$0.5 million paid November 1, 2017, the note is being repaid over four years in equal monthly installments of interest and principal, commencing December 1, 2017, and maturing on October 1, 2021. Approximately \$2.6 million of the principal balance remained outstanding as of September 30, 2018

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Future principal and interest payments, excluding the unamortized losses on refundings and the unamortized bond premium of the Series 1998, 2002, 2008B&C and 2008A&D under the District's long-term debt agreements for the year ending September 30, are, in thousands:

Year Ending September 30,	<u>Principal Payments</u>	<u>Interest Payments</u>	<u>Total Debt Service</u>
2019	\$ 4,102	\$ 16,713	\$ 20,815
2020	4,404	16,577	20,981
2021	4,651	16,423	21,074
2022	4,065	16,272	20,337
2023	7,034	16,104	23,138
2024 – 2028	32,781	76,775	109,556
2029 – 2033	62,039	70,537	132,576
2034 – 2038	77,039	54,355	131,394
2039 – 2043	84,900	33,857	118,757
2044 – 2048	<u>104,267</u>	<u>14,499</u>	<u>118,766</u>
	<u>\$ 385,282</u>	<u>\$ 332,112</u>	<u>\$ 717,394</u>

Activity related to long-term debt excluding capital lease obligations for the years ended September 30, 2018 and 2017, is summarized as follows (in thousands):

	<u>2017</u>	<u>Additions</u>	<u>Reductions</u>	<u>2018</u>	<u>Amount Due Within 1 Year</u>
Hospital Revenue and Refunding Bonds, Series 2017A	\$ -	\$ 192,530	\$ -	\$ 192,530	\$ -
Hospital Revenue and Refunding Bonds, Series 2017B	-	57,332	-	57,332	-
Hospital Revenue and Refunding Bonds, Series 2012A	123,780	-	(2,930)	120,850	1,730
Hospital Revenue and Refunding Bonds, Series 2012B	13,504	-	(1,522)	11,982	1,606
Hospital Revenue Bonds, Series 2009	3,494	-	(3,494)	-	-
Hospital Revenue and Refunding Bonds, Series 2008A	37,440	-	(37,440)	-	-
Hospital Revenue and Refunding Bonds, Series 2008D	18,065	-	(18,065)	-	-
Lines of Credit	125,000	-	(125,000)	-	-
Notes Payable	-	3,900	(1,312)	2,588	766
Add: Unamortized bond premium	<u>7,196</u>	<u>9,294</u>	<u>(1,146)</u>	<u>15,344</u>	<u>-</u>
Total	<u>\$ 328,479</u>	<u>\$ 263,056</u>	<u>\$ (190,909)</u>	<u>\$ 400,626</u>	<u>\$ 4,102</u>

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	<u>2016</u>	<u>Additions</u>	<u>Reductions</u>	<u>2017</u>	<u>Amount Due Within 1 Year</u>
Hospital Revenue and Refunding Bonds, Series 2012A	\$ 125,365	\$ -	\$ (1,585)	\$ 123,780	\$ 1,630
Hospital Revenue and Refunding Bonds, Series 2012B	14,946	-	(1,442)	13,504	1,522
Hospital Revenue Bonds, Series 2009	5,137	-	(1,643)	3,494	1,711
Hospital Revenue and Refunding Bonds, Series 2008A	39,560	-	(2,120)	37,440	2,175
Hospital Revenue and Refunding Bonds, Series 2008D	19,905	-	(1,840)	18,065	1,910
Lines of Credit	125,000	-	-	125,000	-
Add: Unamortized bond premium	<u>7,623</u>	<u>-</u>	<u>(427)</u>	<u>7,196</u>	<u>-</u>
Total	<u>\$ 337,536</u>	<u>\$ -</u>	<u>\$ (9,057)</u>	<u>\$ 328,479</u>	<u>\$ 8,948</u>

Capital lease obligations

Equipment under capital lease obligations is included in major movable equipment and accumulated depreciation. The carrying value and related accumulated depreciation at September 30, 2018 are approximately \$12.4 million and \$11.9 million, respectively, and at September 30, 2017 are approximately \$12.4 million and \$11.1 million, respectively. The assets recorded under capital leases are pledged as collateral for the capital lease obligations.

Activity related to capital lease obligations for the years ended September 30, 2018 and 2017, is summarized as follows (in thousands):

	<u>2017</u>	<u>Additions</u>	<u>Reductions</u>	<u>2018</u>	<u>Amounts Due Within 1 Year</u>
Capital lease obligations	\$ 950	\$ -	\$ (729)	\$ 221	\$ 221

	<u>2016</u>	<u>Additions</u>	<u>Reductions</u>	<u>2017</u>	<u>Amounts Due Within 1 Year</u>
Capital lease obligations	\$ 3,953	\$ -	\$ (3,003)	\$ 950	\$ 895

The District leases certain equipment used in its operations under capital leases with interest rates varying from 2.0% to 9.3% that have noncancellable terms in excess of one year. Future minimum capital lease payments as of September 30, 2018 are as follows in thousands:

<u>Fiscal Year</u>	<u>Capital Leases</u>
2019	\$ 226
Total minimum lease payments	226
Less amounts representing interest	(5)
Present value of minimum lease payments	<u>221</u>
Less current portion	(221)
	<u>\$ -</u>

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7. Net Patient Service Revenues

Net patient service revenues for the years ended September 30, 2018 and 2017 consisted of the following in thousands:

	<u>2018</u>	<u>2017</u>
Gross patient charges at established rates, including charges foregone for charity care	\$ 3,781,262	\$ 3,375,535
Deductions:		
Contractual adjustments	(2,457,429)	(2,155,183)
Charity care provided at established billing rates	(78,965)	(53,581)
Provision for bad debts	<u>(131,548)</u>	<u>(135,817)</u>
Net patient service revenues	<u>\$ 1,113,320</u>	<u>\$ 1,030,954</u>

The District has agreements with third-party payors for health care services that provide for payments at amounts different from established rates. Payment arrangements include prospectively determined rates per discharge, reimbursed costs, discounted charges, and per diem payments. A summary of the payment arrangements with major third-party payors follows:

Medicare

Inpatient acute care services and outpatient services rendered to Medicare program beneficiaries are paid at prospectively determined rates per discharge. These rates vary according to a patient classification system that is based on clinical, diagnostic, and other factors. Outpatient services are reimbursed under a prospective payment system called the Ambulatory Payment Classification System ("APCs"). Inpatient non-acute services and defined capital and medical education costs related to Medicare beneficiaries are paid based on a cost reimbursement methodology. The District is reimbursed for cost-reimbursable items at a tentative rate with final settlement determined after submission of annual cost reports by the District and audits by the Medicare administrative contractor. The SMC cost reports have been settled with or without audit by the Medicare administrative contractor through 2013, except for the Medicare cost reports from 2007 through 2011, which have been reopened. The PMC cost reports have been settled with or without audit by the Medicare administrative contractor through 2015, except for the Medicare cost reports from 2007 through 2009 and 2011, which have been reopened. Final settlement has not been reached for any of the reopened periods. The SHRC Medicare cost reports have been settled with or without audit by the Medicare administrative contractor through 2014. Approximately 37% and 39% of the District's net patient service revenues for the years ended September 30, 2018 and 2017, respectively, were derived from Medicare.

Medicaid

Inpatient reimbursement is based upon prospectively determined rates per discharge. Outpatient services rendered to Medicaid program beneficiaries are reimbursed under various reimbursement methodologies. The District is reimbursed for outpatient services at tentative rates with final settlement determined after submission of annual cost reports by the District and audits thereof by the fiscal intermediary. The SMC and PMC Medicaid cost reports have been audited and final settlements have been determined by the Medicaid fiscal intermediary through 2013. The Medicaid cost reports for SHRC have been audited by the Medicaid fiscal intermediary through 2006. Approximately 16% and 14% of the District's net patient service revenues for the years ended September 30, 2018 and 2017, respectively, were derived from Medicaid, excluding revenues derived from the Medicaid Upper Payment Limit program.

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The District receives payments for serving a disproportionately high volume of Medicaid patients. The District recognized approximately \$34.1 million and \$28.6 million related to the Medicaid disproportionate share program for the years ended September 30, 2018 and 2017. During the year ended September 30, 2018, the South Carolina Department of Health and Human Services provided notification of a redistribution of Medicaid disproportionate share program funds from federal fiscal year 2014. Approximately \$0.8 million of the disproportionate share program funds recognized during 2018 related to the 2014 redistribution. These amounts have been included in net patient service revenues. South Carolina requires that the District pay a Hospital Tax that is used as matching funds for the Medicaid disproportionate share program. The amount of Hospital Tax paid by the District was approximately \$16.7 million and \$17.4 million for the years ended September 30, 2018 and 2017, respectively. The Hospital Tax is included as a fiscal and administrative expense.

During the year ended September 30, 2014, the State of South Carolina implemented the Medicaid Upper Payment Limit (“UPL”) program for certain providers participating in the state Medicaid program. The District has a receivable of \$15.5 million and \$8.1 million from the UPL program as of September 30, 2018 and 2017, respectively, included in other current assets on the combined balance sheets. The District recorded a corresponding liability of \$7.3 million and \$6.0 million to the program as of September 30, 2018 and 2017, respectively, included in accrued expenses on the combined balance sheets. The net receivable to the District associated with its participation in the UPL program totaled \$8.2 million and \$2.1 million for the years ended September 30, 2018 and 2017, respectively. There can be no assurance that the District will continue to qualify for future participation in this program or that the program will not ultimately be discontinued or materially modified.

Other

The District has also entered into payment agreements with certain commercial insurance carriers, health maintenance organizations, and preferred provider organizations. The bases for payments to the District under these agreements include prospectively determined rates per discharge, discounts from established charges, and prospectively determined daily rates.

Laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. The District believes that it is in compliance with all applicable laws and regulations. Compliance with such laws and regulations can be subject to further government review and interpretation as well as significant regulatory action including fines, penalties and exclusion from the Medicare and Medicaid programs. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term. The net patient service revenue increased by approximately \$1.2 million and \$1.1 million for the years ended September 30, 2018 and 2017, respectively, due to changes in allowances for prior years’ cost reports. Net revenue increased by \$4.6 million for the year ended September 30, 2018, due to recognition of bad debt reimbursement by Medicare Managed Care plans for the fiscal years ended September 30, 2018 and 2017 not previously recognized.

HITECH Funding for Meaningful Use of Electronic Health Records (“EHR”)

In prior years, the District recognized revenue for incentives earned under the Medicare and Medicaid programs in the period in which it is reasonably assured that it will comply with the applicable Health Information Technology for Economic and Clinical Health “HITECH” Funding for Meaningful Use of EHR requirements. Incentive revenues are recognized ratably over the applicable meaningful use demonstration period. Incentive payments received under the Medicare program include a discharge-related portion, which is calculated by the Centers for Medicare & Medicaid Services based on the District’s most recently filed cost report. Such amounts are subject to adjustment at the time of settling the 12-month cost report for the District’s fiscal year that begins after the beginning of the payment year. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term.

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The District achieved compliance with meaningful use requirements under the Medicare program during fiscal year 2017 and, accordingly, recognized other operating revenues of approximately \$1.0 million in the accompanying combined statement of revenues, expenses, and changes in net position for the years ended September 30, 2017, respectively. In 2018, there were no incentives available to be earned under this program.

8. Retirement Plans

Retirement System

The District contributes to the South Carolina Retirement System (“SCRS”). SCRS is a cost-sharing multiple-employer defined benefit pension plan administered by the South Carolina Public Employee Benefit Authority.

Under SCRS, employees who entered the plan before July 1, 2012, who retire at or after age sixty-five (65) or have twenty eight (28) years of service are entitled to an annual retirement benefit, payable monthly for life equal to 1.82% of their final compensation times years of credited service. Benefits are fully vested on reaching five (5) years of earned service. Employees who entered the plan on or after July 1, 2012, who retire at or after age sixty-five (65) or whose age plus years of service total at least ninety (90) years are also entitled to an annual retirement benefit, payable monthly for life equal to 1.82% of their final compensation times years of credited service. Benefits are fully vested on reaching eight (8) years of earned service. Vested employees may retire at or after age fifty-five (55) with at least twenty-five (25) years of service and receive reduced retirement benefits. Vested employees may also retire at or after age sixty (60) and receive reduced retirement benefits. SCRS also provides death and disability benefits. Benefits are established by state statute. A Comprehensive Annual Financial Report containing financial statements and required supplementary information of SCRS is issued and publicly available by writing the South Carolina Retirement System, P.O. Box 11960, Columbia, SC 29211-1960 or at www.retirementsc.gov.

The employee and employer contribution rates are actuarially determined for SCRS. Covered employees are required by state statute to contribute 9.00% and 8.66% of their total earnings for the plan’s fiscal year 2018 and 2017, respectively. The District is required to contribute 13.41% and 11.41% of earnable compensation for the plan’s fiscal year 2018 and 2017, respectively.

Net Pension Liability

The most recent annual actuarial valuation reports are as of July 1, 2017. The net pension liability was therefore determined based on the July 1, 2017 actuarial valuations, using membership data and financial information of the pension funds as of July 1, 2017, projected forward to the end of the plan’s fiscal year, June 30, 2018, using generally accepted actuarial procedures. There was no legislation enacted during the 2018 legislative session that had a material change in benefit provisions or any change in assumptions since the actuarial valuation date. Information included in the following schedules is based on the certification provided by SCRS actuary, Gabriel Roeder Smith & Company.

At September 30, 2018 and 2017, the District reported a net pension liability of \$599.3 million and \$656.3 million, respectively. The net pension liability at September 30, 2018 and 2017 was measured as of June 30, 2018 and 2017, respectively.

For the years ended September 30, 2018 and 2017, the District recognized pension expense of approximately \$40.9 million and \$61.1 million, respectively.

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Sensitivity Analysis

The following represents the sensitivity of the net pension liability to changes in the discount rate based on values as of September 30, 2018 in thousands:

	<u>1% Decrease 6.25%</u>	<u>Current Rate 7.25%</u>	<u>1% Increase 8.25%</u>
Net pension liability	\$ 765,883	\$ 599,283	\$ 480,123

Actuarial assumptions and methods

Actuarial valuations involve estimates of the reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality, and future salary increases. Amounts determined during the valuation process are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future. The total pension liability in the July 1, 2018 and 2017 actuarial valuation was determined using the following actuarial assumptions, applied to all periods included in the measurement:

Discount rate	7.25%
Inflation	2.25%
Expected return on plan assets	7.25%
Mortality	Males - 2016 Public Retirees of South Carolina Mortality Tables multiplied by 100%
	Females – 2016 Public Retirees of South Carolina Mortality Table multiplied by 111%

The discount rate adopted by the District for valuing plan liabilities was determined by the methods prescribed under GASB Statement No. 68, *Accounting and Financial Reporting for Pensions* which requires the use of a long term rate of return on plan assets, unless a projection of the net fiduciary position will not be sufficient to provide for projected benefit payments of the covered current and former employees.

The projected return on plan assets and inflation assumptions are developed through review of current and historical capital markets data and historical performance of investment strategies. These projections are combined to produce the long-term expected rate of return by weighting the expected future real rates of return by the target asset allocation percentage and by adding expected inflation.

The target allocation for each major asset class as of September 30, 2018 are summarized in the following table:

	<u>Target Asset Allocation</u>
Global equity	47%
Real assets	10%
Opportunistic	13%
Diversified credit	18%
Conservative fixed income	<u>12%</u>
	<u>100%</u>

Spartanburg Regional Health Services District, Inc.
Notes to the Combined Financial Statements

Deferred outflows and deferred inflows related to pensions

At September 30, 2018, the District reported deferred outflows and inflows related to pensions from the following sources in thousands:

	<u>Deferred Outflow</u>	<u>Deferred Inflow</u>
Differences between expected and actual experience	\$ 1,127	\$ 3,517
Assumption changes	23,817	-
Net difference between projected and actual earnings on pension plan investments	9,668	-
Changes in proportion and differences between District contributions and proportionate share of contributions	921	42,242
District contributions subsequent to the measurement date	<u>8,825</u>	<u>-</u>
	<u>\$ 44,358</u>	<u>\$ 45,759</u>

The \$8.8 million reported as deferred outflows of resources related to pensions resulting from the District's contributions subsequent to the measurement date will be recognized as a reduction of the net pension liability in the year ended September 30, 2019. Other amounts reported as deferred outflows and deferred inflows related to pensions will be recognized in pension expense as follows in thousands:

2019	\$ 7,328
2020	2,970
2021	(18,702)
2022	<u>(1,822)</u>
Net balance of deferred inflows	<u>\$ (10,226)</u>

Alternative retirement plans

Employees are eligible for alternative retirement plans, which include a 401(k) plan and a 457(b) plan. The 401(k) plan is provided through the South Carolina Deferred Compensation Program. Employees can contribute as much as the maximum allowed by the Internal Revenue Service ("IRS") and employees age 50 or older can contribute an additional amount per year under the "catch-up" provisions provided by the IRS. The District may elect to make a matching contribution equal to 100% of employee deferrals up to 4% of compensation deferred. Employees that are not members of SCRS are eligible for a District match. Employees are immediately vested in their contributions and the District's matching contributions. The 457(b) plan is provided by Transamerica. Employees may contribute as much as their pre-tax earnings as allowed annually by the IRS. There is no District match associated with the 457(b) plan. The 457(f) plan is a nonqualified retirement plan available for employees whose compensation exceeds \$275,000 and are not members of SCRS. The 457(f) plan is 100% funded by the District, and discretionary contributions are made annually on all earnings exceeding \$275,000.

Other Retirement Plan

The supplemental executive retirement plan is provided to key executive personnel as a reward for outstanding service. The annual benefit accrual or amount credited to a participant's account for a plan year is compensation based. Vesting of 50% of the participant's account occurs after five full years of participation in the plan. The participant is 100% vested after ten years of participation, upon involuntary separation from service, death or attainment of age sixty-two. This plan was paid out as of September 30, 2017.

Spartanburg Regional Health Services District, Inc.
Notes to the Combined Financial Statements

9. Commitments and Contingencies

Operating Leases

The District leases certain equipment and facilities used in its operations under operating leases that have noncancellable terms in excess of one year. Future minimum lease payments as of September 30, 2018 under leases classified as operating leases are as follows in thousands:

2019	\$	2,436
2020		2,004
2021		1,856
2022		1,570
2023		1,517
Thereafter		<u>4,049</u>
Total minimum lease payments	\$	<u>13,432</u>

Lease expense relating to operating leases was approximately \$3.1 million and \$3.4 million in 2018 and 2017, respectively.

Lease and operations transfer

On August 2, 2015, the District entered into a Lease and Operations Transfer Agreement with Union Hospital District (UHD), a special purpose governmental healthcare provider, whereby certain specified assets and operations were transferred from UHD to the District so that healthcare services will continue to be available to residents of Union County while UHD goes through bankruptcy proceedings and in the future. The transferred operating assets included inventory and supplies, software and systems, books and records (including patient and employee records), trade names and trademarks, licenses and permits (excluding Medicare and Medicaid provider numbers), and other tangible and intangible assets not specifically excluded. Excluded assets include cash and equivalents, patient accounts receivable, leased property and equipment (discussed below), third-party settlements, and nursing home and EMS assets.

The District assumed certain ongoing contracts and expenses, and agreed to participate in the Medicare and Medicaid programs and provide charity and indigent care, but otherwise did not assume any liabilities or obligations of UHD in connection with the lease and transfer agreement.

The agreement included an interim arrangement whereby UHD leases to the District specified real estate and related facilities, fixtures, and improvements for a period of four years (or upon occupancy of the new facilities discussed below), with a nominal rent of \$1 per annum. The lease arrangement also includes all equipment, vehicles, machinery, furniture and other tangible personal property used in connection with the leased facilities. During the lease term the District will acquire real property in Union County for no less than \$10 million and construct a new health care facility. UHD will transfer certain services to the new healthcare facility at the commencement of the lease.

Professional malpractice liability insurance

The District is self-insured for professional and general liability insurance coverage. The self-insurance program is responsible for payment of all claims and costs not to exceed \$0.6 million on an individual case basis. A liability of \$14.8 million has been established for payment of all claims reported as of September 30, 2018 including an accrual of estimated incurred but not reported claims. Stop-loss or excess liability insurance is in effect for any single claim in excess of \$0.6 million or in the aggregate of \$10 million.

At September 30, 2018, management is aware of no claims that might lead to significant amounts not adequately funded by the District or covered by insurance that would have a material adverse effect on the combined financial position of the District.

Spartanburg Regional Health Services District, Inc.
Notes to the Combined Financial Statements

Self-insurance plan

The District's health insurance plan (Plan) is a self-insured plan that provides certain benefits for covered employees. The employee pays a monthly premium and the Plan will pay for certain medical expenses, as defined in the Plan document. The District has an accrual of approximately \$4.6 million and \$4.1 million for estimated incurred but not reported claims as of September 30, 2018 and 2017, respectively. In addition, the District has a stop loss insurance policy should a member's annual claims exceed \$850,000. The member's claims exceeding this dollar threshold will be covered by the stop loss insurance plan for the remainder of the plan year.

Workers' compensation

The District participates in a workers' compensation self-insurance pool operating as Palmetto Hospital Trust (PHT). Beginning in January 2008, the District elected to accept legal and financial responsibility for a per claim deductible of \$350,000 in exchange for a deductible credit against its deposit premium. In order to facilitate the efficient administration of the program and the payment of claims and expenses, PHT from time to time will advance funds on behalf of the District equal to the deductible obligation of the District.

Industry

The healthcare industry is subject to numerous laws and regulations of federal, state and local governments. These laws and regulations include, but are not necessarily limited to, matters such as licensure, accreditation, governmental health care program participation requirements, reimbursement for patient services, and Medicare and Medicaid fraud and abuse. Management believes the District is in compliance with fraud and abuse as well as other applicable government laws and regulations. Compliance with such laws and regulations can be subject to future government review and interpretation as well as regulatory actions unknown or unasserted at this time. Violations of these laws and regulations could result in expulsion from government healthcare programs together with the imposition of significant fines and penalties, as well as significant repayments for patient services previously billed.

10. Related Party Transactions

The amounts due from Regional HealthPlus, LLC ("RHP") are approximately \$4.4 million and \$2.6 million as of September 30, 2018 and 2017, respectively, included in other current assets on the combined balance sheets. The amounts due to RHP are approximately \$2.3 million and \$1.6 million as of September 30, 2018 and 2017, respectively, included in accounts payable on the combined balance sheets. The District pays operating expenses for RHP for which RHP reimburses the District.

The District pays substantially all the operating expenses on behalf of Spartanburg Regional Healthcare System Foundation (the "Foundation"). The District paid approximately \$1.7 million in both 2018 and 2017, respectively, on behalf of the Foundation. The Foundation issues grants to the District with approximately \$0.5 million granted during both 2018 and 2017, respectively. The grant revenue is included in nonoperating revenues.

The District has entered into an agreement to lease medical office space to the Ambulatory Surgery Center of Pelham, LLC initially expiring on September 30, 2015. The lease was extended through May 31, 2020 with monthly payments of approximately \$57,000 increasing up to 5% a year. Future lease revenue will be approximately \$0.7 million per year.

11. Fair Value of Financial Instruments

The fair value of the Series 2017A, 2017B and 2012A bonds were estimated using discounted cash flows based on market yield on comparable bonds for a similar type of borrowing arrangement. The carrying amount approximates fair value for the 2012B bonds and the other long-term notes payable. The carrying values of the District's long-term debt at September 30, 2018 and 2017 are approximately \$400.6 million and \$328.5 million, respectively. The fair values are approximately \$389.3 million and \$334.9 million, respectively.

12. Subsequent Events

The District acquired Mary Black Health System assets from Community Health Systems, Inc. on January 1, 2019, for \$75,785,000, utilizing proceeds from the line of credit entered into on December 17, 2018. The acquisition includes the 207-bed Mary Black hospital in Spartanburg, SC, which becomes Spartanburg Medical Center – Mary Black Campus, and the 125-bed Mary Black hospital in Gaffney, SC, which becomes Cherokee Medical Center. In addition, the acquisition includes all Mary Black physician practices and outpatient services.

On December 17, 2018, the District entered into a revolving line of credit with a financial institution with a maturity date of December 17, 2021. Under the revolving line of credit agreement the District can borrow up to \$125 million with an adjusted LIBOR rate equal to one-month LIBOR plus 0.65%. The revolving line of credit for \$50 million dated February 15, 2018, was paid in full and closed on December 21, 2018.

The District evaluated the effect subsequent events would have on the combined financial statements through March 29, 2019, which is the date the combined financial statements were available for issuance.

Required Supplementary Information

Spartanburg Regional Health Services District, Inc.
Schedule of Proportionate Share of the Net Pension Liability
September 30, 2018, 2017, 2016, 2015 and 2014

	<u>2018</u>	<u>2017</u>	<u>2016</u>	<u>2015</u>	<u>2014</u>
	<i>(In Thousands)</i>				
Proportionate share of the net pension liability	3%	3%	3%	3%	3%
Proportionate share of the net pension liability	\$ 599,283	\$ 656,278	\$ 620,593	\$ 568,567	\$ 522,697
Covered-employee payroll	280,691	286,963	287,255	284,073	281,946
Proportionate share of the net pension liability as a percentage of its covered-employee payroll	214%	229%	216%	200%	185%
Plan fiduciary net position as a percentage of total pension liability	54%	53%	53%	57%	60%

* The amounts presented for each fiscal year were determined as of the plan's fiscal year ended June 30.

See accompanying notes.

Spartanburg Regional Health Services District, Inc.
Schedule of Contributions
September 30, 2018, 2017, 2016, 2015 and 2014

	<u>2018</u>	<u>2017</u>	<u>2016</u>	<u>2015</u>	<u>2014</u>
	<i>(In Thousands)</i>				
Contractually required contribution	\$ 37,660	\$ 34,034	\$ 31,732	\$ 30,683	\$ 29,703
Contributions in relation to the contractually required contribution	<u>37,660</u>	<u>34,034</u>	<u>31,732</u>	<u>30,683</u>	<u>29,703</u>
Contribution deficiency (excess)	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>
District's covered-employee payroll	280,691	286,963	287,255	284,073	281,946
Contribution as a percentage of the covered-employee payroll	13%	12%	11%	11%	11%

See accompanying notes.