Hunterdon Medical Center and Affiliates

Consolidated Financial Statements

December 31, 2018 and 2017

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Independent Auditors' Report

To The Board of Trustees of
Hunterdon Medical Center and Affiliates

We have audited the accompanying consolidated financial statements of Hunterdon Medical Center and Affiliates (the "Medical Center"), which comprise the consolidated balance sheets as of December 31, 2018 and 2017, and the related consolidated statements of operations, changes in net assets, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Consolidated Financial Statements

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

Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits 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 the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Hunterdon Medical Center and Affiliates as of December 31, 2018 and 2017, and the results of its operations, changes in its net assets and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Baker Tilly Virchow Krause, LLP

Philadelphia, Pennsylvania
May 20, 2019

Hunterdon Medical Center and Affiliates

Consolidated Balance Sheets

December 31, 2018 and 2017

	2018	2017
Assets		
Current Assets		
Cash and cash equivalents	$ 21,372,032	$ 25,760,758
Short-term investments	38,087,363	48,121,596
Patient accounts receivable, net	40,030,195	32,113,609
Assets whose use is limited	1,019,848	1,017,495
Inventories	1,451,906	1,639,439
Other receivables, net	564,569	794,400
Prepaid expenses and other current assets	3,924,549	3,763,033
Total current assets	106,450,462	113,210,330
Assets whose use is limited (exclusive of current portion):		
Board-designated funds	49,030,165	53,282,648
Donor-restricted assets	17,649,353	18,511,409
Total assets whose use is limited	66,679,518	71,794,057
Due from affiliates	2,115,095	1,295,673
Property and equipment, net	155,803,900	144,922,158
Beneficial interest in trusts	2,055,375	2,372,968
Beneficial interest in net assets of Hunterdon Medical Center Foundation, Inc.	9,586,504	8,680,218
Real estate held for investment	213,099	213,099
Other assets	19,983,453	18,663,815
Total assets	$ 362,887,406	$ 361,152,318

	2018	2017
Liabilities and Net Assets		
Current Liabilities		
Current portion of long-term debt	$ 1,547,942	$ 1,500,375
Current portion of capital lease obligation	569,679	373,609
Accounts payable and accrued expenses	17,914,856	17,837,153
Accrued payroll and payroll taxes	15,269,620	12,641,686
Estimated third-party payor settlements	1,072,420	1,709,859
Due to affiliates	467,414	2,509,905
Accrued interest payable	1,046,035	1,048,308
Total current liabilities	37,887,966	37,620,895
Estimated third-party payor settlements, net	6,573,052	6,975,497
Long-term debt, net	64,595,248	66,190,583
Capital lease obligation, net	1,808,304	104,597
Pension liability	45,795,393	41,961,129
Other liabilities	10,678,432	10,236,577
Total liabilities	167,338,395	163,089,278
Net Assets		
Net Assets without donor restrictions	166,192,523	168,498,445
Net Assets with donor restrictions	29,356,488	29,564,595
Total net assets	195,549,011	198,063,040
Total liabilities and net assets	$ 362,887,406	$ 361,152,318

See notes to financial statements

Hunterdon Medical Center and Affiliates

Consolidated Statements of Operations
Years Ended December 31, 2018 and 2017

	2018	2017
Revenues		
Patient service revenue (net of contractual allowances and discounts)	$ 322,467,047	$ 298,462,894
Less provision for bad debts	-	(3,003,227)
Net patient service revenue less provision for bad debts	322,467,047	295,459,667
Other revenue	16,248,176	15,841,787
Net assets released from restrictions	610,591	380,292
Total revenues	339,325,814	311,681,746
Expenses		
Salaries and benefits	202,895,292	187,776,296
Physicians' fees	8,872,620	8,352,510
Supplies and services	103,537,904	94,046,678
Depreciation and amortization	17,783,385	18,249,532
Interest	2,701,446	2,754,906
Total expenses	335,790,647	311,179,922
Operating income	3,535,167	501,824
Nonoperating Revenues and Gains		
Interest and dividend income	1,972,207	1,806,527
Net periodic pension credit	7,145,463	5,973,939
Net realized gains on investments	1,178,104	420,051
Change in value of derivative financial instruments	102,201	123,364
Gain on sale of assets	7,002	500
Total nonoperating revenues and gains, net	10,404,977	8,324,381
Excess of revenues and gains over expenses and losses	13,940,144	8,826,205
Change in Net Unrealized Gains and Losses on Investments, Other Than Trading Securities	(5,506,012)	5,408,689
Net Transfers from (to) Affiliates	126,980	(2,912,000)
Pension-related Changes Other Than Net Periodic Pension Credit	(10,979,727)	(14,450,445)
Net Assets Released from Restrictions for Capital Acquisitions	112,693	1,500,000
(Decrease) in net assets without donor restrictions	$ (2,305,922)	$ (1,627,551)

See notes to financial statements

Hunterdon Medical Center and Affiliates

Consolidated Statements of Changes in Net Assets
Years Ended December 31, 2018 and 2017

	2018	2017
Net Assets Without Donor Restrictions		
Excess of revenues and gains over expenses and losses	$ 13,940,144	$ 8,826,205
Change in net unrealized gains and losses on investments, other than trading securities	(5,506,012)	5,408,689
Net transfers from (to) affiliates	126,980	(2,912,000)
Pension-related changes other than net periodic pension cost	(10,979,727)	(14,450,445)
Net assets released from restrictions for capital acquisitions	112,693	1,500,000
Decrease in net assets without donor restrictions	(2,305,922)	(1,627,551)
Net Assets With Donor Restrictions		
Investment income from donor-restricted assets	110,570	102,032
Net realized gains on investments	614,943	18,722
Net assets released from restrictions	(723,284)	(1,880,292)
Change in net unrealized gains and losses on investments	(1,222,994)	1,341,620
Change in value of beneficial interest in trust	(317,593)	276,332
Change in value of beneficial interest in net assets of Hunterdon Medical Center Foundation, Inc.	1,330,251	4,777,794
(Decrease) increase in net assets with donor restrictions	(208,107)	4,636,208
(Decrease) Increase in net assets	(2,514,029)	3,008,657
Net Assets, Beginning	198,063,040	195,054,383
Net Assets, Ending	$ 195,549,011	$ 198,063,040

See notes to financial statements

Hunterdon Medical Center and Affiliates

Consolidated Statements of Cash Flows
Years Ended December 31, 2018 and 2017

	2018	2017
Cash Flows from Operating Activities		
(Decrease) increase in net assets	$ (2,514,029)	$ 3,008,657
Adjustments to reconcile (decrease) increase in net assets to net cash provided by operating activities:		
Depreciation and amortization	17,783,385	18,300,362
Net transfers (from) to affiliates	(126,980)	2,912,000
Accretion of bond premium, net of amortization of bond discount	(78,137)	(78,137)
Net realized gains on investments	(1,793,047)	(438,773)
(Gain) loss on sale of assets	(7,002)	(500)
Pension-related changes other than net periodic pension cost	10,979,727	14,450,445
Change in net unrealized gains and losses on investments, other than trading securities	6,729,006	(6,750,309)
Change in value of derivative financial instruments	(102,201)	(123,364)
Change in value of beneficial interest in Foundation and trusts, net	(588,693)	(3,296,195)
Changes in assets and liabilities:		
Patient accounts receivable	(7,916,586)	(4,711,991)
Due from affiliates	(2,834,933)	(301,497)
Inventories, other receivables, prepaid expenses and other current assets and other assets	(235,676)	(1,093,726)
Estimated third-party payor settlements	(1,039,884)	(355,260)
Accounts payable and accrued expenses, accrued payroll and payroll taxes, accrued interest payable, pension benefit liabilities and other liabilities	(3,898,043)	(3,208,222)
Net cash provided by operating activities	14,356,907	18,313,490
Cash Flows from Investing Activities		
Sales (purchases) of assets whose use is limited and short-term investments, net	10,210,460	(3,260,715)
Purchases of property, plant, and equipment	(26,581,997)	(22,946,196)
Proceeds from sale of assets	-	500
Purchase of physician practices	(305,500)	(1,257,869)
Net cash used in investing activities	(16,677,037)	(27,464,280)
Cash Flows from Financing Activities		
Repayment of long-term debt	(1,469,631)	(1,423,556)
Repayment of capital lease obligations	(698,965)	(445,614)
Proceeds from a note receivable	100,000	100,000
Net cash used in financing activities	(2,068,596)	(1,769,170)
Net decrease in cash and cash equivalents	(4,388,726)	(10,919,960)
Cash and Cash Equivalents, Beginning	25,760,758	36,680,718
Cash and Cash Equivalents, Ending	$ 21,372,032	$ 25,760,758
Supplemental Disclosure of Cash Flow Information		
Interest paid	$ 2,703,719	$ 2,710,126
Supplemental Disclosure of Noncash Investing and Financing Activities		
Capital lease obligation incurred for property and equipment	$ 2,598,742	$ -

See notes to financial statements

1. Organization and Summary of Significant Accounting Policies

Hunterdon Medical Center (the "Medical Center"), located in Flemington, New Jersey, is a not-for-profit acute care medical center. The Medical Center provides inpatient, outpatient and emergency care services for the residents of Hunterdon County and surrounding areas. The Medical Center is an affiliated member of Hunterdon Healthcare System, Inc. (the "System"). The System is also the controlling entity for Hunterdon Healthcare Foundation, Inc. (the "Foundation"); Hunterdon Regional Community Health, Inc. ("HRCH"); and Midjersey Health Corporation ("Midjersey"). The System owns 100% of the outstanding stock of Midjersey Health Corporation and 50% of the outstanding stock of Hunterdon Health Care, LLC, which are for-profit entities.

In 2015, the Hunterdon Medical Center Board of Trustees authorized the creation of three professional corporations ("Captive PCs"); Hunterdon Primary Care, P.C., Hunterdon Specialty Care, P.C., and Hunterdon Urgent Care, P.C.

These Captive PCs, which are controlled by the Medical Center, employ certain physicians, nurse practitioners and physician assistants that were previously employed by the Medical Center directly. The Captive PCs became operational January 1, 2016 and provide services at primary care and specialty practices owned by the Medical Center.

In 2016, Hunterdon Ambulatory Services, LLC was created as a sole member LLC with the Medical Center being the sole member. It includes ambulatory non-provider based diagnostic and therapeutic services.

The consolidated financial statements include the accounts of Hunterdon Medical Center, the Captive PCs, and Hunterdon Ambulatory Services, LLC (collectively, the "Medical Center"). Intercompany transactions and balances have been eliminated.

The following items comprise the significant accounting policies which are followed by the Medical Center.

Basis of Accounting

The consolidated financial statements are prepared on the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America ("GAAP").

Use of Estimates

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

Cash and Cash Equivalents

Cash and cash equivalents include cash on hand and highly liquid investments with an original maturity of twelve months or less.

The Medical Center has balances with financial institutions that exceed federal depository insurance limits. Management does not believe the credit risk related to these deposits to be significant.

Patient Accounts Receivable

The Medical Center assesses collectability on patient contracts prior to the recognition of net patient service revenues. Patient accounts receivable, net, are recorded at net realizable value. Accounts are written off through bad debt expense when the Medical Center has exhausted all collection efforts and determines accounts are impaired based on changes in patient credit worthiness.

Net Patient Service Revenue

Net patient service revenues are recognized at the amount that reflects the consideration to which the Medical Center expects to be entitled in exchange for providing patient care. These amounts are due from patients, third-party payors (including commercial and governmental programs), and others and includes variable consideration for retroactive revenue adjustments due to settlement of audits, reviews and investigations. Generally, the Medical Center 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 provided by the Medical Center. Revenues for performance obligations satisfied over time are recognized based on actual charges incurred in relation to total expected (or actual) charges. The Medical Center 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 in the Medical Center receiving inpatient acute care services. The Medical Center measures the performance obligation from admission into the Medical Center, or the commencement of an outpatient service, to the point when it is no longer required to provide services to that patient, which is generally at the time of discharge or completion of the outpatient services. Revenue for performance obligations satisfied at a point in time, which generally relates to patients receiving outpatient services, is recognized when goods or services are provided and the Medical Center does not believe it is required to provide additional services to the patient.

All of the Medical Center's performance obligations relate to contracts with a duration of less than one year, therefore the Medical Center has elected to apply the optional exemptions provided in Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") 606-10-50-14(a) and as a result 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.

The Medical Center determines the transaction price based on standard charges for services provided, reduced by contractual adjustments provided to third-party payors, discounts provided to uninsured or underinsured patients in accordance with the Medical Center's policies, and/or implicit price concessions provided to uninsured or underinsured patients. The Medical Center determines its estimates of contractual adjustments and discounts based on contractual agreements, its discount policies, and historical experience. The Medical Center determines its estimates of implicit price concessions based on its historical collection experience with a respective class of patient.

The Medical Center 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 the Medical Center'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. The Medical Center does, in certain instances, enter into payment agreements with patients that allow payments in excess of one year. However, in these cases the financing component is not deemed to be significant to the contract.

Inventories

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

Short-Term Investments, Assets Whose Use is Limited and Investment Risk

Assets whose use is limited primarily include assets held by trustees under indenture agreements; designated assets set aside by the Board of Trustees for future capital improvements, over which the Board retains control and may at its discretion subsequently use for other purposes; and donor-restricted assets. Amounts required to meet current liabilities of the Medical Center have been classified as current assets.

Cash and cash equivalents, certificates of deposit, investments in equity securities with readily determinable fair values and all investments in debt securities are measured at fair value. Investments in commingled funds are recorded at the net asset value of the fund as estimated by the external investment managers. The Medical Center reviews and evaluates the values provided by the external investment managers for reasonableness. Investment income or loss (including realized gains and losses on investments and interest and dividends) is included in excess of revenues and gains over expenses and losses unless donor stipulation or law restricts the income or loss. Gains and losses on the sale of investments are based on an identified cost basis. Unrealized gains and losses on investments are excluded from excess of revenues and gains over expenses and losses unless the investments are trading securities. Donated investments are reported at fair value at the date of receipt.

A decline in the fair value below the cost that is deemed to be other than temporary results in a reduction in carrying amount to fair value. The impairment is charged to excess of revenues and gains over expenses and losses and a new cost basis for the security is established. There were no impairment losses at December 31, 2018 and 2017.

The Medical Center's investments are comprised of a variety of financial instruments and are managed by investment advisors. The fair values reported in the consolidated balance sheets are subject to various risks including changes in the equity markets, the interest rate environment, and general economic conditions. Due to the level of risk associated with certain investment securities and the level of uncertainty related to changes in the fair value of investment securities, it is reasonably possible that the amounts reported in the accompanying consolidated financial statements could change materially in the near term.

Property and Equipment

Property and equipment are carried at cost, except donated assets, which are recorded at fair market value at the date of donation. Equipment under capital lease obligations is amortized using the straight-line method over the shorter period of the lease term or the estimated useful life of the equipment. Depreciation expense is calculated on all depreciable assets using the straight-line method based on estimated useful lives ranging from 3 to 40 years.

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 restricted support. 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 and Long-Lived Assets to be Disposed of

Long-lived assets, such as property and equipment and purchased intangibles subject to amortization, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to estimated undiscounted future net cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge is recognized by the amount by which the carrying amount of the asset exceeds the fair value of the asset. Assets to be disposed of would be separately presented in the consolidated balance sheets and reported at the lower of the carrying amount or fair value less costs to sell and are no longer depreciated. The assets and liabilities of a disposed group classified as held for sale would be presented separately in the appropriate asset and liability sections of the consolidated balance sheets.

Beneficial Interests in Trusts

Beneficial interests in trusts are arrangements whereby a donor establishes and funds a trust, and the assets are held in perpetuity with the income earned distributed annually to the Medical Center for both restricted and unrestricted use. The Medical Center recognizes the contribution and receivable as net assets with donor restrictions in the period the trust is established at its present value, which equals the fair value of the underlying assets. The fair value of these assets is based on the net asset values reported by the fund manager, which are reviewed by management for reasonableness. Adjustments to the receivable to reflect changes in fair value are recognized as additional contributions to net assets with donor restrictions.

Deferred Financing Costs

Costs incurred in connection with the issuance of long-term debt have been deferred and are being amortized over the terms of the related debt using the effective interest method. Deferred financing costs are reported as a direct reduction of long-term debt.

Other Assets

Other assets consist primarily of goodwill, and assets related to the Medical Center's deferred compensation and split dollar life insurance plans (see Note 8).

Self-Insured Health Benefits

The Medical Center is self-insured for employee health benefits. The provision for estimated employee health benefits includes estimates for the ultimate cost for both reported claims and claims incurred but not reported and are included in accounts payable and accrued expenses in the accompanying consolidated balance sheets.

Net Assets With Donor Restrictions

Net assets with donor restrictions are those whose use by the Medical Center has been limited by donors to a specific time period or purpose, those that have been restricted by donors to be maintained by the Medical Center in perpetuity.

The Foundation raises or holds contributions on behalf of the Medical Center and other affiliates. The Medical Center periodically requests funds from the Foundation for capital and other needs. The Medical Center's beneficial interest in the Foundation net assets with donor restrictions and its share of the change in those net assets are reported in the accompanying consolidated financial statements in net assets with donor restrictions.

Donor-Restricted Gifts

Unconditional promises to give cash and other assets are reported at fair value at the date the promise is received. The gifts are reported as net assets with donor restrictions support if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, net assets with donor restrictions are reclassified as net assets without donor restrictions and reported in the consolidated statements of operations as net assets released from donor restrictions. In the absence of donor specification that income and gains on donated funds are restricted, such income and gains are reported as unrestricted non-operating revenues and gains.

Excess of Revenues and Gains Over Expenses and Losses

The consolidated statements of operations includes the excess of revenues and gains over expenses and losses, which is the performance indicator. Changes in net assets without donor restrictions that are excluded from the performance indicator, consistent with industry practice, include unrealized gains and losses on investment securities other than trading securities, permanent transfers of assets to and from affiliates for other than goods and services, pension-related changes other than net periodic pension cost, and contributions of long-lived assets (including assets acquired using contributions that by donor restriction were to be used for the purposes of acquiring such assets).

Estimated Medical Malpractice Liability

The liability for estimated medical malpractice claims includes estimates of the ultimate costs for both reported claims and claims incurred but not reported. Anticipated insurance recoveries associated with reported claims are reported separately in the Medical Center's consolidated balance sheets at net realizable value.

Derivative Instruments and Hedging Activities

Derivative financial instruments are utilized to manage risks. The principal financial instruments used for cash flow hedging purposes are interest rate swaps. The Medical Center enters into interest rate swap agreements to manage its exposure to interest rate changes. The Medical Center recognizes all financial instruments in the consolidated balance sheets at fair value. Changes in the fair value of derivatives are recognized either within the performance indicator or in other changes in net assets without donor restrictions, which is excluded from the performance indicator, depending on whether the derivative financial instrument qualifies for hedge accounting. Gains and losses on derivatives designated as cash flow hedges, to the extent they are effective, are recorded in other changes in the consolidated statements of operations and statements of changes in net assets. Changes in the fair value of derivatives not qualifying for hedge accounting, and for any portion of a hedge that is ineffective, are reported within the performance indicator.

Income Taxes

The Medical Center is a not-for-profit corporation as described in Section 501(c)(3) of the Internal Revenue Code (the "Code") and is exempt from federal income taxes on its exempt income under Section 501(a) of the Code.

The Captive PCs are New Jersey professional corporations as described in Section 501(c)(3) of the Code and are exempt from federal income taxes on exempt income under Section 501(a) of the Code.

The Medical Center accounts for uncertainty in income taxes by prescribing a recognition threshold of more-likely-than-not to be sustained upon examination by the appropriate taxing authority. Measurement of the tax uncertainty occurs if the recognition threshold has been met. There were no tax uncertainties that met the recognition threshold in 2018 or 2017.

Subsequent Events

The Medical Center evaluated subsequent events for recognition or disclosure through May 20, 2019, the date the consolidated financial statements were issued. In January 2019 the Medical Center entered into a contract to construct a one and a half megawatt natural gas-fired combined heat and power plant on its campus. The total cost of the project is estimated to be approximately $10,900,000 and will be funded through receipt of a sub-recipient grant from the New Jersey Economic Development Authority by the United States Department of Housing and Urban Development Community Development Block Grant-Disaster Recovery Program and a low-interest loan from Energy Resilience Bank.

New Accounting Standards

Revenue Recognition

In 2018, the Medical Center adopted the FASB Accounting Standards Update ("ASU") No. 2014-09, *Revenue from Contracts with Customers (Topic 606)*, using the modified retrospective approach. ASU No. 2014-09 supersedes the revenue recognition requirements in *Topic 605, Revenue Recognition*, and most industry specific guidance. The core principle under ASU No. 2014-09 is that revenues are recognized to depict the transfer of promised goods or services to customers (patients) in an amount that reflects the consideration at which the entity expects to be entitled in exchange for those goods or services. Additionally, ASU No. 2014-09 requires enhanced disclosures of revenue arrangements.

The Medical Center applied the modified retrospective approach to all contracts when adopting ASU No. 2014-09. As a result of the adoption, the majority of what was previously classified as the provision for bad debts in the consolidated statements of operations is now reflected as implicit price concessions, as defined in Topic 606, and therefore included as a reduction of net patient service revenues. For changes in transaction price related to changes in patient circumstances, the Medical Center will prospectively recognize those amounts as a provision for bad debts within operating expenses on the consolidated statements of operations. For periods prior to January 1, 2018, the provision for bad debts has been presented consistent with the previous revenue recognition standards that required separate presentation of these amounts as a component of net patient service revenue. Additionally, as a result of the adoption of ASU No. 2014-09, the allowance for doubtful accounts of approximately $15,528,000 as of January 1, 2018 was reclassified as a component of patient accounts receivable, net.

Not-for-Profit Financial Statement Presentation

In August 2016, the FASB issued ASU 2016-14, *Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities*. The new guidance is intended to improve and simplify the current net asset classification requirements and information presented in consolidated financial statements and notes that is useful in assessing a not-for-profit's liquidity, financial performance and cash flows. The Medical Center has applied the changes retrospectively to all periods presented except for the disclosures related to liquidity and availability of resources and functional expenses. These disclosures have been presented for 2018 only, as allowed by ASU No. 2016-14. The following summarizes the applicable financial reporting items reflected in The Medical Center's financial statements as required by ASU 2016-14:

- The unrestricted net asset class has been renamed Net Assets Without Donor Restrictions.
- The temporarily and permanently restricted net asset classes have been combined into a single net asset class called Net Assets With Donor Restrictions.
- The functional expense disclosure for 2018 includes expenses reported both by nature and function (Note 14).
- The financial statements include a disclosure about liquidity and availability of resources (Note 13).

Pension Accounting

In 2018 the Medical Center adopted the FASB ASU No. 2017-07, *Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost (Topic 715)*. Under ASU 2017-07 the service cost component is required to be reported in the same line item as other compensation costs and other components of the net benefit cost are required to be presented in the consolidated statements of changes in net assets separately from the service cost component and outside of operating income (loss). The Medical Center has adjusted the presentation of the consolidated financial statements accordingly, recording the other components of net periodic pension (credit) cost as net periodic pension credit in the accompanying consolidated statements of operations. The Medical Center has applied the changes retrospectively to all periods presented (credit of $5,973,939 reclassified for 2017).

Financial Assets and Financial Liabilities

In January 2016, the FASB issued ASU No. 2016-01, *Recognition and Measurement of Financial Assets and Financial Liabilities (Subtopic 825-10)*. ASU No. 2016-01 was issued to enhance the reporting model for financial instruments in financial statements. The provisions of ASU No. 2016-01 requires marketable equity securities to be reported at fair value with changes in fair value recognized within the performance indicator, establishes a qualitative factor in evaluating impairment on equity investments without readily determinable fair values, and eliminates the requirement to disclose the fair value on financial instruments measured at amortized cost. The Medical Center will be required to adopt the guidance in ASU No. 2016-01 for its fiscal year ending December 31, 2019. The Medical Center is currently assessing the impact that ASU No. 2016-01 will have on its consolidated financial statements.

Restricted Cash

In November 2016, the FASB issued ASU 2016-18, *Statement of Cash Flows (Topic 230): Restricted Cash*. The amendments in this update require that a 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. 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 consolidated statements of cash flows. The Medical Center will be required to retroactively adopt the guidance in ASU No. 2016-18, with transitive provisions, for its fiscal year ending December 31, 2019. The Medical Center is currently assessing the impact that ASU 2016-18 will have on its consolidated financial statements.

Leases

In February 2016, the FASB issued ASU No. 2016-02, *Leases (Topic 842)*. ASU No. 2016-02 was issued to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. Under the provisions of ASU No. 2016-02, a lessee is required to recognize a right-to-use asset and lease liability, initially measured at the present value of the lease payments, in the consolidated balance sheets. In addition, lessees are required to provide qualitative and quantitative disclosures that enable users to understand more about the nature of the Medical Center's leasing activities. The Medical Center will be required to retrospectively adopt the guidance in ASU No. 2016-02 for its fiscal year ending December 31, 2019. The Medical Center is currently assessing the impact that adoption of ASU No. 2016-02 will have on its consolidated financial statements.

2. Charity and Uncompensated Care

In furtherance of its charitable purpose, the Medical Center provides a wide variety of benefits to the community, including offering various community-based programs, such as health screenings, training for emergency service personnel, social service, support counseling for patients and families, pastoral care, and crisis intervention. Additionally, a large number of health-related educational programs are provided for the benefit of the community, including health enhancements and wellness, classes on specific conditions, and telephone information services designed to improve the general standards of the health of the community.

The Medical Center also provides medical care without charge or at reduced costs to residents of its community who meet the criteria under state regulation for charity care. The Medical Center's definition of charity care includes services provided at no charge or at a reduced charge to patients who are uninsured or underinsured. The Medical Center maintains records to identify and monitor the level of charity care it provides. These records include the amount of charges forgone for services and supplies furnished under its charity care policy. An overall cost to charge ratio was applied to arrive at the cost of charity care, and as a result the cost of charity care amounted to $3,485,961 and $4,088,624 in 2018 and 2017, respectively. Because the Medical Center does not pursue collection of amounts determined to qualify as charity care, they are not reported as revenue.

The state provides certain subsidy payments to qualified hospitals to partially fund uncompensated care and certain other costs. Subsidy payments recognized as revenue amounted to $318,836 and $216,055 in 2018 and 2017, respectively, and are included in other revenue in the accompanying consolidated statements of operations.

3. Net Patient Service Revenue

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

- **Medicare:** Inpatient acute care, psychiatric and rehabilitation services and outpatient services rendered to Medicare program beneficiaries are paid at prospectively determined rates. These rates vary according to patient classification systems that are based on clinical, diagnostic, and other factors. In addition, the Medical Center is reimbursed for certain cost reimbursable items at tentative interim rates, with final settlement determined after submission of annual costs reports and audits thereof by the Medicare fiscal intermediary. The Medical Center's Medicare cost reports have been settled through December 31, 2015.

- **Medicaid:** Inpatient acute care services rendered to Medicaid program beneficiaries are paid at prospectively determined rates per discharge based on severity of illness. These rates vary according to a patient classification system that is based on clinical, diagnostic, and other factors. Inpatient non-acute services are paid at prospectively determined per diem rates. Outpatient services are paid based on a published fee schedule. The Medical Center's Medicaid cost reports have been settled through December 31, 2015.

- **Blue Cross:** Inpatient acute care services rendered to Blue Cross subscribers 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. Inpatient non-acute services are paid at prospectively determined per diem rates. Outpatient services are reimbursed based on ambulatory payment classifications.

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

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 the Medical Center'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 the Medical Center. In addition, the contracts the Medical Center 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 with the payor and the Medical Center'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 no longer subject to such audits, reviews and investigations. Net patient service revenue include favorable and unfavorable adjustments of approximately $860,000 and $1,328,000 in 2018 and 2017, respectively, related to tentative and/or final settlements of prior year cost reports and other third-party payor adjustments.

Generally, patients who are covered by third-party payors are responsible for related deductibles and coinsurance, which vary in amount. The Medical Center also provides services to uninsured patients, and offers those uninsured or underinsured patients a discount, either by policy or law, from standard charges. The Medical Center 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 charges by any contractual adjustment, discounts, and implicit price concessions. Subsequent changes to the estimate of the transaction price are generally recorded as an adjustment to net patient service revenues in the period of the change. For the year ended December 31, 2018, the impact of changes in estimates of implicit price concessions, discounts and contractual adjustments used to determine the transaction price was immaterial to the consolidate financial statements.

Consistent with the Medical Center's mission, care is provided to patients regardless of their ability to pay. Therefore, the Medical Center has determined it has provided implicit price concessions to uninsured patients and other patient balances (for example, copays and deductibles). The implicit price concessions included in estimating the transaction price represent the difference between amounts billed to patients and the amounts the Medical Center expects to collect based on its collection history with those patients.

The Medical Center disaggregates revenue from contracts with customers by type of service and payor source as this depicts the nature, amount, timing and uncertainty of its revenue and cash flows as affected by economic factors. Tables providing details of these factors are presented below.

The composition of patient care service revenue by primary payor for the years ended December 31 is as follows:

	2018	2017
Medicare	$ 103,993,457	$ 89,592,576
Medicaid	20,699,519	19,266,798
Aetna	48,369,364	47,746,470
Blue Cross	91,205,452	86,573,680
Self-pay/uninsured	3,366,338	2,651,775
Other third-party commercial	54,832,917	49,628,368
Total	$ 322,467,047	$ 295,459,667

Revenue from patient's deductibles and coinsurance are included in the categories presented above based on the primary payor.

	2018	2017
Inpatient	$ 88,464,169	$ 81,353,738
Outpatient	173,796,972	160,940,003
Physician services	60,205,906	53,165,926
Total	$ 322,467,047	$ 295,459,667

The Medical Center has not further disaggregated other revenue as the economic factors affecting the nature, timing, amount, and uncertainty of revenue and cash flows do not significantly vary within the revenue category.

4. Short-Term Investments and Assets Whose Use is Limited

The composition of short-term investments and assets whose use is limited at December 31, 2018 and 2017 is set forth in the following table:

	2018	2017
Short-term investments:		
Cash and cash equivalents	$ 156,637	$ 194,202
Certificates of deposit	2,921,248	3,989,816
Government bonds	1,475,171	4,361,220
Investment-grade corporate bonds	33,337,350	33,875,640
Mutual funds - fixed income	146,930	5,678,800
Accrued interest receivable	50,027	21,918
Total short-term investments	$ 38,087,363	$ 48,121,596
Assets whose use is limited:		
Board-designated funds:		
Cash and cash equivalents	$ 4,883,882	$ 5,509,208
Certificates of deposit	2,749,569	3,266,683
Mutual funds - international equity	6,530,277	7,626,345
Mutual funds - fixed income	15,780,371	14,051,806
Mutual funds - domestic equity	19,041,383	22,812,027
Accrued interest receivable	44,683	16,579
Total	49,030,165	53,282,648
Donor-restricted assets:		
Cash and cash equivalents	1,526,917	469,395
Commingled funds - U.S. large cap equities	4,722,379	5,997,405
Commingled funds - U.S. bonds	3,831,296	3,832,834
Mutual funds - international equity	2,523,214	2,954,161
Mutual funds - fixed income	1,693,828	1,494,799
Mutual funds - domestic equity	3,351,719	3,762,815
Total	17,649,353	18,511,409
Funds held by trustee under bond indenture agreements, Cash and cash equivalents	1,019,848	1,017,495
Total assets whose use is limited	67,699,366	72,811,552
Less current portion	1,019,848	1,017,495
Noncurrent portion of assets whose use is limited	$ 66,679,518	$ 71,794,057

Investment return includes the following for the years ended December 31, 2018 and 2017:

	2018	2017
Interest and dividend income	$ 2,082,777	$ 1,908,559
Net realized gains on investments	1,793,047	438,773
Change in net unrealized gains (losses) on investments, other than trading securities	(6,729,006)	6,750,309
Total investment return	$ (2,853,182)	$ 9,097,641

5. Fair Value Measurements and Financial Instruments

The Medical Center measures its short-term investments and assets whose use is limited on a recurring basis in accordance with accounting principles generally accepted in the United States of America.

Fair value is defined as the price that would be received to sell an asset or the price that would be paid to transfer a liability in an orderly transaction between market participants at the measurement date. The framework that the authoritative guidance establishes for measuring fair value includes a hierarchy used to classify the inputs used in measuring fair value. The hierarchy prioritizes the inputs used in determining valuations into three levels. The level in the fair value hierarchy within which the fair value measurement falls is determined based on the lowest level input that is significant to the fair value measurement.

The levels of the fair value hierarchy are as follows:

Level 1 - Fair value is based on unadjusted quoted prices in active markets that are accessible to the Medical Center for identical assets. These generally provide the most reliable evidence and are used to measure fair value whenever available.

Level 2 - Fair value is based on significant inputs, other than Level 1 inputs, that are observable either directly or indirectly for substantially the full term of the asset through corroboration with observable market data. Level 2 inputs include quoted market prices in active markets for similar assets, quoted market prices in markets that are not active for identical or similar assets, and other observable inputs.

Level 3 - Fair value would be based on significant unobservable inputs. Examples of valuation methodologies that would result in Level 3 classification include option pricing models, discounted cash flows, and other similar techniques.

The following tables present financial instruments measured at fair value at December 31, 2018 and 2017:

	Fair Value as of December 31, 2018			
	Total	**Level 1**	**Level 2**	**Level 3**
Reported at Fair Value				
Assets:				
Short-term investments:				
Cash and cash equivalents	$ 206,664	$ 206,664	$ -	$ -
Certificates of deposit	2,921,248	2,921,248	-	-
Government bonds	1,475,171	-	1,475,171	-
Investment-grade corporate bonds	33,337,350	-	33,337,350	-
Mutual funds - fixed income	146,930	146,930	-	-
Assets whose use is limited:				
Cash and cash equivalents	7,475,330	7,475,330	-	-
Certificates of deposit	2,749,569	2,749,569	-	-
Mutual funds - international equity	9,053,491	9,053,491	-	-
Mutual funds - fixed income	17,474,199	17,474,199	-	-
Mutual funds -domestic equity	22,393,102	22,393,102	-	-
Beneficial interest in trusts	2,055,375	-	-	2,055,375
Total assets in the fair value hierarchy	99,288,429	$ 62,420,533	$ 34,812,521	$ 2,055,375
Assets recorded at net asset value (a)	8,553,675			
Assets at fair value	$ 107,842,104			
Liabilities,				
Swap agreements	$ 163,287	$ -	$ 163,287	$ -
Disclosed at Fair Value				
Cash and cash equivalents	$ 21,372,032	$ 21,372,032	$ -	$ -
Long-term debt (carrying value of $66,569,750)	$ 69,626,734	$ -	$ 47,823,561	$ 21,803,173

	Fair Value as of December 31, 2017			
	Total	Level 1	Level 2	Level 3
Reported at Fair Value				
Assets:				
Short-term investments:				
Cash and cash equivalents	$ 216,120	$ 216,120	$ -	$ -
Certificates of deposit	3,989,816	3,989,816	-	-
Government bonds	4,361,220	-	4,361,220	-
Investment-grade corporate bonds	33,875,640	-	33,875,640	-
Mutual funds - fixed income	5,678,800	5,678,800	-	-
Assets whose use is limited:				
Cash and cash equivalents	7,012,677	7,012,677	-	-
Certificates of deposit	3,266,683	3,266,683	-	-
Mutual funds - international equity	10,580,506	10,580,506	-	-
Mutual funds - fixed income	15,546,605	15,546,605	-	-
Mutual funds -domestic equity	26,574,842	26,574,842	-	-
Beneficial interest in trusts	2,372,968	-	-	2,372,968
Total assets in the fair value hierarchy	113,475,877	$ 72,866,049	$ 38,236,860	$ 2,372,968
Assets recorded at net asset value (a)	9,830,239			
Assets at fair value	$ 123,306,116			
Liabilities,				
Swap agreements	$ 265,487	$ -	$ 265,487	$ -
Disclosed at Fair Value				
Cash and cash equivalents	$ 25,760,758	$ 25,760,758	$	$ -
Long-term debt (carrying value of $68,148,263)	$ 72,803,178	$ -	$ 49,499,631	$ 23,303,547

(a) In accordance with ASU No. 2015-07, certain investments that are measured at net asset value per share (or its equivalent) have not been classified in the fair value hierarchy. The fair value amounts presented in this table are intended to permit reconciliation of the fair value hierarchy to the line items presented in the consolidated balance sheets.

Fair Value of Financial Instruments

The carrying amounts of cash and cash equivalents and certificates of deposit approximate fair value at December 31, 2018 and 2017 due to the short maturity of those financial instruments.

Mutual funds are valued at the net asset value ("NAV") of shares held by the Medical Center at year end.

Government bonds and investment-grade corporate bonds are valued at fair value, which are the amounts reported in the consolidated balance sheets, based on quoted market prices, if available, or estimated using quoted market process of similar securities.

Beneficial interest in perpetual trusts is valued using discounted cash flow methodologies.

The fair value of the interest rate swap derivative financial instruments is determined by an independent third party valuation specialist based on proprietary models of discounted cash flow. The fair value takes into consideration the prevailing interest rate environment and the specific terms and conditions of the derivative financial instruments and the credit risk of the Medical Center. The value represents the estimated exit price the Medical Center would pay or receive upon termination of the agreements.

The fair value of long-term debt is calculated based on quoted market prices, if available, or estimated using quoted market prices of similar securities using a discount rate that a market participant would demand.

Changes to the beneficial interest in trusts in 2018 and 2017 were as follows:

	2018	2017
Beginning balance	$ 2,372,968	$ 2,096,636
Investment income from beneficial interest in trusts	24,175	23,546
Distributions from beneficial interest in trusts	(113,211)	(92,369)
Change in value of beneficial interest in trusts	(228,557)	345,155
Ending balance	$ 2,055,375	$ 2,372,968

Change in value of beneficial interest in trusts is reported as changes in permanently restricted net assets within the statements of changes in net assets.

6. Property and Equipment

Property and equipment and accumulated depreciation at December 31, 2018 and 2017 are as follows:

	2018	2017
Land	$ 6,796,849	$ 6,796,849
Land improvements	7,905,788	7,905,788
Buildings	155,262,075	138,865,437
Fixed equipment	41,224,062	41,224,062
Major moveable equipment	175,353,999	160,045,210
Leasehold improvements	9,094,937	9,094,937
Minor equipment	51,244	51,244
Construction in progress	4,878,312	7,219,367
	400,567,266	371,202,894
Less accumulated depreciation and amortization	244,763,366	226,280,736
Property and equipment, net	$ 155,803,900	$ 144,922,158

7. Long-Term Debt and Capital Lease Obligations

Bonds Payable

Bonds payable at December 31, 2018 and 2017 consist of the following:

	2018	2017
New Jersey Health Care Facilities Financing Authority ("Authority") Revenue and Refunding Bonds, Series 2014A, Serial Bonds payable annually through July 1, 2030, bearing interest at a rate of 5% (a)	$ 1,845,000	$ 1,845,000
Authority Revenue and Refunding Bonds, Series 2014A, Serial Bonds, maturing July 1, 2031, bearing interest at a rate of 5% (a)	1,940,000	1,940,000
Authority Revenue and Refunding Bonds, Series 2014A, Serial Bonds, maturing July 1, 2032, bearing interest at a rate of 5% (a)	2,035,000	2,035,000
Authority Revenue and Refunding Bonds, Series 2014A, Serial Bonds, maturing July 1, 2033, bearing interest at a rate of 5% (a)	2,140,000	2,140,000
Authority Revenue and Refunding Bonds, Series 2014A, Serial Bonds, maturing July 1, 2034, bearing interest at a rate of 5% (a)	2,245,000	2,245,000
Authority Revenue and Refunding Bonds, Series 2014A, Term Bonds, maturing July 1, 2036, bearing interest at a rate of 4% (a)	4,805,000	4,805,000
Authority Revenue and Refunding Bonds, Series 2014A, Term Bonds, maturing July 1, 2045, bearing interest at a rate of 5% (a)	18,225,000	18,225,000
Authority Revenue and Refunding Bonds, Series 2014A, Term Bonds, maturing July 1, 2045, bearing interest at a rate of 4% (a)	9,500,000	9,500,000
Authority Refunding Bonds, Series 2014B, payable monthly through December 1, 2029, bearing interest at a fixed rate of 2.44% (a)	16,260,000	16,260,000
Authority Refunding Bonds, Series 2014C, payable monthly through December 1, 2019, bearing interest at a variable rate of 2.43% (a)	1,348,735	2,656,772
Authority Refunding Bonds, Series 2014D, payable monthly through December 1, 2034, bearing interest at a variable rate of 2.59% (a)	4,194,438	4,386,776
	64,538,173	66,038,548
Less current portion due within one year	1,547,942	1,500,375
Long-term debt, excluding deferred financing costs, bond premium and original issue discount	62,990,231	64,538,173
Less deferred financing costs	426,561	457,305
Plus unamortized bond premium, net of original issue discount	2,031,578	2,109,715
Long-term debt, net	$ 64,595,248	$ 66,190,583

Capital Lease Obligations

Capital lease obligations at December 31, 2018 and 2017 consist of the following:

	2018	2017
TD Equipment Finance/Equipment (c)	$ 2,272,805	$ -
Siemens/Symbia S-Series (d)	-	62,318
TD Equipment Finance/Davinci Robot (e)	105,178	415,888
Subtotal	2,377,983	478,206
Less portion due within one year	569,679	373,609
Long-term portion	$ 1,808,304	$ 104,597

(a) On December 1, 2014, the Medical Center issued $42,735,000 of Revenue and Refunding Bonds, Series 2014A ("Series 2014A bonds") pursuant to a loan agreement between the Medical Center and the Authority. The Series 2014A Bonds include $10,205,000 of Serial Bonds maturing July 1, 2030 through 2034, bearing interest at 5% and $32,530,000 of Term Bonds maturing July 1, 2036 through 2045, with interest ranging from 4% to 5%. Interest is payable semiannually on July 1 and January 1.

The Medical Center also entered into a Master Trust Indenture and First Supplemental Indenture, both dated as of December 1, 2014 ("Master Trust Indenture"), with U.S. Bank National Association, as Master Trustee in connection with the issuance of the Series 2014A Bonds. As security for the repayment of the bonds, the Medical Center has granted a security interest in and a first lien on its gross revenues. The Master Trust Indenture requires the Medical Center to comply with certain covenants and ratios.

Proceeds from the Series 2014A bonds were used to refund and redeem the Series 2006A bonds and approximately $15,204,000 of 2014 Bonds issued by the Authority on January 1, 2014; to finance a portion of the costs of various capital improvements to the Medical Center's acute care facility; and to pay costs of issuance of the Series 2014A bonds.

The Medical Center also issued $16,260,000, $6,360,000 and $4,935,000 of Refunding Bonds, Series 2014B, C and D, respectively, ("Series 2014B-D bonds") pursuant to a loan agreement between the Medical Center and the Authority on December 1, 2014. The Series 2014B-D bonds were special and limited obligations of the Authority, payable in monthly installments ranging from $29,000 to $153,000 from January 2016 to December 2034.

TD Bank N.A. (the "Bank") purchased the Series 2014B-D bonds pursuant to a Direct Bond Purchase Agreement dated December 23, 2014. The Medical Center has entered into a Continuing Covenants Agreement with the Bank which requires the Medical Center to comply with certain covenants and ratios.

Proceeds from the Series 2014B and C bonds were used to refund and redeem the Series 2006B bonds and Series 2009 bonds, respectively and the proceeds from the Series 2014D bonds were used to refinance an existing bank loan issued by Midjersey.

Effective December 11, 2009, the Medical Center entered into an interest rate swap exchange agreement with TD Bank, N.A. On December 23, 2014, the Medical Center entered into a novation agreement with TD Bank, N.A. and the Toronto-Dominion Bank for the interest rate swap. The Toronto-Dominion Bank replaced TD Bank, N.A. as the counterparty, under this agreement. The novated swap agreement has a notional amount of $1,459,353 and requires the Medical Center to pay a fixed rate of 2.21% to the bank in exchange for the bank agreeing to pay the Medical Center a variable rate equal to 69% of one-month LIBOR (1.76% at December 31, 2018).

Effective December 23, 2014, the Medical Center entered into a novation agreement with TD Bank, N.A. and the Toronto-Dominion Bank. Under this agreement, an interest rate swap was transferred from Midjersey to the Medical Center and The Toronto-Dominion Bank replaced TD Bank, N.A. as the counterparty. The novated swap agreement has a notional amount of $4,210,891 and requires the Medical Center to pay a fixed rate of 2.5% to the bank in exchange for the bank agreeing to pay the Medical Center a variable rate equal to 69% of one-month LIBOR (1.76% at December 31, 2018).

At December 31, 2018 and 2017, the fair value of the derivative financial instruments is ($163,287) and ($265,487), respectively, and is included in other liabilities in the accompanying consolidated balance sheets. The change in fair value recognized during the years ended December 31, 2018 and 2017, in the amount of $102,201 and $123,364, respectively, is recorded in the consolidated statements of operations and is included in the performance indicator.

Future principal debt payments at December 31, 2018 are as follows:

Years ending December 31:	
2019	$ 1,547,942
2020	1,659,388
2021	1,702,965
2022	1,747,312
2023	1,792,836
Thereafter	56,087,730
Total	$ 64,538,173

(b) The Medical Center has a $6,000,000 unsecured line of credit with a bank. The interest rate is 5.5% and 4.5% at December 31, 2018 and 2017, respectively, and the term was extended to December 31, 2019. There are no amounts outstanding on the line of credit as of December 31, 2018 and 2017.

(c) During 2018, the Medical Center entered into a capital lease with TD Equipment Finance for an MRI system, an Ultrasound, and other radiology equipment. The term of the lease is five years with a total monthly lease payment of $47,419, including interest, required monthly beginning May 31, 2018. The lease includes interest at 3.746% and a purchase option of $1 at the end of the lease term.

(d) During 2013, the Medical Center entered into two capital leases with Siemens for two pieces of radiology equipment. The terms of both leases is five years with a total monthly lease payment of $6,883, including interest, required monthly beginning October 11, 2013. The leases include interest at 2.93% and purchase options of $1 each at the end of the terms.

(e) During 2014, the Medical Center entered in a capital lease with TD Equipment Finance for a Davinci Surgical System. The term of the lease is five years with a total monthly lease payment of $26,406, including interest, required monthly beginning May 1, 2014. The lease includes interest at 2.25% and a purchase option of $10 at the end of the term.

8. Pension Plans

Defined Benefit Pension Plan

The Medical Center sponsors a noncontributory defined benefit pension plan (the "Plan") that covers all eligible employees. The plan provides for benefits to be paid to eligible employees at retirement, based primarily upon years of service and compensation. Contributions are intended to provide not only for benefits attributed to service to date but also for those expected to be earned in the future. The Medical Center's funding policy is to contribute annually an amount equal to or greater than the minimum funding requirements of the Employee Retirement Income Security Act of 1974 (ERISA). The Medical Center uses a December 31 measurement date. In November 2013, the Board of Trustees approved an amendment to freeze the Plan effective January 15, 2014.

The Medical Center recognizes the funded status of the benefit plan, which is measured as the difference between plan assets at fair value and the benefit obligation, in the consolidated balance sheets. Additionally, the Medical Center recognizes changes in the funded status of the Plan in the year in which the changes occur through a separate line within changes in unrestricted net assets, apart from expenses, to the extent those changes are not included in the net periodic benefit cost.

The following tables set forth the plan's funded status, amounts recognized in the Medical Center's consolidated balance sheets, and components of net periodic pension cost for 2018 and 2017.

	2018	2017
Change in benefit obligation:		
Benefit obligation at beginning of year	$ 259,584,010	$ 233,560,667
Interest cost	8,199,550	8,533,075
Benefits paid	(8,445,328)	(13,171,376)
Actuarial loss (gain)	(20,470,280)	30,661,644
Benefit obligation at end of year	238,867,952	259,584,010
Change in plan assets:		
Fair value of plan assets at beginning of year	217,622,881	200,076,044
Actual (loss) return on plan assets	(16,104,994)	30,718,213
Benefits paid	(8,445,328)	(13,171,376)
Fair value of plan assets at end of year	193,072,559	217,622,881
Funded status	(45,795,393)	(41,961,129)
Amounts recognized in accumulated unrestricted net assets consist of,		
Net actuarial loss	$ 83,654,829	$ 72,675,102

The actuarial gain of $20,470,280 in 2018 is primarily attributed to an increase in the discount rate.

	2018	2017
Weighted average assumptions used to determine benefit obligations at December 31:		
Discount rate	4.20 %	3.56 %
Rate of compensation increases	N/A	N/A
Weighted average assumptions used to determine net periodic benefit cost:		
Discount rate	3.56 %	4.31 %
Expected long-term rate of return on plan assets	8.00	8.00
Rate of compensation increases	N/A	N/A
Components of net periodic benefit (credit) cost:		
Interest cost	$ 8,199,550	$ 8,533,075
Expected return on plan assets	(17,041,986)	(15,654,653)
Amortization of unrecognized actuarial loss	1,696,973	1,147,639
Net periodic benefit (credit) cost	$ (7,145,463)	$ (5,973,939)
Amounts recognized as changes in net assets without donor restrictions consist of,		
Net actuarial loss	$ 10,979,727	$ 14,450,445

The estimated net actuarial loss that is expected to be amortized from other changes in unrestricted net assets into net pension cost for the year ending December 31, 2019 is $2,219,962.

The expected long-term rate of return on pension assets is selected by taking into account the expected duration of the projected benefit obligation ("PBO") for the plan and the asset mix of the plan. The rate of return is expected to be the rate earned over the period until the benefits represented by the current PBO are paid. The expected return on plan assets is based on the Medical Center's expectation of historical long-term average rates of return on the different asset classes held in the pension fund. This is reflective of the current and projected asset mix of the funds and considers the historical returns earned on the Medical Center's asset allocation and the duration of the plan liabilities. Thus, the Medical Center has taken a historical approach to the development of the expected return on asset assumption. The Medical Center believes the fundamental changes in the markets cannot be predicted over the long term. Rather, historical returns, realized across numerous economic cycles, should be representative of the market return expectations applicable to the funding of a long-term benefit obligation.

Actual year-by-year returns can deviate substantially from the long-term expected return assumption. However, over time it is expected that the amount of over-performance will equal the amount of under-performance.

The fair value hierarchy for the Medical Center's pension plan assets at December 31, 2018 are as follows:

	Fair Value	Level 1	Level 2	Level 3
Pension assets:				
Mutual funds - domestic fixed income	$ 77,478,553	$ 77,478,553	$ -	$ -
Mutual funds - domestic equity	69,443,330	69,443,330	-	-
Mutual funds -international equity	45,235,732	45,235,732	-	-
Cash and cash equivalents	914,944	914,944	-	-

The fair value hierarchy for the Medical Center's pension plan assets at December 31, 2017 are as follows:

	Fair Value	Level 1	Level 2	Level 3
Pension assets:				
Mutual funds - domestic fixed income	$ 77,056,175	$ 77,056,175	$ -	$ -
Mutual funds - domestic equity	95,438,851	95,438,851	-	-
Mutual funds -international equity	43,986,649	43,986,649	-	-
Cash and cash equivalents	1,141,206	1,141,206	-	-

The Plan's actual weighted average asset allocations and target asset allocations by asset category are as follows:

Asset Category	2018 Target Allocations	2018	2017 Target Allocations	2017
Mutual funds invested in equity securities	63 %	60 %	64 %	64 %
Mutual funds invested in debt securities	37	40	36	36
		100 %		100 %

In determining the asset allocation, the investment manager recognizes the Medical Center's desire for funding and expense stability, the long-term nature of the pension obligation, and current and projected cash needs for retiree benefit payments. An asset allocation analysis is performed to determine the long-term targets for the major asset classes of equity, debt and cash using an efficient frontier model. The asset allocation is reviewed quarterly and rebalanced if the variance to the targets exceeds 2.5%.

The Medical Center does not expect to contribute to the Plan during 2019.

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid as follows:

Years ending December 31:	
2019	$ 10,323,288
2020	11,228,682
2021	12,149,079
2022	13,034,481
2023	13,591,238
Thereafter	72,751,647

In addition to the defined benefit plan, the Medical Center also provides a deferred compensation plan for certain employees and physicians. At December 31, 2018 and 2017, the assets related to this plan are included in other assets and the related liability is included in other liabilities in the amount of $2,090,678 and $2,065,613, respectively.

In addition, certain of the Medical Center's key employees participate in a split dollar life insurance plan. Under the insurance policy, all premium payments are divided between the participant's portion and the Medical Center's portion. Any withdrawal or death benefit must first be used to repay the Medical Center's portion of the policy. At December 31, 2018 and 2017, the assets related to this plan are included in other assets in the amount of $4,259,829 and $4,717,422, respectively.

Defined Contribution Pension Plan

On January 1, 2010, the Medical Center established the Hunterdon Healthcare 403(B) Retirement Savings Plan. Certain System employees are eligible for participation in the plan. The Medical Center will make a core annual contribution between 2% and 4% of each employee's annual compensation based on years of service and a 50% match of each employee's annual individual contribution to the plan to a maximum of 2%. Total expense recorded by the Medical Center for contributions into the plan in 2018 and 2017 was approximately $4,746,000 and $5,097,000, respectively.

9. Related-Party Transactions

Distributions of restricted funds from the Foundation are recorded as decreases to beneficial interest in net assets of Hunterdon Medical Center Foundation, Inc. in the consolidated balance sheets. These restricted distributions consisted of the following for the years ended December 31, 2018 and 2017:

	2018	2017
Restricted for capital acquisitions	$ 112,693	$ 1,500,000
Restricted for program support	311,272	257,931
Total	$ 423,965	$ 1,757,931

The Medical Center has entered into various financing and operating arrangements with its affiliates. Interest is not charged under these arrangements. The following net amounts are due from (to) affiliates at December 31, 2018 and 2017:

	2018	2017
Hunterdon Healthcare System, Inc.	$ 1,975,830	$ 1,243,351
Hunterdon Medical Center Foundation, Inc.	(545,010)	(2,314,614)
Hunterdon Regional Community Health, Inc.	310,894	(150,057)
Midjersey Health Corporation and Subsidiaries	(94,033)	7,088
	1,647,681	(1,214,232)
Exclude amounts classified as current liabilities	(467,414)	(2,509,905)
Total noncurrent due from affiliates	$ 2,115,095	$ 1,295,673

The System has entered into a noninterest-bearing loan agreement with the Medical Center. The System used the funds borrowed to purchase all of the outstanding stock of Midjersey Health Corporation. The outstanding balance of this note is $430,000 and $530,000 at December 31, 2018 and 2017, respectively. The System makes payments on this note to the Medical Center as Midjersey Health Corporation declares dividends to the System. Payments made during 2018 and 2017 were $100,000. The remaining balance owed by the System of $1,545,830 and $713,351 at December 31, 2018 and 2017, respectively, primarily represents operating expenses paid by the Medical Center on the System's behalf.

The amounts due from (to) the Foundation, HRCH, and Midjersey primarily represent salaries and benefits paid by the Medical Center on the affiliate organization's behalf. The Medical Center recorded equity transfers from (to) the Foundation and HRCH of approximately $0 and $126,980 in 2018, respectively, and ($2,425,000) and ($487,000) in 2017, respectively. The transfers in 2018 and 2017 pertained to the reduction of amounts due from (to) the Medical Center from these affiliates.

HRCH provides certain services on behalf of the Medical Center. Fees associated with these services in the amounts of $281,873 and $305,319 were recorded by the Medical Center during 2018 and 2017, respectively, and are included in supplies and services expenses in the accompanying consolidated statements of operations. These amounts represent fair value for services charged.

Space lease amounts were billed by Midjersey to the Medical Center under a sublease agreement in the amounts of $943,236 and $1,208,268 for the years ended December 31, 2018 and 2017, respectively, and were recorded in supplies and services expenses in the accompanying consolidated statements of operations.

On May 13, 2016, Midjersey entered into a loan agreement with Fulton Bank of New Jersey to finance leasehold improvements in the System's secondary service area. These leasehold improvements include the fit-out of several physician practices which will be operated by the Medical Center. In addition, on August 7, 2017, Midjersey entered into a capital lease arrangement for medical equipment for $183,494. On behalf of Midjersey, the Medical Center is the guarantor of the loan and the capital lease. The guaranty on the loan is limited to $10,200,000 in principal, together with any scheduled interest thereon and shall continue to be effective for the life of the loan, currently a term of twenty years. The outstanding loan balance was $9,644,011 and $6,866,817 at December 31, 2018 and 2017, respectively.

10. Professional Liability Insurance

The Medical Center has annually purchased a claims-made professional liability insurance policy, which provides coverage of $1,000,000 per occurrence and $3,000,000 annual aggregate. In addition, the Medical Center has purchased an additional layer of insurance above the base policy of $15,000,000. Beginning July 1, 2015, the Medical Center's professional liability insurance policy includes a deductible of $100,000 per occurrence and a $300,000 annual aggregate. Each individual employed physician is provided an individual limit of coverage in the amount of $3,000,000 per occurrence and $5,000,000 annual aggregate through a group purchased policy. Employed physicians are not covered by the Medical Center's policy or additional layer of insurance. The Medical Center has estimated losses and recorded an undiscounted liability of $717,000 and $635,000 at December 31, 2018 and 2017, respectively, relating to unasserted claims and incidents not yet reported to the insurance carrier, which are included in other liabilities in the accompanying consolidated balance sheets. In addition, the Medical Center has recorded a receivable (included in other assets), and related claim liability (included in other liabilities), for anticipated insurance recoveries of $2,266,000 and $1,690,000 at December 31, 2018 and 2017, respectively.

11. Operating Leases

The Medical Center is obligated under noncancelable operating leases with terms in excess of one year for certain office space and equipment. Rental expense was $8,367,560 and $7,199,337 during 2018 and 2017, respectively. The required minimum lease payments at December 31, 2018 are as follows:

Years ending December 31:	
2019	$ 5,396,575
2020	4,073,759
2021	3,664,416
2022	3,433,400
2023	3,637,959
Thereafter	43,407,951
Total	$ 63,614,060

12. Net Assets With Donor Restrictions

Net assets with donor restrictions in the amount of $7,214,764 and $6,430,130 at December 31, 2018 and 2017, respectively, are available for use by the Medical Center, as specified by the donor, for capital acquisitions, research, and education. Net assets with donor restrictions of $22,141,724 and $23,134,465 at December 31, 2018 and 2017, respectively, are funds to be held in perpetuity by the Medical Center and consist of the Medical Center's beneficial interest in trusts and donor-restricted endowments. The income earned on these funds is expendable either to support patient care services or as specified by the donor. Realized gains and losses are retained in either Net assets without donor restrictions or Net assets with donor restrictions in accordance with the donors' wishes.

The Medical Center's endowment consists of eight funds that have been established by the Medical Center and are invested by the Medical Center and five funds that have been established by the Medical Center and are invested by the Foundation on behalf of the Medical Center. The endowment also includes three trusts where the Medical Center has a beneficial interest only and for which the funds have been invested based upon the trust's direction. These funds are invested by the Medical Center and Foundation. As required by generally accepted accounting principles, net assets associated with endowment funds are classified and reported based upon the existence or absence of donor-imposed restrictions.

From time to time, the fair value of assets associated with individual donor restricted endowment funds may fall below the level that the donor requires the Medical Center to retain as a fund of perpetual duration. In accordance with generally accepted accounting principles, deficiencies of this nature are to be reported in unrestricted net assets without donor restrictions as of year-end. There were no such deficiencies as of December 31, 2018 and 2017.

Interpretation of Relevant Law

The Board of Trustees of the Medical Center and the Foundation have interpreted the New Jersey Uniform Prudent Management of Institutional Funds Act as requiring the preservation of the fair value of the original gift as of the gift date of the donor-restricted endowment funds absent explicit donor stipulations to the contrary. The Medical Center classifies as net assets with donor restrictions (a) the original value of gifts donated to the donor-restricted endowment, (b) the original value of subsequent gifts to the donor-restricted endowment, and (c) accumulations to the donor-restricted endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund. The interest and dividend income earned on the accumulations to the donor-restricted endowment funds is classified as net assets with donor restrictions until the donor-imposed restrictions have been met and the amounts have been appropriated for expenditure.

Spending Policy

The Foundation distributes to the Medical Center funds from its endowment account when donor-imposed restrictions have been met. The Medical Center spends earnings on donor-restricted endowment funds when expenses have been incurred that satisfy the donor-imposed restrictions.

Return Objectives and Risk Parameters

The Foundation and Medical Center have adopted investment and spending policies for endowment assets that attempt to provide a predictable stream of income and growth, while seeking to maintain the purchasing power of the endowment assets. Endowment assets include those assets of donor-restricted funds that the Medical Center and Foundation must hold in perpetuity under this policy, as approved by the Medical Center's and Foundation's Boards of Trustees, the endowment assets are invested in a manner that is intended to produce moderate to high rates of return while assuming a moderate to low level of investment risk.

The Medical Center has no board-designated endowment funds. The following represents the net asset classes of the Medical Center's donor-restricted endowment funds at December 31, 2018 and 2017:

	2018	2017
Endowment net assets	$ 20,086,349	$ 20,984,032

The following table presents changes in endowments for the years ended December 31, 2018 and 2017:

Endowment net assets at December 31, 2016	$ 17,177,464
Contributions, net asset transfers, and other changes	2,394,851
Investment income	65,045
Change in net unrealized gains (losses) on investments	1,341,620
Net realized gains on investments	5,052
Endowment net assets at December 31, 2017	20,984,032
Contributions, net asset transfers, and other changes	(321,489)
Investment income	98,980
Change in net unrealized gains (losses) on investments	(1,081,220)
Net realized gains on investments	406,046
Endowment net assets at December 31, 2018	$ 20,086,349

13. Liquidity and Availability of Resources

As of December 31, 2018, the Medical Center has working capital of approximately $68,562,000 and days cash on hand of 125.

Financial assets available for general expenditure within one year of the balance sheet date, consist of the following:

Cash and cash equivalents	$ 21,372,032
Accounts receivable, net	40,030,195
Investments	38,087,363
Assets whose use is limited - board designated	49,030,165
Total	$ 148,519,755

The Medical Center has other assets whose use is limited that are externally designated under bond indenture agreements and endowments that have donor-restricted purposes. These assets are not available for general expenditure within the next year and are not reflected in the amounts above.

Additionally, the Medical Center maintains a $6,000,000 line of credit, as discussed in more detail in Note 7. As of December 31, 2018, $6,000,000 remained available on the Medical Center's line of credit.

14. Functional Expenses

The Medical Center provides general healthcare services to residents within its geographic location. Expenses related to providing these services for the years ended December 31, 2018 and 2017 are as follows:

	2018		
	Healthcare Services	**General and Administrative**	**Total**
Salaries and benefits	$ 188,751,286	$ 14,144,006	$ 202,895,292
Physicians' fees	8,872,620	-	8,872,620
Supplies and services	83,073,287	20,464,617	103,537,904
Depreciation and amortization	11,429,201	6,354,184	17,783,385
Interest	2,701,446	-	2,701,446
Total	$ 294,827,840	$ 40,962,807	$ 335,790,647

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. Certain costs not directly attributable to a function, including depreciation and amortization, are allocated to a function based on a square footage basis.

In 2017, approximately $275,320,346 related to healthcare services and approximately $35,859,576 of expenses related to general and administrative.

15. Concentration of Risk

The Medical Center grants credit without collateral to its patients, most of whom are local residents and are insured under third-party agreements. The significant concentrations of accounts receivable for services to patients include the following at December 31, 2018 and 2017:

	2018	**2017**
Medicare	24.9 %	23.8 %
Medicaid	3.0	4.1
Blue Cross	18.5	19.3
Aetna	12.7	13.2
HMO/PPO payors	20.6	19.2
Other third-party payors	8.2	7.3
Self-pay patients	12.1	13.1
	100 %	100 %

16. Contingencies

The health care industry is subject to numerous laws and regulations of federal, state, and local governments. Compliance with these laws and regulations is subject to future government review and interpretation as well as regulatory actions unknown or unasserted at this time. Government activity continues to increase with respect to investigations and allegations concerning possible violations by health care providers of fraud and abuse statues and regulations, which could result in the imposition of significant fines and penalties as well as significant repayments for patient services previously billed. Management is not aware of any material incidents of noncompliance; however, the possible future financial effects of this matter on the Medical Center, if any, are not presently determinable.