SOUTHWELL, INC.

CONSOLIDATED FINANCIAL STATEMENTS

for the year ended September 30, 2019

CONTENTS

Draffin Tucker

INDEPENDENT AUDITOR'S REPORT

Board of Directors
Southwell, Inc.
Tifton, Georgia

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of Southwell, Inc. (Southwell), (formerly known as Keystone Medical Services Corporation), which comprise the consolidated balance sheet as of September 30, 2019, and the related consolidated statements of operations and changes in net assets, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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

Continued

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Southwell, Inc. as of September 30, 2019, and the results of its operations, changes in net assets and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As disclosed in Note 1 to the consolidated financial statements, effective November 19, 2018, Keystone Medical Services Corporation changed its name to Southwell, Inc. and effective September 20, 2018, Healthway Medical Services, Inc. changed its name to Tift Regional Health System, Inc. (System). The System is a wholly owned subsidiary of Southwell. Also, effective March 1, 2019, the System undertook a corporate restructuring and executed a Lease and Transfer Agreement with Tift County Hospital Authority (Authority), whereby the System agreed to lease substantially all of the assets, liabilities, and operations of the Authority for an initial period of forty years. Our opinion is not modified with respect to these matters.

Changes in Accounting Principle

As discussed in Note 1 to the consolidated financial statements, Southwell adopted new accounting guidance, Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Accounting Standards Update (ASU) No. 2014-09, *Revenue from Contracts with Customers (Topic 606)* and ASU No. 2016-14 *Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities.* Our opinion is not modified with respect to this matter.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated February 27, 2020, on our consideration of Southwell's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is solely to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the effectiveness of Southwell's internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering Southwell's internal control over financial reporting and compliance.

Draffin & Tucker, LLP

Atlanta, Georgia
February 27, 2020

SOUTHWELL, INC.

Consolidated Balance Sheet
September 30, 2019

	2019
Assets	
Current assets:	
Cash and cash equivalents	$ 61,187,000
Short-term investments	5,259,000
Patient accounts receivable, net	56,667,000
Supplies, at lower of cost and net realizable value	2,912,000
Professional insurance recoverable	1,188,000
Other current assets	7,303,000
Total current assets	134,516,000
Assets limited as to use	493,974,000
Property and equipment, net	269,696,000
Other investments	849,000
Prepaid recruitment expense	1,425,000
Goodwill	4,491,000
Total assets	$ 904,951,000
Liabilities and Net Assets	
Current liabilities:	
Current portion of long-term debt	$ 25,124,000
Accounts payable	26,068,000
Accrued expenses	26,307,000
Estimated third-party payor settlements	3,286,000
Professional insurance payable	1,543,000
Total current liabilities	82,328,000
Long-term debt, net of current portion	255,974,000
Total liabilities	338,302,000
Net assets without donor restrictions	566,649,000
Total liabilities and net assets	$ 904,951,000

See accompanying notes to consolidated financial statements.

Consolidated Statement of Operations and Changes in Net Assets
Year Ended September 30, 2019

	2019
Revenues, gains, and other support:	
Net patient service revenue	$ 225,508,000
Employee lease revenue from Authority	27,394,000
Other revenue	3,652,000
Total revenues, gains, and other support	256,554,000
Expenses:	
Salaries and wages	122,964,000
Employee benefits	29,256,000
Contract and purchased services	10,692,000
Physician services	8,973,000
Supplies and drugs	42,557,000
Depreciation	18,746,000
Goodwill amortization	1,468,000
Interest expense	2,601,000
Other expense	20,065,000
Total expenses	257,322,000
Operating loss	(768,000)
Nonoperating gains:	
Investment income	24,045,000
Rural hospital tax credit contribution	529,000
Total nonoperating gains	24,574,000
Excess of revenues over expenses	23,806,000
Transfers from affiliated entities	311,000
Transfer from Tift County Hospital Authority	541,866,000
Change in net assets without donor restrictions	565,983,000
Net assets without donor restrictions, beginning of year	666,000
Net assets without donor restrictions, end of year	$ 566,649,000

See accompanying notes to consolidated financial statements.

SOUTHWELL, INC.

Consolidated Statement of Cash Flows
Year Ended September 30, 2019

	2019
Cash flows from operating activities:	
Receipts from and on behalf of patients	$ 229,857,000
Payments to employees	(123,943,000)
Payments to suppliers and contractors	(73,639,000)
Other receipts	3,652,000
Interest paid	(2,731,000)
Investment income	15,193,000
Rural hospital tax credit contributions	529,000
Transfers from affiliates	311,000
Transfer from Tift County Hospital Authority	75,023,000
Net cash provided by operating activities	124,252,000
Cash flows from financing activities:	
Proceeds from issuance of long-term debt	24,293,000
Payments on long-term debt	(2,505,000)
Net cash provided by financing activities	21,788,000
Cash flows from investing activities:	
Purchases of property and equipment, net of retirements	(52,614,000)
Sale of debt and equity securities	161,897,000
Purchase of debt and equity securities	(155,689,000)
Sale of short-term investments	4,250,000
Purchase of short-term investments	(4,003,000)
Net cash used by investing activities	(46,159,000)
Net change in cash and cash equivalents	99,881,000
Cash and cash equivalents, beginning of year	93,000
Cash and cash equivalents, end of year	$ 99,974,000

Continued

SOUTHWELL, INC.

Consolidated Statement of Cash Flows, Continued
Year Ended September 30, 2019

	2019
Reconciliation of cash and cash equivalents to the balance sheet:	
Cash and cash equivalents	$ 61,187,000
Cash and cash equivalents included in short-term investments	609,000
Cash and cash equivalents included in assets limited as to use	38,178,000
Total cash and cash equivalents	$ 99,974,000
Reconciliation of change in net assets to net cash provided by operating activities:	
Change in net assets	$ 565,983,000
Adjustments to reconcile change in net assets to cash provided by operating activities:	
Depreciation	18,746,000
Goodwill amortization	1,468,000
Change in unrealized gains and losses on investments	(8,852,000)
Bond premium amortization	(130,000)
Transfer from Tift County Hospital Authority	(466,843,000)
Changes in:	
Patient accounts receivable	4,349,000
Supplies	63,000
Professional insurance recoverable	(1,188,000)
Other current assets	1,212,000
Prepaid recruitment expense	28,000
Accounts payable	9,395,000
Accrued expenses	883,000
Estimated third-party payor settlements	(1,405,000)
Professional insurance payable	543,000
Net cash provided by operating activities	$ 124,252,000

See accompanying notes to consolidated financial statements.

1. Description of Reporting Entity and Summary of Significant Accounting Policies

Reporting entity. Southwell, Inc. (Southwell) (formerly known as Keystone Medical Services Corporation), located in Tifton, Georgia, is a comprehensive healthcare system which provides short-term medical, surgical, obstetrical, pediatric, geriatric psychiatry, and physician care and long-term nursing care to patients in Tift County and the surrounding area. Southwell operates Tift Regional Medical Center (an acute care hospital), Southwell Medical (an acute care hospital formerly known as Cook Medical Center), Southwell Health and Rehabilitation (a nursing home formerly known as Cook Senior Living Center), and several physician practices.

Southwell is the sole member of Tift Regional Health System, Inc. (System) (formerly known as Healthway Medical Services, Inc.).

Effective March 1, 2019, the System undertook a corporate restructuring and executed a Lease and Transfer Agreement (Agreement) with Tift County Hospital Authority (Authority), a public body corporate and politic organized under the Hospital Authorities Law of the State of Georgia. Under the Agreement, the System assumed substantially all of the operations, assets, and liabilities of the Authority and agreed to operate the facilities for an initial period of forty years. Also, the System makes nominal lease payments to the Authority plus amounts sufficient to make debt service payments on Authority conduit debt obligations as they come due, and assumes all operational, financial, indigent care, and community responsibilities. The governing board of the System is initially comprised of five former members of the Authority plus three additional members and is self-perpetuating. The governing board of Southwell is initially comprised of three current members of the Authority, four former members of the Authority, plus one additional member, and is self-perpetuating. Because Southwell's and the System's Board of Directors are self-perpetuating, and the Authority does not have financial accountability for Southwell or the System, Southwell and the System are excluded from the Authority's reporting entity subsequent to the restructuring.

The Authority was the sole corporate member of CareAlliance: An Accountable Care Organization, LLC (ACO). In connection with the restructuring, the Authority's membership in the ACO was transferred to the System.

In connection with the restructuring, the Authority and the System entered into a Workforce Transfer Agreement and a Workforce Services Agreement. Under the Workforce Transfer Agreement, the Authority transferred all of its workforce (employees and independent contractors) to the System on January 1, 2019. Under the Workforce Services Agreement, the System provided the services of the workforce to the Authority from January 1, 2019 through February 28, 2019 at cost.

Due to the nature of the restructuring, the Agreement was accounted for as a transaction between entities under common control, whereby the Authority transferred its net position at carrying values as of March 1, 2019.

The accompanying consolidated financial statements include Southwell, the System, and the ACO. All significant intercompany transactions have been eliminated.

Continued

1. Description of Reporting Entity and Summary of Significant Accounting Policies, Continued

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

Significant items subject to such estimates and assumptions include the determination of variable consideration for patient contracts, estimated third-party payor settlements, and insurance reserves. In particular, laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates associated with these programs will change by a material amount in the near term.

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

Short-term investments. Short-term investments consist of certificates of deposit with maturities ranging from 6 months to 12 months.

Investments. Investments in equity securities with readily determinable fair values and all investments in debt securities, which are all classified as trading securities, are measured at fair value in the balance sheet. Investments without a readily determinable fair value are measured at cost, minus impairment, if any, plus or minus changes resulting from observable price changes in orderly transactions for the identical or similar investment of the same issuer. Investment income or loss (including interest, dividends, and gains and losses, both realized and unrealized) is included in excess of revenue over expenses unless the income is restricted by donor or law.

Investments without a readily determinable fair value are included in other investments on the balance sheet. These investments consist of an 8.00% investment in Distribution Cooperative, Inc. and a 15.12% investment in Stratus Healthcare, LLC.

Fair value measurements. FASB ASC 820, *Fair Value Measurement and Disclosures* defines fair value as the amount that would be received for an asset or paid to transfer a liability (i.e., an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. FASB ASC 820 also establishes a fair value hierarchy that requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. FASB ASC 820 describes the following three levels of inputs that may be used:

- *Level 1:* Quoted prices (unadjusted) in active markets that are accessible at the measurement date for identical assets and liabilities. The fair value hierarchy gives the highest priority to Level 1 inputs.

Continued

1. Description of Reporting Entity and Summary of Significant Accounting Policies, Continued

Fair value measurements, continued.

- *Level 2:* Observable prices that are based on inputs not quoted on active markets but corroborated by market data.

- *Level 3:* Unobservable inputs when there is little or no market data available, thereby requiring an entity to develop its own assumptions. The fair value hierarchy gives the lowest priority to Level 3 inputs.

Assets limited as to use. Assets limited as to use include assets held by trustee for capital acquisitions and for debt service reserve, and assets internally designated for capital acquisitions and malpractice self-insurance, over which the Board retains control and may at its discretion subsequently use for other purposes.

Property and equipment. Property and equipment acquisitions are recorded at cost. Depreciation is provided over the estimated useful life of each class of depreciable asset and is computed on the straight-line method. Buildings and equipment under capital lease obligations are amortized on the straight-line method over the shorter period of the lease term or the estimated useful life of the building or equipment. Such amortization is included in depreciation in the consolidated financial statements.

Gifts of long-lived assets such as land, buildings, or equipment are reported as increases in net assets without donor restrictions, and are excluded from excess of revenue over expenses, unless explicit donor stipulations specify how the donated assets must be used. Gifts of long-lived assets with explicit restrictions that specify how the assets are to be used and gifts of cash or other assets that must be used to acquire long-lived assets are reported as increases in net assets with donor restrictions. Absent explicit donor stipulations about how long those long-lived assets must be maintained, expirations of donor restrictions are reported when the donated or acquired long-lived assets are placed in service.

Impairment of long-lived assets. Southwell evaluates on an ongoing basis the recoverability of its assets for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is required to be recognized if the carrying value of the asset exceeds the undiscounted future net cash flows associated with that asset. The impairment loss to be recognized is the amount by which the carrying value of the long-lived asset exceeds the asset's fair value. In most instances, the fair value is determined by discounted estimated future cash flows using an appropriate interest rate. Southwell has not recorded any impairment charges in the accompanying consolidated statement of operations and changes in net assets for the year ended September 30, 2019.

Continued

1. Description of Reporting Entity and Summary of Significant Accounting Policies, Continued

Prepaid recruitment expense. Southwell has entered into recruiting arrangements and educational loans with physicians that are to be repaid with interest at the prime rate plus 1%. The loans may be considered repaid by the physicians meeting certain community service obligations for a period of time. When and if these conditions are met, the loans are forgiven. If the physician ceases to meet the community service obligations before the loan is forgiven, the outstanding principal and accrued interest becomes due immediately. The amount of loans to physicians charged to expense during 2019 was approximately $456,000. These expenses are reflected in physician services in the accompanying consolidated statement of operations and changes in net assets.

Costs of borrowing. Interest cost incurred on borrowed funds during the period of construction of capital assets is capitalized as a component of the cost of acquiring those assets. Interest cost capitalized during 2019 was approximately $2,511,000.

Costs incurred in connection with the issuance of long-term debt are deferred and amortized over the term of the debt using the effective interest method. Debt issuance costs related to a recognized debt liability are presented in the balance sheet as a direct deduction from the carrying amount of the related debt liability.

Goodwill. Goodwill represents the excess of the acquisition price over the fair value of net assets acquired through business combinations. Goodwill is being amortized over five years, the time period of restrictive non-compete covenants included with the acquisition of physician practices. When events or circumstances indicate that goodwill may be impaired, goodwill is tested for impairment. Impairment, if any, will be recognized for the difference between the fair value of the physician practice and its carrying amount and will be limited to the carrying amount of goodwill.

Net assets. Net assets, revenues, gains, and losses are classified based on the existence or absence of donor imposed restrictions. Accordingly, net assets and changes therein are classified and reported as follows:

- *Net assets without donor restrictions* – net assets available for use in general operations and not subject to donor imposed restrictions. The Board of Directors has discretionary control over these resources. Designated amounts represent those net assets that the Board has set aside for a particular purpose. All revenue not restricted by donors and donor restricted contributions whose restrictions are met in the same period in which they are received are accounted for in net assets without donor restrictions.

- *Net assets with donor restrictions* – net assets subject to donor imposed restrictions. Some donor imposed restrictions are temporary in nature, such as those that will be met by the passage of time or other events specified by the donor. Other donor imposed restrictions are perpetual in nature, where the donor stipulates that resources be maintained in perpetuity. All revenues restricted by donors as to either timing or purpose of the related expenditures or required to be maintained in perpetuity as a source of investment income are accounted for in net assets with donor restrictions. When a donor restriction expires, that is when a stipulated time restriction ends or purpose restriction is accomplished, net assets with donor restrictions are reclassified to net assets without donor restrictions.

Continued

1. Description of Reporting Entity and Summary of Significant Accounting Policies, Continued

Excess of revenues over expenses. The statement of operations includes excess of revenues over expenses. Changes in net assets without donor restrictions which are excluded from excess of revenues over expenses, consistent with industry practice, include permanent transfers of assets to and from affiliates for other than goods and services and contributions of long-lived assets (including assets acquired using contributions which by donor restriction were to be used for the purposes of acquiring such assets).

Net patient service revenue. Southwell has agreements with third-party payors that provide for payments to Southwell at amounts different from its established rates. Payment arrangements include prospectively determined rates per discharge, reimbursed costs, discounted charges, and per diem payments. Net patient service revenue is reported at the amount that reflects the consideration to which Southwell expects to be entitled in exchange for providing patient care. These amounts are due from patients, third-party payors, and others and includes variable consideration for retroactive revenue adjustments under reimbursement arrangements with third-party payors. Retroactive adjustments are included in the determination of the estimated transaction price and adjusted in future periods as settlements are determined.

Charity care. Southwell provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. Because Southwell does not pursue collection of amounts determined to qualify as charity care, they are not reported as revenue.

Donor restricted gifts. Unconditional promises to give cash and other assets to Southwell are reported at fair value at the date the promise is received. Conditional promises to give and indications of intentions to give are reported at fair value at the date the gift is received. The gifts are reported as increases in the appropriate categories of net assets in accordance with donor restrictions.

Estimated malpractice and other self-insurance costs. The provisions for estimated medical malpractice claims and other claims under self-insurance plans include estimates of the ultimate costs for both reported claims and claims incurred but not reported.

Income taxes. Southwell and the System are not-for-profit corporations and have been recognized as tax-exempt pursuant to Section 501(c)(3) of the Internal Revenue Code. ACO is considered a disregarded entity of the System.

Southwell applies accounting policies that prescribe when to recognize and how to measure the financial statement effects of income tax positions taken or expected to be taken on its income tax returns. These rules require management to evaluate the likelihood that, upon examination by the relevant taxing jurisdictions, those income tax positions would be sustained. Based on that evaluation, Southwell only recognizes the maximum benefit of each income tax position that is more than 50% likely of being sustained. To the extent that all or a portion of the benefits of an income tax position are not recognized , a liability would be recognized for the unrecognized benefits, along with any interest and penalties that would result from disallowance of the position. Should any such penalties and interest be incurred, they would be recognized as operating expenses.

Continued

1. Description of Reporting Entity and Summary of Significant Accounting Policies, Continued

Income taxes, continued. Based on the results of management's evaluation, no liability is recognized in the accompanying balance sheet for unrecognized income tax positions. Further, no interest or penalties have been accrued or charged to expense as of September 30, 2019 or for the year then ended. Southwell's tax returns are subject to possible examination by the taxing authorities. For federal income tax purposes, the tax returns essentially remain open for possible examination for a period of three years after the respective filing deadlines of those returns.

Recently adopted accounting pronouncements. In 2019, Southwell adopted FASB ASU No. 2014-09, *Revenue from Contracts with Customers (Topic 606),* which is a new comprehensive revenue recognition standard. The core principle of the revenue model is that an entity recognizes revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. Southwell adopted ASU No. 2014-09 on October 1, 2018 using the modified retrospective method of transition and practical expedient in FASB ASC 606-10-65-1(f)(4) with no significant impact. The new guidance was applied only to contracts that are not completed at the date of initial application. Southwell performed an analysis of revenue streams and transactions under ASU No. 2014-09. In particular, for net patient service revenue, Southwell performed an analysis into the application of the portfolio approach as a practical expedient to group patient contracts with similar characteristics, such that revenue for a given portfolio would not be materially different than if it were evaluated on a contract-by-contract basis. Upon adoption, the majority of what was previously classified as provision for bad debts and presented as a reduction to net patient service revenue on the statements of operations is now treated as a price concession that reduces the transaction price, which is reported as net patient service revenue. Changes in credit issues not assessed at the date of service, are recognized as bad debt expense and included as a component of operating expenses on the statement of operations. The new standard also requires enhanced disclosures related to the disaggregation of revenue and significant judgments made in measurement and recognition. The adoption of this guidance did not materially impact total operating revenues, excess of revenues over expenses, or net assets.

In 2019, Southwell adopted FASB ASU No. 2016-14, *Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities.* This comprehensive standard provides guidance on net asset classification and required disclosures on liquidity and availability of resources, requires expanded disclosure about expense and investment returns, and eliminates the requirement to present or disclose the indirect method reconciliation if using the direct method when presenting cash flows.

In 2019, Southwell adopted FASB ASU No. 2019-06, *Intangibles – Goodwill and Other (Topic 350), Business Combinations (Topic 805), and Not-for-Profit Entities (Topic 958),* which allows goodwill to be amortized on a straight-line basis and tested for impairment only when events or circumstances indicate that goodwill is impaired. Management believes that this accounting method more accurately reflects the financial position and results of operations.

In 2019, Southwell early adopted FASB issued ASU No. 2016-01, *Financial Instruments-Overall (Subtopic 825-10): Recognition and Measurement of Financial* Assets *and Financial Liabilities.* The new guidance requires equity investments (except those accounted for under the equity method or those that result in consolidation) to be measured at fair value, with changes in fair value recognized in net income; simplifies the impairment assessment of equity investments without readily determinable fair values; and amends certain disclosure requirements associated with the fair value of financial instruments.

Continued

1. Description of Reporting Entity and Summary of Significant Accounting Policies, Continued

Recently adopted accounting pronouncements, continued. In 2019, Southwell early adopted FASB ASU 2016-18, *Statement of* Cash *Flows – Restricted* Cash, which requires that the statement of cash flows explain the change during the period in the total of cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents. Therefore, amounts generally described as restricted cash and restricted cash equivalents should be included with cash and cash equivalents when reconciling the beginning-of-period and end-of-period total amounts shown on the statement of cash flows.

Accounting pronouncement not yet adopted. In February 2016, the FASB issued ASU No. 2016-02, *Leases (Topic 842),* which is a new comprehensive lease accounting model. The new standard clarifies the definition of a lease and requires lessees to recognize right-of-use assets and related lease liabilities for all leases with terms greater than twelve months. The new guidance, including subsequent amendments, is effective for Southwell as of October 1, 2019. Southwell is continuing to evaluate the impact the guidance will have on the financial statements.

Subsequent event. In preparing these financial statements, Southwell has evaluated events and transactions for potential recognition or disclosure through February 27, 2020, the date the financial statements were issued.

2. Net Patient Service Revenue

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

Performance obligations are determined based on the nature of the services. Revenue for performance obligations satisfied over time is recognized based on actual charges incurred in relation to total expected (or actual) charges. Southwell believes that this method provides a faithful depiction of the transfer of services over the term of the performance obligation based on the inputs needed to satisfy the obligation. Generally, performance obligations satisfied over time relate to patients receiving inpatient, outpatient, and emergency care services. Southwell measures the performance obligation from admission into the hospital to the point when it is no longer required to provide services to that patient, which is generally at the time of discharge. These services are considered to be a single performance obligation and have a duration of less than one year. Revenue for performance obligations satisfied at a point in time is recognized when services are provided and it is believed that additional services are not required to be provided to the patient.

Continued

2. Net Patient Service Revenue, Continued

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

Southwell is utilizing the portfolio approach practical expedient in ASC 606 for contracts related to net patient service revenue. Southwell accounts for the contracts within each portfolio as a collective group, rather than individual contracts, based on the payment pattern expected in each portfolio category and the similar nature and characteristics of the patients within each portfolio. As a result, Southwell has concluded that revenue for a given portfolio would not be materially different than if accounting for revenue on a contract by contract basis.

Southwell has arrangements with third-party payors that provide for payments to Southwell at amounts different from its established rates. For uninsured patients that do not qualify for charity care, Southwell recognizes revenue on the basis of its standard rates, subject to certain discounts and implicit price concessions as determined by Southwell. Southwell determines the transaction price based on standard charges for services provided, reduced by contractual adjustments provided to third-party payors, discounts provided to uninsured patients in accordance with Southwell's policy, and implicit price concessions provided to uninsured patients. Implicit price concessions represent difference between amounts billed and the estimated consideration Southwell expects to receive from patients, which are determined based on historical collection experience, current market conditions, and other factors. Southwell determines its estimates of contractual adjustments and discounts based on contractual agreements, discount policies, and historical experience.

Agreements with third-party payors typically provide for payments at amounts less than established charges. A summary of the payment arrangements with major third-party payors follows:

- *Medicare.* Inpatient and outpatient services rendered to Medicare program beneficiaries are generally are paid at prospectively determined rates. These rates vary according to a patient classification system that is based on clinical, diagnostic, and other factors. Certain other reimbursable items are reimbursed at a tentative rate with final settlement determined after submission of annual cost reports by Southwell and audits thereof by the Medicare Administrative Contractor (MAC). Southwell's Medicare cost reports have been settled by the MAC through September 30, 2014.

  Nursing home services rendered to Medicare program beneficiaries are paid at prospectively determined rates. These rates vary according to a patient classification system called Resource Utilization Groups (RUGs).

Continued

2. Net Patient Service Revenue, Continued

- *Medicaid.* Inpatient services rendered to Medicaid program beneficiaries are paid at prospectively determined rates. Outpatient services rendered to Medicaid program beneficiaries are generally reimbursed under a cost reimbursement methodology. Southwell is reimbursed for cost reimbursable items at a tentative rate with final settlement determined after submission of annual cost reports by Southwell and audits thereof by the Medicaid fiscal intermediary. Southwell's Medicaid cost reports have been settled by the Medicaid fiscal intermediary through September 30, 2015.

  Southwell has also entered into contracts with certain care management organizations (CMOs) to receive reimbursement for providing services to selected enrolled Medicaid beneficiaries. Payment arrangements with these CMOs consist primarily of prospectively determined rates and discounts from established charges.

  Long-term care services are reimbursed by the Medicaid program based on a prospectively determined per diem. The per diem is determined by the facility's historical allowable operating costs adjusted for certain incentives and inflation factors.

  Southwell participates in the Indigent Care Trust Fund (ICTF) Program. Southwell receives ICTF payments for treating a disproportionate number of Medicaid and other indigent patients. ICTF payments are based on Southwell's estimated uncompensated cost of services to Medicaid and uninsured patients. The net amount of ICTF payments recognized in net patient service revenue was approximately $1,026,000 for the year ended September 30, 2019.

  The State of Georgia has legislation known as the Provider Payment Agreement Act (Act) whereby hospitals in Georgia are assessed a “provider payment” in the amount of 1.45% of their net patient revenue. The provider payments are due on a quarterly basis to the State of Georgia. The payments are used for the sole purpose of obtaining federal financial participation for medical assistance payments to providers on behalf of Medicaid recipients. The provider payment results in a corresponding increase in Medicaid payments for hospital services of approximately 11.88%. Southwell made provider payments to the State of Georgia of approximately $2,427,000 for the year ended September 30, 2019. The payments are included in other expenses in the accompanying statement of operations.

- *Other arrangements.* Southwell also has entered into payment agreements with certain commercial insurance carriers, health maintenance organizations, and preferred provider organizations. The basis for payment to Southwell under these agreements includes prospectively determined rates per discharge, discounts from established charges, and prospectively determined daily rates.

Continued

2. Net Patient Service Revenue, Continued

Laws and regulations concerning government programs, including Medicare and Medicaid, are complex and subject to varying interpretation. As a result of investigations by governmental agencies, various health care organizations have received requests for information and notices regarding alleged noncompliance with those laws and regulations, which, in some instances, have resulted in organizations entering into significant settlement agreements. Compliance with such laws and regulations may also be subject to future government review and interpretation as well as significant regulatory action, including fines, penalties, and potential exclusion from the related programs. There can be no assurance that regulatory authorities will not challenge Southwell's compliance with these laws and regulations, and it is not possible to determine the impact (if any) such claims or penalties would have upon Southwell. In addition, the contracts Southwell has with commercial payors also provide for retroactive audit and review of claims.

Settlements with third-party payors for retroactive adjustments due to audits, reviews or investigations are considered variable consideration and are included in the determination of the estimated transaction price for providing patient care. These settlements are estimated based on the terms of the payment agreement with the payor, correspondence from the payor and Southwell's historical settlement activity, including an assessment to ensure that it is probable that a significant reversal in the amount of cumulative revenue recognized will not occur when the uncertainty associated with the retroactive adjustment is subsequently resolved. Estimated settlements are adjusted in future periods as adjustments become known (that is, new information becomes available), or as years are settled or are no longer subject to such audits, reviews, and investigations. Adjustments arising from a change in the transaction price, were not significant in 2019.

Generally patients who are covered by third-party payors are responsible for related deductibles and coinsurance, which vary in amount. Southwell also provides services to uninsured patients, and offers those uninsured patients a discount, either by policy or law, from standard charges. Southwell estimates the transaction price for patients with deductibles and coinsurance and from those who are uninsured based on historical experience and current market conditions. The initial estimate of the transaction price is determined by reducing the standard charge by any contractual adjustments, discounts, and implicit price concessions. Subsequent changes to the estimate of the transaction price are generally recorded as adjustments to patient service revenue in the period of the change. Adjustments arising from a change in the transaction price were not significant for the year ending September 30, 2019. Subsequent changes that are determined to be the result of an adverse change in the patient's ability to pay are recorded as bad debt expense. Bad debt expense for the years ended September 30, 2019 was not significant.

Consistent with Southwell's mission, care is provided to patients regardless of their ability to pay. Therefore, Southwell has determined it has provided implicit price concessions to uninsured patients and patients with other uninsured balances (for example, copays and deductibles).

Patients who meet Southwell's criteria for charity care are provided care without charge or at amounts less than established rates. Such amounts determined to qualify as charity care are not reported as revenue.

Continued

2. Net Patient Service Revenue, Continued

Net patient service revenue by major payor source for the year ended September 30, 2019 is as follows:

	2019
Medicare	$ 87,340,000
Medicaid	12,220,000
Blue Cross	73,771,000
Other third-party payors	52,177,000
Total	$ 225,508,000

Net patient service revenue by facility and timing of revenue recognition for the year ended September 30, 2019 is as follows:

	2019
Tift Regional Medical Center	$ 216,649,000
Southwell Medical	8,859,000
Total services transferred over time	$ 225,508,000

Net patient service revenue includes a variety of services mainly covering inpatient acute care services requiring overnight stays, outpatient procedures that require anesthesia or use of diagnostic and surgical equipment, and emergency care services. Performance obligations are satisfied over time as the patient simultaneously receives and consumes the benefits Southwell performs. Requirements to recognize revenue for inpatient services are generally satisfied over periods that average approximately five days and for outpatient services are generally satisfied over a period of less than one day. For employee pharmacy and cafeteria, recorded in other revenue on the consolidated statement of operations, performance obligations are satisfied at a point in time when the goods are provided.

Southwell has elected the practical expedient allowed under FASB ASC 606-10-32-18 and does not adjust the promised amount of consideration from patients and third-party payors for the effects of a significant financing component due to Southwell's expectation that the period between the time the service is provided to a patient and the time that the patient or a third-party payor pays for that service will be one year or less. However, Southwell does, in certain instances, enter into payment agreements with patients that allow payments in excess of one year. For those cases, the financing component is not deemed to be significant to the contract.

Southwell has applied the practical expedient provided by FASB ASC 340-40-25-4 and all incremental customer contract acquisition costs are expensed as they are incurred as the amortization period of the asset that Southwell otherwise would have recognized is one year or less in duration.

Continued

3. Uncompensated Care

Southwell was compensated for services at amounts less than its standard charges. Net patient service revenue includes amounts representing the transaction price based on standard charges reduced by variable considerations such as contractual adjustments, discounts, and implicit price concessions. The following is a reconciliation of gross patient revenue at standard charges to net patient service revenue:

	2019
Gross patient charges	$ 851,052,000
Uncompensated services:	
Medicare	358,312,000
Medicaid	103,725,000
Blue Cross	28,387,000
Other third-party payors	48,468,000
Charity/indigent/uninsured discount	54,118,000
Price concessions	32,534,000
Total uncompensated care	625,544,000
Net patient service revenue	$ 225,508,000

The estimated cost of charity/indigent care/uninsured discount was approximately $16,363,000 in 2019. The estimated cost of charity/indigent care/uninsured discount includes the direct and indirect cost of providing charity/indigent care services/uninsured discount and is estimated by utilizing a ratio of cost to gross charges applied to the gross uncompensated charges associated with providing charity/indigent care.

4. Concentrations of Credit Risk

Southwell grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payor agreements. The mix of receivables from patients and third-party payors at September 30, 2019 was as follows:

	2019
Medicare	28%
Medicaid	9%
Blue Cross	25%
Other third-party payors	34%
Self-pay	4%
Total	100%

Southwell maintains deposits at major financial institutions which exceed the $250,000 Federal Deposit Insurance Corporation limit. Management believes the credit risks related to these deposits is minimal.

Continued

5. Assets Limited as to Use

The composition of assets limited as to use as of September 30, 2019 is set forth in the following table.

	2019
Internally designated for capital acquisitions:	
Cash	$ 101,000
Money market (cash equivalent)	10,544,000
Certificates of deposit	2,831,000
U.S. Treasury obligations	49,917,000
U.S. Government agency obligations	8,136,000
Corporate obligations	56,349,000
Asset-backed securities	81,136,000
Marketable equity securities	142,269,000
Non-U.S. equity mutual funds	18,159,000
Commodity funds	15,997,000
Other mutual funds	19,003,000
Total	404,442,000
Internally designated for self-insurance:	
Cash	784,000
Certificates of deposit	3,100,000
Total	3,884,000
Held by trustee for capital acquisitions:	
Money market (cash equivalent)	26,570,000
U.S. Treasury obligations	58,899,000
Total	85,469,000
Held by trustee for debt service reserve:	
Cash	179,000
Total assets limited as to use	$ 493,974,000

Continued

5. Assets Limited as to Use, Continued

The fair values of investments measured on a recurring basis at September 30, 2019 are as follows:

	Total	Level 1	Level 2	Level 3
Money market funds	$ 37,114,000	$ 37,114,000	$ -	$ -
Certificates of deposit	5,931,000	5,931,000	-	-
U.S. Treasury obligations	108,816,000	108,816,000	-	-
U.S. Government agency obligations	8,136,000	8,136,000	-	-
Corporate obligations	56,349,000	-	56,349,000	-
Asset-backed securities	81,136,000	-	81,136,000	-
Marketable equity securities	142,269,000	142,269,000	-	-
Non-U.S. equity mutual funds	18,159,000	18,159,000	-	-
Commodity mutual funds	15,997,000	15,997,000	-	-
Other mutual funds	19,003,000	19,003,000	-	-
Total	$ 492,910,000	$ 355,425,000	$ 137,485,000	$ -

A summary of investment income follows:

	2019
Interest and dividends	$ 5,188,000
Realized gains from sale of investments	9,565,000
Unrealized gains on investments	8,852,000
Rental income, net of expenses	(36,000)
Gain on disposal of capital assets	11,000
Other income	465,000
Total	$ 24,045,000

Southwell's investments are exposed to various risks such as interest rate, market, and credit risks. Due to the level of risk associated with certain investment securities, it is at least reasonably possible that changes in the values of investment securities will occur in the near term and that such change could materially affect the amounts reported in the accompanying consolidated financial statements.

Continued

6. Property and Equipment

A summary of property and equipment at September 30, 2019 follows:

	2019
Land	$ 9,749,000
Land improvements	3,526,000
Buildings and improvements	190,334,000
Fixed equipment	24,966,000
Major movable equipment	308,347,000
	536,922,000
Less accumulated depreciation	339,806,000
	197,116,000
Construction-in-progress	72,580,000
Property and equipment, net	$ 269,696,000

Contracts of approximately $154,716,000 exist for the construction of a new patient tower, the renovation and expansion of the emergency center, the construction of the Cook Medical Center replacement facility, and various other projects. At September 30, 2019, the remaining commitment on these contracts approximated $102,210,000.

7. Goodwill

Goodwill is related to the purchases of Tiftarea Surgical Partners, LLC (TSP), Georgia Sports Medicine & Orthopedic Clinic, P.C. (GSM), Tiftarea Urology, P.C. (TU), Urosurg, LLC (US), and Tifton Ophthalmology Associates, P.C. (TOA). The changes in the carrying amount of goodwill are as follows:

	Balance at September 30, 2018	Transfer from Authority	Amortization	Balance at September 30, 2019
TSP and GSM	$ -	$ 1,244,000	$(580,000)	$ 664,000
TU and US	-	4,618,000	(874,000)	3,744,000
TOA	-	97,000	(14,000)	83,000
Total	$ -	$ 5,959,000	$(1,468,000)	$ 4,491,000

Continued

8. Long-Term Debt

A summary of long-term debt at September 30, 2019 follows:

	2019
2013 Series – 2.00% to 5.00% 2013 Series Revenue Anticipation Certificates, principal maturing in varying annual amounts and interest payable semi-annually, secured by the Trust Estate and an intergovernmental contract with Tift County, due December 1, 2042.	$ 76,100,000
2016-A Bank – 1.80% note payable, payable in monthly installments of $383,000 including interest, secured by EMR system and Trust Estate, due July 2026.	29,508,000
2018-A Bank – 2.80% note payable, interest payable quarterly and principal payment due at maturity, secured by Trust Estate, due March 24, 2022.	90,300,000
2018-C Bank – interest at a rate equal to 81.50% of the sum of the LIBOR daily floating rate plus 0.29% (1.95% at September 30, 2019), interest payable monthly and principal due at maturity, secured by the Trust Estate, due February 27, 2020.	18,200,000
2018-D Bank – interest at a rate equal to 81.50% of the sum of the LIBOR daily floating rate plus 0.29% (1.95% at September 30, 2019), interest payable monthly and principal due at maturity, secured by the Trust Estate, due February 27, 2020.	20,000,000
2019-USDA – 2.375% note payable, payable in monthly installments of $163,000 including interest, secured by the Trust Estate, due November 17, 2048.	41,130,000

Continued

8. Long-Term Debt, Continued

	2019
Building lease – interest at a rate equal to 65% of the prime rate published by the *Wall Street Journal* (3.58% at September 30, 2019), secured by leased building. Payable in monthly installments of $4,000 including interest, due October 16, 2034.	$ 634,000
Total long-term debt	275,872,000
Add unamortized bond premium	5,226,000
Less current portion of long-term debt	(25,124,000)
Long-term debt, net of current portion	$ 255,974,000

Southwell operates under a Master Trust Indenture (MTI) that provides for the issuance of long-term debt under an obligated group structure. Through February 28, 2019, the Authority was the sole member of the Obligated Group. Effective March 1, 2019, Southwell and the System were added as members of the Obligated Group. All bonds and notes payable are covered under the MTI. Debt agreements covered by the MTI are secured by the Trust Estate which consists of a first pledge and lien on gross revenues of the Obligated Group.

On January 17, 2013, Southwell issued $83,260,000 Revenue Anticipation Certificates Series 2013 (2013 Series). As security, Southwell created a first pledge of and lien on the gross revenues of Southwell. Pursuant to an intergovernmental contract, Tift County is obligated to make payments, if necessary, in amounts sufficient (limited to ad valorem tax not to exceed 7 mills) to enable Southwell to provide for the payment of principal and interest on the 2013 Series. Proceeds from the Series 2013 were issued to (i) finance or refinance certain additions, extensions, and improvements to Southwell's healthcare and related facilities, (ii) refund Southwell's outstanding 2002 Fixed, (iii) repay a bank loan, and (iv) pay the cost of issuing the 2013 Series.

On July 1, 2016, Southwell entered into a master equipment lease/purchase agreement (2016-A Bank) for $42,000,000 with a financial institution. Proceeds of the 2016-A Bank will be used for the acquisition, installation, and implementation of an Electronic Medical Records (EMR) system. During the term of the 2016-A Bank, Southwell must maintain a debt service coverage ratio greater than or equal to 1.10.

On December 20, 2016, Southwell entered into a loan agreement (2016-B Bank) for $47,695,000 with a financial institution. Proceeds of the 2016-B Bank was used for (i) financing the costs of certain additions, extensions, and improvements to Southwell's facilities, (ii) repay a bank loan, and (iii) paying the closing costs of the loan. During the term of the 2016-B Bank, Southwell must maintain a debt service coverage ratio greater than or equal to 1.25 and days unrestricted cash on hand greater than or equal to 90. The 2016-B Bank was paid off with proceeds of the 2019-USDA loan.

Continued

8. Long-Term Debt, Continued

On September 24, 2018, Southwell entered into a loan agreement (2018-A Bank) for $90,300,000 with a financial institution. Proceeds of the 2018-A Bank will be used for the construction of a patient tower and a new emergency center. During the term of the 2018-A Bank, Southwell must maintain a debt service coverage ratio greater than or equal to 1.25 and days unrestricted cash on hand greater than or equal to 75. Also on that date, Southwell obtained a nonrevolving line-of-credit with the financial institution for $62,020,000 (2018-B Bank) subject to the same use and covenants as the 2018-A Bank. As of September 30, 2019, Southwell had not drawn on 2018-B Bank.

On February 28, 2018, Southwell entered into a loan agreement (2018-C Bank) for $18,200,000 with a financial institution. Proceeds of the 2018-C Bank will be used for the Cook Medical Center replacement facility. During the term of the 2018-C Bank, Southwell must maintain a debt service coverage ratio greater than or equal to 1.25 and days unrestricted cash on hand greater than or equal to 75. Also on that date, Southwell entered into a loan agreement with the financial institution for $20,000,000 (2018-D Bank) subject to the same use and covenants as the 2018-C Bank.

On December 17, 2018, Southwell entered into a loan agreement (2019-USDA) for $41,856,000 with the United States Department of Agriculture (USDA). Proceeds of the 2019-USDA were used to repay the 2016-B Bank. During the term of the 2019-USDA, Southwell must maintain a debt service coverage ratio greater than or equal to 1.10 and fund a debt service reserve fund.

On December 19, 2016, Southwell received a loan commitment from the USDA to borrow $90,300,000 for the future refinancing of the 2018-A Bank. On August 22, 2017, Southwell received a loan commitment from the USDA to borrow $20,000,000 for the future refinancing of the 2018-D Bank. All of the USDA loans will be payable over 30 years.

On October 15, 2004, Southwell entered into a contract for the construction and lease of a medical office building. Southwell and the Tift County Development Authority (Tift Development) each provided $800,000 towards the acquisition of property and construction of a building used for occupational health services. Tift Development holds title to the premises and leases the premises to Southwell. The lease is for a primary term of ten years without any rental payments or accrued interest and for an extended twenty-year term at a monthly rental sufficient in amount to amortize Tift Development's $800,000 investment in equal and consecutive payments. The payments include interest computed at a rate equal to 65% of the prime rate published by *The Wall Street Journal* and adjusted on January 1 of each year. Southwell may purchase the premises at any time during the primary or extended term of the lease for the unamortized balance of Tift Development's investment plus $1,000.

Continued

8. Long-Term Debt, Continued

As a condition of its worker's compensation insurance, Southwell has a letter-of-credit from a bank. The letter-of-credit is for $1,095,000 for insurance policy year ending December 31, 2019. As of September 30, 2019, Southwell had not drawn on the letter-of-credit.

Scheduled principal repayments on long-term debt and payments on capital lease obligations are as follows:

Year Ending September 30,	Long-Term Debt	Capital Lease Obligations
2020	$ 25,320,000	$ 36,000
2021	7,484,000	37,000
2022	8,711,000	38,000
2023	9,982,000	38,000
2024	10,246,000	39,000
Thereafter	213,495,000	446,000
Total	275,238,000	634,000
Add unamortized bond premium	5,226,000	-
Total	$ 280,464,000	$ 634,000

9. Retirement Plan

The Tift Regional Health System 403(b) Plan (Plan) is a defined contribution plan established to provide benefits at retirement to all employees. All employees may make contributions up to a maximum annual amount as set periodically by the Internal Revenue Service. Southwell makes a matching contribution of 100% of the first 5% of each employee's contribution to the Plan. Southwell's contributions to the Plan were approximately $2,183,000 for the year ended September 30, 2019.

10. Commitments and Contingencies

Operating leases. Southwell leases various equipment and facilities under operating leases. Total rental expense in 2019 for all operating leases was approximately $503,000. There are no future minimum lease payments under operating leases that have initial or remaining lease terms in excess of one year.

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

Continued

10. Commitments and Contingencies, Continued

Medicare recovery audit contractors. The Centers for Medicare and Medicaid Services utilizes Recovery Audit Contractors (RACs) who are paid a contingent fee to detect and correct improper Medicare payments. RACs have authority to pursue improper payments with a three year look back from the date a claim was paid.

Southwell has received notifications from RACs regarding potential Medicare overpayments due to incorrect coding of claims. When notification of a potential claim overpayment is received, Southwell accrues a liability for the estimated amount of Medicare overpayment. The liability is then reduced when claims are refunded to Medicare or successfully appealed. Southwell has recorded an estimated liability of $250,000 at September 30, 2019, related to claims being audited by the RAC. The estimated liability is reported in estimated third-party payor settlements in the balance sheet.

Health care reform. There has been increasing pressure on Congress and some state legislatures to control and reduce the cost of healthcare at the national and the state levels. Legislation has been passed that includes cost controls on healthcare providers, insurance market reforms, delivery system reforms, and various individual and business mandates among other provisions. The costs of certain provisions will be funded in part by reductions in payments by government programs, including Medicare and Medicaid. There can be no assurance that these changes will not adversely affect Southwell.

11. Insurance Arrangements

General and professional liability. Southwell has claims-made insurance coverage for professional liability and occurrence insurance coverage for general liability. The insurance policies have limits of $1,000,000 per claim/occurrence and $3,765,000 annual aggregate. Southwell is self-insured to cover the deductible portion of its general and professional insurance policy. Southwell's deductible is $50,000 for individual claims or $500,000/$150,000 (professional/general) annual aggregate. Southwell had professional insurance payable of $1,543,000 and professional insurance recoverable of $1,188,000 at September 30, 2019.

Employee health. Southwell has a self-insured health plan for its employees. Southwell has purchased stop loss insurance to supplement the health plan, which will reimburse Southwell for individual claims in excess of $150,000 annually. Southwell incurred expense related to this plan of approximately $18,335,000 in 2019. Estimated accruals for claims incurred but not reported have been recorded in accrued expenses on the balance sheet. Estimated accruals were approximately $3,245,000 at September 30, 2019.

Also, Southwell has entered into a loss financing agreement with other Georgia hospitals through a program developed by Georgia ADS, LLC. The program is designed to provide for the financing and payment of covered claims between $225,000 and $650,000. Commercial insurance has been obtained to provide coverage for claims exceeding $500,000. Estimated accruals for amounts owed to the program under the loss financing agreement have been recorded in accrued expenses on the balance sheet. Estimated accruals were approximately $288,000 at September 30, 2019.

Continued

12. Functional Expenses

Southwell provides health care services to residents within its geographic location. Expenses related to providing these services in 2019 are as follows:

	Patient Care Services	General and Administrative	Total
Salaries and wages	$ 97,308,000	$ 25,656,000	$ 122,964,000
Employee benefits	23,152,000	6,104,000	29,256,000
Contract and purchased services	6,506,000	4,186,000	10,692,000
Physician services	7,851,000	1,122,000	8,973,000
Supplies and drugs	40,057,000	2,500,000	42,557,000
Depreciation	17,059,000	1,687,000	18,746,000
Goodwill amortization	1,468,000	-	1,468,000
Interest expense	2,601,000	-	2,601,000
Other expense	5,627,000	14,438,000	20,065,000
Total	$ 201,629,000	$ 55,693,000	$ 257,322,000

The consolidated financial statements report certain expense categories that are attributable to more than one health care service or support function. Therefore, these expenses require an allocation on a reasonable basis that is consistently applied. Cost not directly attributable to a function is depreciation which is allocated to a function based on square footage. Employee benefits are allocated based on salaries and wages.

13. Fair Value of Financial Instruments

The following methods and assumptions were used by Southwell in estimating the fair value of its financial instruments:

- *Cash and cash equivalents, short-term investments, accounts payable, accrued expenses, and third-party payor settlements:* The carrying amount reported in the balance sheet approximate their fair value due to the short-term nature of these instruments.

- *Assets as limited as to use:* Amounts reported in the balance sheet are at fair value. See Note 5 for fair value measurement disclosures.

- *Long-term debt:* Fair value of Southwell's revenue anticipation certificates are based on quoted market prices and the carrying amounts for other long-term debt approximate their fair value.

	2019	
	Carrying Amount	Fair Value
Long-term debt	$ 280,464,000	$ 280,832,000

Continued

13. Fair Value of Financial Instruments, Continued

Following is a description of the valuation methodologies used for assets at fair value. There have been no changes in the methodologies used at September 30, 2019.

Money market funds and certificates of deposit: Valued at amortized cost, which approximates fair value.

U.S. Treasury obligations and U.S. Government agency obligations: Certain U.S. government securities are valued at the closing price reported in the active market in which the individual security is traded. Other U.S. government securities are valued based on yields currently available on comparable securities of issuers with similar credit ratings.

Corporate obligations: Certain corporate obligations are valued at the closing price reported in the active market in which the security is traded. Other corporate obligations are valued based on yields currently available on comparable securities of issuers with similar credit ratings. When quoted prices are not available for identical or similar securities, the security is valued under a discounted cash flows approach that maximizes observable inputs, such as current yields of similar instruments, but includes adjustments for certain risks that may not be observable, such as credit and liquidity risks.

Asset-backed securities: Asset-backed securities use valuation techniques that reflect market participants' assumptions and maximize the use of relevant observable inputs including quoted prices for similar assets, benchmark yield curves, and market corroborated inputs.

Marketable equity securities, non-U.S. equity mutual funds, commodity mutual funds, and other mutual funds: Certain equity securities and mutual funds are valued at the closing price reported on the active market on which the individual securities are traded. Other equity securities and mutual funds are valued based on quoted prices for similar investments in active or inactive markets or valued using observable market data.

14. Rural Hospital Tax Credit Contributions

The State of Georgia (State) passed legislation which will allow individuals or corporations to receive a State tax credit for making a contribution to certain qualified rural hospital organizations during calendar years 2017 through 2021. Southwell submitted the necessary documentation and was approved by the State to participate in the rural hospital tax credit program for calendar years 2017, 2018, and 2019. Contributions received under the program approximated $529,000 during fiscal year 2019. Southwell will have to be approved by the State to participate in the program in each subsequent year.

Continued

15. Liquidity and Availability

Financial assets available for general expenditure within one year of September 30, 2019, consist of the following:

Cash and cash equivalents	$ 61,187,000
Short-term investments	5,259,000
Patient accounts receivable, net	56,667,000
Total	$ 123,113,000

Southwell has internally designated and held by trustee assets limited as to use, which are more fully described in Note 5, that are not available for expenditure within the next year and not reflected in the amounts above. However, the internally designated amounts could be made available if necessary.

As of September 30, 2019, Southwell was in compliance with loan covenants regarding days cash on hand.

16. Subsequent Events

On October 21, 2019, Southwell Ambulatory, Inc. (Ambulatory), a Georgia not-for-profit corporation, was created with Southwell as the sole member. On January 1, 2020, Ambulatory purchased Valdosta Endoscopy Center, LLC and Valdosta Gastroenterology Associates, LLC for approximately $1,895,000. Also on January 1, 2020, Ambulatory purchased Lowndes County Ambulatory Surgical Center, Inc. for approximately $1,856,000.

INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL OVER
FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS
BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED
IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

Board of Directors
Southwell, Inc.
Tifton, Georgia

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the consolidated financial statements of Southwell, Inc. (Southwell), which comprise the consolidated balance sheet as of September 30, 2019, and the related consolidated statements of operations and changes in net assets, and cash flows for the year then ended, and the related notes to the consolidated financial statements, and have issued our report thereon dated February 27, 2020.

Internal Control over Financial Reporting

In planning and performing our audit of the consolidated financial statements, we considered Southwell's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the consolidated financial statements, but not for the purpose of expressing an opinion on the effectiveness of Southwell's internal control. Accordingly, we do not express an opinion on the effectiveness of Southwell's internal control.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the Authority's financial statements will not be prevented, or detected and corrected on a timely basis.

Continued

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A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

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

Compliance and Other Matters

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

Purpose of this Report

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

Draffin & Tucker, LLP

Atlanta, Georgia
February 27, 2020