

# Hunterdon Medical Center and Affiliates

Consolidated Financial Statements

December 31, 2019 and 2018

# Hunterdon Medical Center and Affiliates

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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, 2019 and 2018, 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 consolidated financial position of Hunterdon Medical Center and Affiliates as of December 31, 2019 and 2018, 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.

**Emphasis of Matter**

As discussed in Note 1 to the consolidated financial statements, in 2019, the Medical Center adopted new accounting guidance related to the Financial Accounting Standards Board Accounting Standard Update No. 2016-02, *Leases (Topic 842)* and No. 2016-18, *Statement of Cash Flows (Topic 230): Restricted Cash*. Our opinion is not modified with respect to this matter.

*Baker Tilly Virchow Krause, LLP*

Iselin, New Jersey  
May 28, 2020

## Hunterdon Medical Center and Affiliates

Consolidated Balance Sheets  
December 31, 2019 and 2018

	<u>2019</u>	<u>2018</u>		<u>2019</u>	<u>2018</u>
<b>Assets</b>			<b>Liabilities and Net Assets</b>		
<b>Current Assets</b>			<b>Current Liabilities</b>		
Cash and cash equivalents	\$ 44,421,789	\$ 21,372,032	Accounts payable and accrued expenses	\$ 24,956,363	\$ 17,914,856
Short-term investments	38,308,814	38,087,363	Accrued payroll and payroll taxes	16,572,939	15,269,620
Patient accounts receivable	44,325,307	40,030,195	Current portion of long-term debt	1,659,388	1,547,942
Assets whose use is limited	1,021,027	1,019,848	Current portion of finance lease obligation	895,267	569,679
Inventories	3,478,184	1,451,906	Current portion of operating lease obligations	3,964,127	-
Other receivables, net	2,085,559	564,569	Estimated third-party payor settlements	1,320,654	1,072,420
Prepaid expenses and other current assets	6,158,873	3,924,549	Due to affiliates	-	467,414
			Accrued interest payable	1,041,756	1,046,035
Total current assets	<u>139,799,553</u>	<u>106,450,462</u>	Total current liabilities	50,410,494	37,887,966
<b>Assets Whose Use is Limited (Exclusive of Current Portion)</b>			Estimated third-party payor settlements, net	4,914,370	6,573,052
Board-designated funds	51,350,032	49,030,165	Long-term debt, net	64,125,533	64,595,248
Donor-restricted assets	16,539,909	17,649,353	Finance lease obligation, net	2,428,485	1,808,304
			Operating lease obligations, net	12,183,014	-
Total assets whose use is limited	67,889,941	66,679,518	Pension liability	50,232,462	45,795,393
Due from affiliates	3,058,708	2,115,095	Other liabilities	12,860,157	10,678,432
Property and equipment, net	152,011,392	155,803,900			
Right-of-use assets, operating leases	15,641,516	-	Total liabilities	<u>197,154,515</u>	<u>167,338,395</u>
Beneficial interest in trusts	2,424,482	2,055,375			
Beneficial interest in net assets of Hunterdon Medical Center Foundation, Inc.	11,108,300	9,586,504	<b>Net Assets</b>		
Real estate held for investment	213,099	213,099	Net assets without donor restrictions	188,921,339	166,192,523
Other assets	22,592,113	19,983,453	Net assets with donor restrictions	28,663,250	29,356,488
Total assets	<u>\$ 414,739,104</u>	<u>\$ 362,887,406</u>	Total net assets	<u>217,584,589</u>	<u>195,549,011</u>
			Total liabilities and net assets	<u>\$ 414,739,104</u>	<u>\$ 362,887,406</u>

See notes to consolidated financial statements

## Hunterdon Medical Center and Affiliates

Consolidated Statements of Operations  
Years Ended December 31, 2019 and 2018

	<u>2019</u>	<u>2018</u>
<b>Revenues</b>		
Net patient service revenue	\$ 336,998,571	\$ 322,467,047
Other revenue	18,777,990	16,248,176
Net assets released from restrictions	519,643	610,591
	<u>356,296,204</u>	<u>339,325,814</u>
<b>Expenses</b>		
Salaries and benefits	210,882,461	202,895,292
Physicians' fees	9,113,456	8,872,620
Supplies and services	103,094,051	103,537,904
Depreciation and amortization	20,046,332	17,783,385
Interest	2,660,727	2,701,446
	<u>345,797,027</u>	<u>335,790,647</u>
Total expenses	<u>345,797,027</u>	<u>335,790,647</u>
Operating income	<u>10,499,177</u>	<u>3,535,167</u>
<b>Nonoperating Revenues and Gains (Losses)</b>		
Interest and dividend income	2,117,123	1,972,207
Net periodic pension credit	2,058,424	7,145,463
Net realized gains on investments	2,240,749	1,178,104
Change in value of derivative financial instruments	(83,104)	102,201
Gain on sale of assets	2,204,000	7,002
Change in net unrealized gains and losses on equity securities	5,204,900	-
	<u>13,742,092</u>	<u>10,404,977</u>
Total nonoperating revenues and gains, net	<u>13,742,092</u>	<u>10,404,977</u>
Excess of revenues and gains over expenses and losses	24,241,269	13,940,144
<b>Change in Net Unrealized Gains and Losses on Investments, Fixed Income Securities</b>	1,190,629	(5,506,012)
<b>Net Transfers (to) From Affiliates</b>	(661,663)	126,980
<b>Pension-Related Changes Other Than Net Periodic Pension Credit</b>	(6,495,493)	(10,979,727)
<b>Net Assets Released From Restrictions for Capital Acquisitions and Other Transfers From Net Assets With Donor Restriction</b>	4,454,074	112,693
	<u>4,454,074</u>	<u>112,693</u>
Increase (decrease) in net assets without donor restrictions	<u>\$ 22,728,816</u>	<u>\$ (2,305,922)</u>

See notes to consolidated financial statements

## Hunterdon Medical Center and Affiliates

Consolidated Statements of Changes in Net Assets  
Years Ended December 31, 2019 and 2018

	<u>2019</u>	<u>2018</u>
<b>Net Assets Without Donor Restrictions</b>		
Excess of revenues and gains over expenses and losses	\$ 24,241,269	\$ 13,940,144
Change in net unrealized gains and losses on investments, other than trading equity securities	1,190,629	(5,506,012)
Net transfers (to) from affiliates	(661,663)	126,980
Pension-related changes other than net periodic pension cost	(6,495,493)	(10,979,727)
Net assets released from restrictions for capital acquisitions and other transfers from net assets with donor restriction	<u>4,454,074</u>	<u>112,693</u>
Increase (decrease) in net assets without donor restrictions	<u>22,728,816</u>	<u>(2,305,922)</u>
<b>Net Assets With Donor Restrictions</b>		
Investment income from donor-restricted assets	107,766	110,570
Net realized gains on investments	8,459	614,943
Net asset transfers to net assets without donor restriction	(4,454,074)	-
Net assets released from restrictions	(519,643)	(723,284)
Change in net unrealized gains and losses on investments	1,910,496	(1,222,994)
Change in value of beneficial interest in trust	369,107	(317,593)
Change in value of beneficial interest in net assets of Hunterdon Medical Center Foundation, Inc.	<u>1,884,651</u>	<u>1,330,251</u>
Decrease in net assets with donor restrictions	<u>(693,238)</u>	<u>(208,107)</u>
Increase (decrease) in net assets	22,035,578	(2,514,029)
<b>Net Assets, Beginning</b>	<u>195,549,011</u>	<u>198,063,040</u>
<b>Net Assets, Ending</b>	<u><u>\$ 217,584,589</u></u>	<u><u>\$ 195,549,011</u></u>

See notes to consolidated financial statements

**Hunterdon Medical Center and Affiliates**Consolidated Statements of Cash Flows  
Years Ended December 31, 2019 and 2018

	<u>2019</u>	<u>2018</u> (As Adjusted)
<b>Cash Flows From Operating Activities</b>		
Increase (decrease) in net assets	\$ 22,035,578	\$ (2,514,029)
Adjustments to reconcile increase (decrease) in net assets to net cash provided by operating activities:		
Depreciation and amortization	20,046,332	17,783,385
Operating lease expense	4,335,927	-
Net transfers to (from) affiliates	661,663	(126,980)
Amortization of deferred financing costs	30,745	30,744
Accretion of bond premium, net of amortization of bond discount	(78,139)	(78,137)
Operating lease payments	(3,830,302)	-
Net realized gains on investments	(2,249,208)	(1,793,047)
Gain on sale of assets	(2,204,000)	(7,002)
Pension-related changes other than net periodic pension cost	6,495,493	10,979,727
Change in net unrealized gains and losses on investments, other than trading securities	(8,306,025)	6,729,006
Change in value of derivative financial instruments	83,104	(102,201)
Change in value of beneficial interest in Foundation and trusts, net	(1,826,823)	(534,656)
Changes in assets and liabilities:		
Patient accounts receivable	(4,295,112)	(7,916,586)
Due from affiliates	(2,172,690)	(2,834,933)
Inventories, other receivables, prepaid expenses and other current assets and other assets	(8,390,252)	(235,676)
Estimated third-party payor settlements	(1,410,448)	(1,039,884)
Accounts payable and accrued expenses, accrued payroll and payroll taxes, accrued interest payable, pension benefit liabilities and other liabilities	8,380,744	(3,898,043)
Net cash provided by operating activities	<u>27,306,587</u>	<u>14,441,688</u>
<b>Cash Flows From Investing Activities</b>		
Sales of assets whose use is limited and short-term investments, net	9,119,196	11,270,335
Purchases of property, plant and equipment	(12,120,779)	(26,581,997)
Purchase of physician practices	-	(305,500)
Net cash used in investing activities	<u>(3,001,583)</u>	<u>(15,617,162)</u>
<b>Cash Flows From Financing Activities</b>		
Repayment of long-term debt	(1,547,913)	(1,500,375)
Proceeds from note payable	1,237,038	-
Repayment of finance lease obligations	(983,276)	(698,965)
Proceeds from a note receivable	100,000	100,000
Net cash (used in) financing activities	<u>(1,194,151)</u>	<u>(2,099,340)</u>
Net increase (decrease) in cash and cash equivalents and restricted cash and cash equivalents	23,110,853	(3,274,814)
<b>Cash and Cash Equivalents and Restricted Cash and Cash Equivalents, Beginning</b>	<u>23,972,834</u>	<u>27,247,648</u>
<b>Cash and Cash Equivalents and Restricted Cash and Cash Equivalents, Ending</b>	<u>\$ 47,083,687</u>	<u>\$ 23,972,834</u>
<b>Supplemental Disclosure of Cash Flow Information</b>		
Interest paid	<u>\$ 2,665,006</u>	<u>\$ 2,703,719</u>
Right of use assets obtained in exchange for operating lease obligations	<u>\$ 19,316,020</u>	<u>\$ -</u>
<b>Supplemental Disclosure of Noncash Investing and Financing Activities</b>		
Finance lease obligation incurred for property and equipment	<u>\$ 1,929,045</u>	<u>\$ 2,598,742</u>
<b>Reconciliation of Cash and Cash Equivalents and Restricted Cash and Cash Equivalents</b>		
Cash and cash equivalents	\$ 44,421,789	\$ 21,372,032
Assets whose use is limited under bond indenture agreements, cash	1,021,027	1,019,848
Assets whose use is limited, donor-restricted cash	1,522,754	1,526,917
Beneficial interests in trusts, cash	118,117	54,037
	<u>\$ 47,083,687</u>	<u>\$ 23,972,834</u>

See notes to consolidated financial statements

# Hunterdon Medical Center and Affiliates

Notes to Consolidated Financial Statements

December 31, 2019 and 2018

## 1. Organization and Summary of Significant Accounting Policies

Hunterdon Medical Center (HMC), located in Flemington, New Jersey, is a not-for-profit acute care medical center. HMC provides inpatient, outpatient and emergency care services for the residents of Hunterdon County and surrounding areas. HMC 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 percent of the outstanding stock of Midjersey Health Corporation and 50 percent of the outstanding stock of Hunterdon Health Care, LLC, which are for-profit entities.

In 2015, HMC's 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 HMC, employ certain physicians, nurse practitioners and physician assistants that were previously employed by HMC directly. The Captive PCs became operational January 1, 2016 and provide services at primary care and specialty practices owned by HMC.

In 2016, Hunterdon Ambulatory Services, LLC was created as a sole member LLC with HMC being the sole member. It includes ambulatory nonprovider based diagnostic and therapeutic services. On December 1, 2019, HMC contributed approximately \$2.1 million of assets of Hunterdon Ambulatory Services, LLC to a newly formed joint venture with Atlantic Health System, and recognized a gain on sale of assets of approximately \$2.2 million. HMC has a 50 percent investment in the newly created joint venture.

The consolidated financial statements include the accounts of HMC, the Captive PCs and operations through November 30, 2019 of 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 GAAP 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 and restricted cash and cash equivalents include cash on hand and highly liquid investments with an original maturity of 12 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.

# Hunterdon Medical Center and Affiliates

Notes to Consolidated Financial Statements

December 31, 2019 and 2018

## Patient Accounts Receivable

The Medical Center assesses collectability on patient contracts prior to the recognition of net patient service revenue. Patient accounts receivable 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 revenue is 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. Revenue for performance obligations satisfied over time is 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.

# Hunterdon Medical Center and Affiliates

Notes to Consolidated Financial Statements

December 31, 2019 and 2018

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## 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 (NAV) 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. During 2018, unrealized gains and losses on investments are excluded from excess of revenues and gains over expenses and losses unless the investments are trading securities. In 2019, due to an accounting standard update, the Medical Center recorded unrealized gains and losses on investments without donor restrictions within the performance indicator. 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 the 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, 2019 and 2018.

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.

# Hunterdon Medical Center and Affiliates

Notes to Consolidated Financial Statements

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## **Impairment of Long-Lived Assets and Long-Lived Assets to be Disposed of**

Long-lived assets, such as property plant, 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.

## **Leases and Right-of-Use Assets**

Under Topic 842, the Medical Center evaluates at contract inception whether a lease exists and recognizes a lease obligation and right-of-use (ROU) asset for all leases with a term greater than 12 months. Leases are classified as either financing or operating. All lease liabilities are measured as the present value of the future lease payments using a discount rate. The future lease payments used to measure the lease liability include fixed payments, as well as the exercise price of any options to purchase the underlying asset that have been deemed reasonably certain of being exercised, if applicable. Future lease payments for optional renewal periods that are not reasonably certain of being exercised are excluded from the measurement of the lease liability. For all leases, the ROU asset is initially derived from the measurement of the lease liability and adjusted for certain items, such as initial direct costs and lease incentives received. ROU assets are subject to long-lived impairment testing.

Amortization of financing lease ROU assets, which is recognized on a straight-line basis over the lesser of the lease term and the estimated useful life of the asset, is included within depreciation and amortization expense in the consolidated statements of operations. Interest expense associated with financing lease obligations is included within interest expense in the consolidated statements of operations. Operating lease expense is recognized on a straight-line basis over the lease term and is included within building and maintenance in the consolidated statements of operations. The lease term is determined based on the date HMC acquires control of the leased premises through the end of the lease term. Optional renewal periods are initially not included in the lease term unless they are deemed to be reasonably certain of being exercised at lease commencement.

## **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 NAVs 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.

# Hunterdon Medical Center and Affiliates

Notes to Consolidated Financial Statements

December 31, 2019 and 2018

## 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). The Medical Center elected to test goodwill for impairment at the entity level and will perform such testing upon the occurrence of a triggering event indicating that the fair value of the Medical Center might be less than its carrying amount. There were no triggering events during 2019 or 2018.

## 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.

## Beneficial Interest in Foundation

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's 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.

## Net Assets

Net assets, revenues, gains and other support 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 restrictions. All revenues, gains, and other support 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 with donor restrictions are those whose use by the Medical Center have been limited by donors to a specific time period or purpose. 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. Certain net assets with donor restrictions are required to be maintained by the Medical Center in perpetuity.

## Contributions

The Medical Center reports gifts of cash and other assets as restricted support if they are received with donor stipulations that limit the use of the donated assets. Donor-restricted contributions whose restrictions are met within the same year as received are reported as contributions without donor restrictions in other revenue.

## Excess of Revenues and Gains Over Expenses and Losses

The consolidated statements of operations includes the determination of 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 equity trading securities (for 2019 only), 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).

# Hunterdon Medical Center and Affiliates

Notes to Consolidated Financial Statements

December 31, 2019 and 2018

## Measure of Operations

The consolidated statements of operations reflect all operating revenues and expenses that are an integral part of the Medical Center's healthcare services and supporting activities and net assets released from donor restrictions to support operating expenditures. Changes in revenues in excess of expenses that are excluded from operating income, consistent with industry practice, include investment and dividend income, net periodic pension credit, net realized gains or losses on investments, change in value of derivative financial instruments, gain and loss on sale of assets in unusual business situations and change in net unrealized gains and losses on other than trading debt securities.

## 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

HMC 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 2019 or 2018.

## Reclassifications

Certain reclassifications have been made to 2018 to conform with the 2019 presentation.

# Hunterdon Medical Center and Affiliates

Notes to Consolidated Financial Statements

December 31, 2019 and 2018

## Subsequent Events

The Medical Center evaluated subsequent events for recognition or disclosure through May 28, 2020, the date the consolidated financial statements were issued.

In December 2019, a novel strain of coronavirus was reported in Wuhan, Hubei province, China. In the first several months of 2020, the virus, SARS-CoV-2, and resulting disease, COVID-19, spread to the United States. The COVID-19 pandemic is having significant effects on global markets, supply chains, businesses and communities. The Medical Center's evaluation of the effects of these events is ongoing as of the date the accompanying consolidated financial statements were issued. COVID-19 may impact various parts of the Medical Center's 2020 operations and financial performance, including but not limited to additional costs for emergency preparedness, disease control and containment, potential shortages of personnel or supply chain disruption. The extent of the impact will depend on future developments, including the duration and spread of the outbreak and related governmental or other regulatory actions.

In January 2020, the Medical Center also executed a contract to acquire the physician practice "Your Doctors Care, PA". The purchase price was \$2,050,000 which is to be made in two installments, January 2020 and January 2021.

## New Accounting Standards

### Leases

Effective January 1, 2019, HMC adopted the FASB Accounting Standards Update (ASU) No. 2016-02, *Leases (as amended) (Topic 842)*. ASC 842 was issued to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the consolidated balance sheet and disclosing key information about leasing arrangements. Under the provisions of ASC 842, a lessee is required to recognize a ROU asset and lease liability, initially measured at the present value of the remaining lease payments, in the consolidated balance sheet. In addition, lessees are required to provide qualitative and quantitative disclosures that enable users to understand more about the nature of HMC's leasing activities.

HMC elected the option to apply the transition requirements at the effective date of January 1, 2019, which the effects of initially applying ASU 2016-02 (as amended) recognized as a cumulative-effect adjustment to net assets without donor restrictions in the period of adoption. Consequently, the consolidated financial statements and disclosures required under ASC 842 have not been updated as of and for year ended December 31, 2018. HMC also elected the package of practical expedients, which permits it to not reassess its prior conclusions about lease identification, classification and initial direct costs. In addition, HMC elected the short-term lease recognition exemption for all leases that qualify under Topic 842.

The adoption of ASU 2016-02 had a material effect on the Medical Center's consolidated financial statements. The most significant effects relate to the recognition of new ROU assets and lease liabilities on its consolidated balance sheets for operating leases and providing significant new disclosures about leasing activities. Upon adoption, the Medical Center recognized operating lease liabilities of \$19,316,020 based on the present value of the remaining minimum rental payments as determined in accordance with Topic 842 for leases that had historically been accounted for as operating leases under Topic 840. The Medical Center recognized the corresponding ROU assets of \$19,316,020 based on the operating lease liabilities. The Medical Center has made the transition-specific election to apply the package of practical expedients which allows for the carryforward of historical assessments of (i) whether contracts are or contain leases, (ii) the lease classification and (iii) initial direct costs. Certain other accounting policy elections and quantitative and qualitative information pertaining to the Medical Center's adoption of ASU 2016-02 are described in Note 11.

# Hunterdon Medical Center and Affiliates

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## Restricted Cash

In 2019, the Medical Center retrospectively adopted FASB 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 year in total of cash, cash equivalents and amounts generally described as restricted cash and cash equivalents. Amounts generally described as restricted cash and 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 following line items on the consolidated statement of cash flows for the year ended December 31, 2018 were affected by this change in accounting principle:

	<u>As Previously Reported</u>	<u>As Reported Under ASU 2016-18</u>	<u>Effect of Change</u>
Change in value of beneficial interest in Foundation and trusts, net	\$ (588,693)	\$ (534,656)	\$ 54,037
Net cash provided by operating activities	14,356,907	14,441,688	84,781
Sales of assets whose use is limited and short-term investments, net	10,210,460	11,270,335	1,059,875
Net cash used in investing activities	(16,677,037)	(15,617,162)	1,059,875
Net decrease in cash and cash equivalents and restricted cash and cash equivalents	-	(3,274,814)	(3,274,814)
Cash and cash equivalents and restricted cash and cash equivalents, beginning	-	27,247,648	27,247,648
Cash and cash equivalents and restricted cash and cash equivalents, ending	-	23,972,834	23,972,834
Net decrease in cash and cash equivalents	(4,388,726)	-	4,388,726
Cash and cash equivalents, beginning	25,760,758	-	(25,760,758)
Cash and cash equivalents, ending	21,372,032	-	(21,372,032)

## Financial Assets and Financial Liabilities

In 2019, the Medical Center adopted FASB ASU 2016-01, *Recognition and Measurement of Financial Assets and Financial Liabilities*. The provisions of ASU 2016-01: (a) requires equity investments (except those accounted for under the equity method of accounting or those that result in consolidation of the investee) to be measured at fair value with changes in fair value recognized in the performance indicator; (b) eliminates the requirement to disclose the fair value of financial instruments measured at amortized cost for entities that are not public business entities; (c) eliminates the requirement for public business entities to disclose the method(s) and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost on the consolidated balance sheets. The Medical Center has adjusted the presentation of these consolidated financial statements accordingly.

The new standard changed the consolidated statement of operations by recognizing unrealized gains and losses on investments as a component of both nonoperating revenues and the performance indicator in 2019. The adoption of ASU 2016-01 did not result in a change in the Medical Center's net assets as of January 1, 2019.

Prior to the adoption of ASU 2016-01, unrealized gains and losses on the Medical Center's equity investments were excluded from its performance indicator. ASU 2016-01 does not allow for the restatement of the Medical Center's 2018 consolidated financial statements for the impact of the new standard. As a result, comparability of total nonoperating revenues and revenues in excess of expenses from 2019 to 2018 have been affected.

# Hunterdon Medical Center and Affiliates

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## Compensation Retirement Benefits Defined Benefit Plans

During August 2018, the FASB issued ASU 2018-14, *Disclosure Framework - Changes to the Disclosure Requirements for Defined Benefit Plans*. The provisions of ASU 2018-14 modifies and clarifies the required disclosures for employers that sponsor defined benefit pension or other postretirement plans. These amendments remove disclosures that are no longer considered cost beneficial, clarify the specific requirements of disclosures and add disclosure requirements identified as relevant. ASU 2018-14 is effective for fiscal years ending after December 15, 2021. Early adoption is permitted. HMC is currently assessing the effect that ASU 2018-14 will have on its results of operation, financial position and cash flow.

## 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 \$4,616,546 and \$3,485,961 in 2019 and 2018, 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 \$317,892 and \$318,836 in 2019 and 2018, 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 nonacute 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, 2016.

## Hunterdon Medical Center and Affiliates

### Notes to Consolidated Financial Statements

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- **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 nonacute 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, Medicare and Medicaid managed care 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 included favorable adjustments of approximately \$1,834,000 and \$860,000 in 2019 and 2018, 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 revenue in the period of the change. For the years ended December 31, 2019 and 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 consolidated financial statements. 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.

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.

## Hunterdon Medical Center and Affiliates

### Notes to Consolidated Financial Statements

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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:

	<u>2019</u>	<u>2018</u>
Medicare and Medicare managed care	\$ 108,157,967	\$ 103,993,457
Medicaid and Medicaid managed care	22,058,823	20,699,519
Aetna	53,066,963	48,369,364
Blue Cross all products except Medicaid/Medicare	97,538,395	91,205,452
Self-pay/uninsured	2,978,915	3,366,338
Other third-party commercial	53,197,508	54,832,917
Total	<u>\$ 336,998,571</u>	<u>\$ 322,467,047</u>

Revenue from patient's deductibles and coinsurance are included in the categories presented above based on the primary payor. The composition of patient care service revenue by type of service for the years ended December 31 is as follows:

	<u>2019</u>	<u>2018</u>
Inpatient	\$ 87,928,748	\$ 88,464,169
Outpatient	180,383,038	173,796,972
Physician services	68,686,785	60,205,906
Total	<u>\$ 336,998,571</u>	<u>\$ 322,467,047</u>

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.

## Hunterdon Medical Center and Affiliates

Notes to Consolidated Financial Statements

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### 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, 2019 and 2018 is set forth in the following table:

	<u>2019</u>	<u>2018</u>
Short-term investments:		
Cash and cash equivalents	\$ 187,347	\$ 156,637
Certificates of deposit	1,701,745	2,921,248
Government bonds	2,696,195	1,475,171
Investment-grade corporate bonds	33,544,308	33,337,350
Mutual funds, fixed income	154,064	146,930
Accrued interest receivable	25,155	50,027
Total short-term investments	<u>\$ 38,308,814</u>	<u>\$ 38,087,363</u>
Assets whose use is limited:		
Board-designated funds:		
Cash and cash equivalents	\$ 3,933,699	\$ 4,883,882
Certificates of deposit	2,827,818	2,749,569
Mutual funds, international equity	7,049,172	6,530,277
Mutual funds, fixed income	15,115,815	15,780,371
Mutual funds, domestic equity	22,398,516	19,041,383
Accrued interest receivable	25,012	44,683
Total	<u>51,350,032</u>	<u>49,030,165</u>
Donor-restricted assets:		
Cash and cash equivalents	1,522,754	1,526,917
Commingled funds, U.S. large cap equities	6,249,873	4,722,379
Commingled funds, U.S. bonds	3,985,709	3,831,296
Mutual funds, international equity	2,413,440	2,523,214
Mutual funds, fixed income	459,609	1,693,828
Mutual funds, domestic equity	1,908,524	3,351,719
Total	<u>16,539,909</u>	<u>17,649,353</u>
Funds held by trustee under bond indenture agreements:		
Cash and cash equivalents	<u>1,021,027</u>	<u>1,019,848</u>
Total assets whose use is limited	68,910,968	67,699,366
Less current portion	<u>1,021,027</u>	<u>1,019,848</u>
Noncurrent portion of assets whose use is limited	<u>\$ 67,889,941</u>	<u>\$ 66,679,518</u>

Investment return includes the following for the years ended December 31, 2019 and 2018:

	<u>2019</u>	<u>2018</u>
Interest and dividend income, net	\$ 2,224,889	\$ 2,082,777
Net realized gains on investments	2,249,208	1,793,047
Change in net unrealized gains (losses) on investments	<u>8,306,025</u>	<u>(6,729,006)</u>
Total investment return	<u>\$ 12,780,122</u>	<u>\$ (2,853,182)</u>

## Hunterdon Medical Center and Affiliates

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Notes to Consolidated Financial Statements

December 31, 2019 and 2018

### 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 GAAP.

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.

## Hunterdon Medical Center and Affiliates

Notes to Consolidated Financial Statements

December 31, 2019 and 2018

The following tables present financial instruments measured at fair value at December 31, 2019 and 2018:

	Fair Value as of December 31, 2019			
	Total	Level 1	Level 2	Level 3
<b>Reported at Fair Value</b>				
Assets:				
Short-term investments:				
Certificates of deposit	\$ 1,701,745	\$ 1,701,745	\$ -	\$ -
Government bonds	2,696,195	-	2,696,195	-
Investment-grade corporate bonds	33,544,308	-	33,544,308	-
Mutual funds, fixed income	154,064	154,064	-	-
Assets whose use is limited:				
Certificates of deposit	2,827,818	2,827,818	-	-
Mutual funds, international equity	9,462,612	9,462,612	-	-
Mutual funds, fixed income	15,575,424	15,575,424	-	-
Mutual funds, domestic equity	24,307,040	24,307,040	-	-
Beneficial interest in trusts	2,424,482	-	-	2,424,482
Total assets in the fair value hierarchy	92,693,688	\$ 54,028,703	\$ 36,240,503	\$ 2,424,482
Assets recorded at NAV (a)	10,235,582			
Cash and cash equivalents	6,714,994			
Total assets at fair value	\$ 109,644,264			
Liabilities:				
Swap agreements	\$ 246,391	\$ -	\$ 246,391	\$ -

## Hunterdon Medical Center and Affiliates

Notes to Consolidated Financial Statements

December 31, 2019 and 2018

	Fair Value as of December 31, 2018			
	Total	Level 1	Level 2	Level 3
<b>Reported at Fair Value</b>				
Assets:				
Short-term investments:				
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:				
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	<u>91,606,435</u>	<u>\$ 54,738,539</u>	<u>\$ 34,812,521</u>	<u>\$ 2,055,375</u>
Assets recorded at NAV (a)	8,553,675			
Cash and cash equivalents	<u>7,681,994</u>			
Total assets at fair value	<u>\$ 107,842,104</u>			
Liabilities:				
Swap agreements	<u>\$ 163,287</u>	<u>\$ -</u>	<u>\$ 163,287</u>	<u>\$ -</u>

(a) In accordance with ASU 2015-07, certain investments that are measured at NAV 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.

### Investments Measured Using NAV per Share Practical Expedient

Commingled funds are valued at the quoted NAV of shares held by the Medical Center at year-end. The NAV is used as a practical expedient to estimate fair value. The NAV is based on the fair value of the underlying investments held by the fund less its liabilities. This practical expedient is not used when it is determined to be probable that the fund will sell the investment for an amount different than the reported NAV. Purchases and sales may occur daily.

## Hunterdon Medical Center and Affiliates

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The following table summarizes investments for which fair value is measured using NAV per share practical expedient as of December 31, 2019 and 2018, respectively.

<b>December 31, 2019</b>				
<b>Fund</b>	<b>Fair Value</b>	<b>Unfunded Commitments</b>	<b>Redemption Frequency (if currently eligible)</b>	<b>Redemption Notice Period</b>
State Street Passive Bond				
Market Index Strategy	\$ 3,985,709	N/A	Daily	30 days
S&P 500 Index Strategy	2,092,243	N/A	Daily	30 days
State Street FTSE RAFI				
U.S. 1000 Index	<u>4,157,630</u>	N/A	Daily	30 days
Total NAV investments	<u>\$ 10,235,582</u>			
<b>December 31, 2018</b>				
<b>Fund</b>	<b>Fair Value</b>	<b>Unfunded Commitments</b>	<b>Redemption Frequency (if currently eligible)</b>	<b>Redemption Notice Period</b>
State Street Passive Bond				
Market Index Strategy	\$ 3,831,296	N/A	Daily	30 days
S&P 500 Index Strategy	1,594,246	N/A	Daily	30 days
State Street FTSE RAFI				
U.S. 1000 Index	<u>3,128,133</u>	N/A	Daily	30 days
Total NAV investments	<u>\$ 8,553,675</u>			

### Fair Value of Financial Instruments

The carrying amounts of certificates of deposit approximate fair value at December 31, 2019 and 2018 due to the short maturity of those financial instruments.

Mutual funds are valued at the quoted NAV of shares held by the System 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.

## Hunterdon Medical Center and Affiliates

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Changes to the beneficial interest in trusts in 2019 and 2018 were as follows:

	<u>2019</u>	<u>2018</u>
Balance, beginning	\$ 2,055,375	\$ 2,372,968
Investment income from beneficial interest in trusts	35,509	24,175
Distributions from beneficial interest in trusts	(76,254)	(113,211)
Change in value of beneficial interest in trusts	<u>409,852</u>	<u>(228,557)</u>
Balance, ending	<u>\$ 2,424,482</u>	<u>\$ 2,055,375</u>

Change in value of beneficial interest in trusts is reported as changes in net assets with donor restrictions within the consolidated statements of changes in net assets.

### 6. Property and Equipment

Property and equipment and accumulated depreciation at December 31, 2019 and 2018 are as follows:

	<u>2019</u>	<u>2018</u>
Land	\$ 6,796,849	\$ 6,796,849
Land improvements	7,932,624	7,905,788
Buildings	160,657,172	155,262,075
Fixed equipment	41,224,062	41,224,062
Major moveable equipment	186,362,494	175,353,999
Leasehold improvements	9,094,937	9,094,937
Minor equipment	51,244	51,244
Construction in progress	<u>3,701,179</u>	<u>4,878,312</u>
	415,820,561	400,567,266
Less accumulated depreciation and amortization	<u>263,809,169</u>	<u>244,763,366</u>
Property and equipment, net	<u>\$ 152,011,392</u>	<u>\$ 155,803,900</u>

## Hunterdon Medical Center and Affiliates

Notes to Consolidated Financial Statements

December 31, 2019 and 2018

### 7. Long-Term Debt and Finance Lease Obligations

#### Bonds Payable

Bonds payable at December 31, 2019 and 2018 consist of the following:

	<u>2019</u>	<u>2018</u>
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
Authority Refunding Bonds, Series 2014D, payable monthly through December 1, 2034, bearing interest at a variable rate of 2.59% (a)	3,995,260	4,194,438
New Jersey Economic Development Authority Energy Resilience Bank (ERB) loan promissory note payable upon completion of COGEN project (accruable up to \$9,527,715 (e))	1,237,038	-
	<u>64,227,298</u>	<u>64,538,173</u>
Less current portion due within one year	<u>1,659,388</u>	<u>1,547,942</u>
Long-term debt, excluding deferred financing costs, bond premium and original issue discount	62,567,910	62,990,231
Less deferred financing costs	395,816	426,561
Plus unamortized bond premium, net of original issue discount	<u>1,953,439</u>	<u>2,031,578</u>
Long-term debt, net	<u>\$ 64,125,533</u>	<u>\$ 64,595,248</u>

## Hunterdon Medical Center and Affiliates

Notes to Consolidated Financial Statements

December 31, 2019 and 2018

### Finance Lease Obligations

Finance lease obligations at December 31, 2019 and 2018 consist of the following:

	<u>2019</u>	<u>2018</u>
TD Equipment Finance/Equipment (c)	\$ 1,780,516	\$ 2,272,805
US Bank Beds (d)	1,543,236	-
TD Equipment Finance/Davinci Robot	-	105,178
Subtotal	3,323,752	2,377,983
Less current portion due within one year	895,267	569,679
Long-term portion, net	<u>\$ 2,428,485</u>	<u>\$ 1,808,304</u>

- (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 percent and \$32,530,000 of Term Bonds maturing July 1, 2036 through 2045, with interest ranging from 4 percent to 5 percent. 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 percent to the bank in exchange for the bank agreeing to pay the Medical Center a variable rate equal to 69 percent of one-month LIBOR. This interest rate swap exchange agreement matured during 2019.

## Hunterdon Medical Center and Affiliates

### Notes to Consolidated Financial Statements

December 31, 2019 and 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 \$4,012,284 and requires the Medical Center to pay a fixed rate of 1.5 percent to the bank in exchange for the bank agreeing to pay the Medical Center a variable rate equal to 69 percent of one-month LIBOR (1.67 percent at December 31, 2019).

At December 31, 2019 and 2018, the fair value of the derivative financial instruments is \$(246,391) and \$(163,287), 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, 2019 and 2018, in the amount of (\$83,104) and \$102,201, respectively, is recorded in the consolidated statements of operations and is included in the performance indicator.

Future principal debt payments at December 31, 2019 are as follows:

Years ending December 31:	
2020	\$ 1,659,388
2021	1,702,966
2022	1,747,313
2023	1,792,836
2024	1,839,264
Thereafter	<u>55,485,531</u>
Total	<u>\$ 64,227,298</u>

Future minimum lease payments at December 31, 2019 are as follows:

Years ending December 31:	
2020	\$ 895,267
2021	914,681
2022	934,835
2023	<u>578,969</u>
Total	<u>\$ 3,323,752</u>

- (b) The Medical Center has a \$6,000,000 and a separate \$7,000,000 unsecured line of credit with TD Bank. The interest rate is 4.75 percent and 5.5 percent at December 31, 2019 and 2018, respectively, and the term was extended to December 31, 2020. There are no amounts outstanding on the lines of credit as of December 31, 2019 and 2018.
- (c) During 2018, the Medical Center entered into a finance 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 percent and a purchase option of \$1 at the end of the lease term.
- (d) During 2019, the Medical Center entered into a finance lease with US Bank for beds. The terms of both leases is five years with a total yearly rent payments of \$385,809, which does not include interest, required yearly beginning December 1, 2019. There is a purchase option of \$1 at the end of the lease term.

# Hunterdon Medical Center and Affiliates

Notes to Consolidated Financial Statements

December 31, 2019 and 2018

- (e) On December 21, 2018, the Medical Center entered into a funding agreement with the New Jersey Economic Development Authority to construct a one and a half megawatt natural gas-fired combined heat and power plant on its campus. As part of the agreement, the Medical Center obtained a \$9,527,715 loan from the New Jersey Energy Resilience Bank (the ERB Loan) bearing interest at 2 percent. During 2019, the Medical Center drew down \$1,237,038 on the loan. Principal payments are due beginning the first day of the seventh month following the project completion date and monthly thereafter for 12 years.

## 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 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 net assets without donor restrictions, 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 2019 and 2018.

	<u>2019</u>	<u>2018</u>
Change in benefit obligation:		
Benefit obligation, beginning	\$ 238,867,952	\$ 259,584,010
Interest cost	9,177,906	8,199,550
Amendments/curtailments/special termination benefits	1,545,177	-
Benefits paid	(12,575,932)	(8,445,328)
Actuarial loss (gain)	32,851,080	(20,470,280)
Benefit obligation, ending	<u>269,866,183</u>	<u>238,867,952</u>
Change in plan assets:		
Fair value of plan assets, beginning	193,072,559	217,622,881
Actual (loss) return on plan assets	39,137,094	(16,104,994)
Benefits paid	(12,575,932)	(8,445,328)
Fair value of plan assets, ending	<u>219,633,721</u>	<u>193,072,559</u>
Funded status	<u>\$ (50,232,462)</u>	<u>\$ (45,795,393)</u>
Accumulated benefit obligation	<u>\$ 269,866,183</u>	<u>\$ 238,867,952</u>
Amounts recognized in accumulated net assets without donor restrictions consist of:		
Net actuarial loss	<u>\$ 90,150,322</u>	<u>\$ 83,654,829</u>

## Hunterdon Medical Center and Affiliates

Notes to Consolidated Financial Statements

December 31, 2019 and 2018

The actuarial loss of \$32,851,080 in 2019 is primarily attributed to a decrease in the discount rate. During 2019, the Plan was amended to offer select employees an option to retire early, which resulted in additional incurred liabilities of \$1,545,177.

	<u>2019</u>	<u>2018</u>
Weighted average assumptions used to determine benefit obligations at December 31:		
Discount rate	3.19 %	4.20 %
Rate of compensation increases	N/A	N/A
Weighted average assumptions used to determine net periodic benefit cost:		
Discount rate	4.20 %	3.56 %
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	\$ 9,177,906	\$ 8,199,550
Expected return on plan assets	(15,043,361)	(17,041,986)
Effect of special termination benefits	1,545,177	-
Amortization of unrecognized actuarial loss	<u>2,261,854</u>	<u>1,696,973</u>
Net periodic benefit (credit) cost	<u>\$ (2,058,424)</u>	<u>\$ (7,145,463)</u>
Amounts recognized as changes in net assets without donor restrictions consist of:		
Net actuarial loss	<u>\$ 6,495,493</u>	<u>\$ 10,979,727</u>

The estimated net actuarial loss that is expected to be amortized from other changes in net assets without donor restrictions into net pension cost for the year ending December 31, 2020 is \$2,416,362.

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.

## Hunterdon Medical Center and Affiliates

Notes to Consolidated Financial Statements

December 31, 2019 and 2018

The fair value hierarchy for the Medical Center's pension plan assets at December 31, 2019 are as follows:

	<u>Fair Value</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Pension assets:				
Mutual funds, domestic fixed income	\$ 78,851,775	\$ 78,851,775	\$ -	\$ -
Mutual funds, domestic equity	84,182,578	84,182,578	-	-
Mutual funds, international equity	<u>55,623,499</u>	<u>55,623,499</u>	<u>-</u>	<u>-</u>
Total assets in the fair value hierarchy	218,657,852	<u>\$ 218,657,852</u>	<u>\$ -</u>	<u>\$ -</u>
Cash and cash equivalents	<u>975,869</u>			
Total assets at fair value	<u>\$ 219,633,721</u>			

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

	<u>Fair Value</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
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	<u>45,235,732</u>	<u>45,235,732</u>	<u>-</u>	<u>-</u>
Total assets in the fair value hierarchy	192,157,615	<u>\$ 192,157,615</u>	<u>\$ -</u>	<u>\$ -</u>
Cash and cash equivalents	<u>914,944</u>			
Total assets at fair value	<u>\$ 193,072,559</u>			

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

<u>Asset Category</u>	<u>2019 Target Allocations</u>	<u>2019</u>	<u>2018 Target Allocations</u>	<u>2018</u>
Mutual funds invested in equity securities	60 %	64 %	60 %	63 %
Mutual funds invested in debt securities	40	<u>36</u>	40	<u>37</u>
		<u>100 %</u>		<u>100 %</u>

## Hunterdon Medical Center and Affiliates

### Notes to Consolidated Financial Statements

December 31, 2019 and 2018

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 percent.

The Medical Center does not expect to contribute to the Plan during 2020.

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

Years ending December 31:

2020	\$ 11,155,649
2021	12,116,478
2022	13,035,227
2023	13,622,072
2024	13,977,502
Thereafter	74,327,454

In addition to the defined benefit plan, the Medical Center also provides a deferred compensation plan for certain employees and physicians. At December 31, 2019 and 2018, the assets related to this plan are included in other assets and the related liability is included in other liabilities in the amount of \$2,162,249 and \$2,090,678, 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, 2019 and 2018, the assets related to this plan are included in other assets in the amount of \$4,891,279 and \$4,259,829, 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 percent and 4 percent of each employee's annual compensation based on years of service and a 50 percent match of each employee's annual individual contribution to the plan to a maximum of 2 percent. Total expense recorded by the Medical Center for contributions into the plan in 2019 and 2018 was approximately \$5,908,000 and \$4,746,000, 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, 2019 and 2018:

	<u>2019</u>	<u>2018</u>
Restricted for capital acquisitions	\$ -	\$ 112,693
Restricted for program support	325,129	311,272
Total	<u>\$ 325,129</u>	<u>\$ 423,965</u>

## Hunterdon Medical Center and Affiliates

### Notes to Consolidated Financial Statements

December 31, 2019 and 2018

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, 2019 and 2018:

	<u>2019</u>	<u>2018</u>
Hunterdon Healthcare System, Inc.	\$ 1,666,572	\$ 1,975,830
Hunterdon Medical Center Foundation, Inc.	796,740	(545,010)
Hunterdon Regional Community Health, Inc.	815,222	310,894
Midjersey Health Corporation and Subsidiaries	(344,442)	(94,033)
Hunterdon Ambulatory Services, LLC	124,616	-
	<u>3,058,708</u>	<u>1,647,681</u>
Exclude amounts classified as current liabilities	<u>-</u>	<u>(467,414)</u>
Total noncurrent due from affiliates	<u>\$ 3,058,708</u>	<u>\$ 2,115,095</u>

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 \$330,000 and \$430,000 at December 31, 2019 and 2018, respectively. The System makes payments on this note to the Medical Center as Midjersey Health Corporation declares dividends to the System. Payments made during 2019 and 2018 were \$100,000. The remaining balance owed by the System of \$1,336,572 and \$1,545,830 at December 31, 2019 and 2018, 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 the Foundation of \$126,980 in 2018. There were no transfers during 2019. The transfers in 2018 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 \$300,303 and \$281,873 were recorded by the Medical Center during 2019 and 2018, 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 amount of \$943,236 for the years ended December 31, 2019 and 2018, 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 20 years. The outstanding loan balance was \$9,233,724 and \$9,644,011 at December 31, 2019 and 2018, respectively.

## Hunterdon Medical Center and Affiliates

Notes to Consolidated Financial Statements

December 31, 2019 and 2018

### 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 \$452,000 and \$717,000 at December 31, 2019 and 2018, 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 \$2,666,000 and \$2,266,000 at December 31, 2019 and 2018, respectively.

### 11. Operating Leases

As described in Note 1, the Medical Center adopted ASU 2016-02 effective January 1, 2019. The Medical Center leases certain medical offices, administrative offices and equipment under finance and operating leases. At the inception of a contract, a determination is made if the arrangement is or contains a lease. Leases are classified as either finance or operating leases based on the underlying terms of the agreement and certain criteria, such as the term of the lease relative to the useful life of the asset and the total lease payments to be made as compared to the fair value of the asset, amongst other criteria.

The Medical Center's ROU assets pertaining to operating leases represent the right to use the agreement's underlying assets for the lease term, and the corresponding lease liabilities represent the obligation to make lease payments arising from the lease. Such ROU assets and lease liabilities are recognized at the lease's commencement date at the present value of lease payments over the lease term for leases with initial terms greater than a year. The present value of lease payments is calculated by utilizing the discount rate stated in the lease, when readily determinable. For leases for which this rate is not readily available, the Medical Center has elected to use a discount rate comparable to the Medical Center's incremental borrowing rate for financing over a comparable period, which was 3.76 percent as of December 31, 2019. A ROU asset and lease liability are not recognized for leases with an initial term of 12 months or less, and the Medical Center recognizes lease expense for such leases over the lease term within supplies and services in the consolidated statements of operations. The deferred rent liability resulting from recording operating lease expense using the straight-line method is recorded within other long-term liabilities in the accompanying consolidated balance sheet at December 31, 2018. As a result of implementing ASU 2016-02, this amount is now reported as a reduction to ROU assets, operating leases line of the accompanying consolidated balance sheet at December 31, 2019.

The Medical Center's operating and finance leases have remaining lease terms ranging from less than one year to ten years, some of which may include options to extend. Weighted-average remaining lease term is 5.71 years. Lease payments related to periods subject to renewal options are excluded from the amounts used to determine the ROU leased assets and liabilities, unless the Medical Center is reasonably certain to exercise the option to extend the lease. The Medical Center's leases may also include variable lease payments. Variable lease payments are excluded from the amounts used to determine the ROU leased assets and liabilities, unless the variable lease payments depend on an index or rate or are in substance fixed payments.

The Medical Center has made an election for all leases to not separate lease components from nonlease components in contracts in the accounting for its lease payments, as permitted by ASU 2016-02. As such, the Medical Center accounts for the applicable nonlease components (e.g. fixed common area maintenance costs) together with the related lease components when determining the ROU assets and lease liabilities.

## Hunterdon Medical Center and Affiliates

### Notes to Consolidated Financial Statements

December 31, 2019 and 2018

The Medical Center's lease agreements do not contain material residual value guarantees. There are also no covenants.

The components of lease cost included in the accompanying consolidated statement of operations for the year ended December 31, 2019 are as follows:

Operating lease cost:		
Lease cost, leases with terms greater than one year	\$	4,335,927
Short-term lease cost		<u>2,142,250</u>
Total lease cost	\$	<u>6,478,177</u>

Future minimum payments under operating leases as of December 31, 2019 were as follows:

Years ending December 31:		
2020	\$	4,347,989
2021		3,850,358
2022		3,725,364
2023		2,999,875
2024		2,857,789
Thereafter		3,148,297
Interest		<u>(4,782,531)</u>
Total operating lease obligations	\$	<u>16,147,141</u>

## 12. Net Assets With Donor Restrictions

Net assets with donor restrictions in the amount of \$4,234,235 and \$7,214,764 at December 31, 2019 and 2018, respectively, are available for use by the Medical Center, as specified by the donor, for capital acquisitions, research and education. During 2019, as a result of management's review of these donor-restricted accounts, it was determined that a portion of amounts previously classified as net assets with donor restrictions were not donor-restricted and \$4,454,074 was transferred from net assets with donor restrictions to net assets without donor restriction. Net assets with donor restrictions of \$24,429,015 and \$22,141,724 at December 31, 2019 and 2018, 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 GAAP, 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 GAAP, deficiencies of this nature are to be reported in net assets without donor restrictions as of year-end. There were no such deficiencies as of December 31, 2019 and 2018.

# Hunterdon Medical Center and Affiliates

Notes to Consolidated Financial Statements

December 31, 2019 and 2018

## 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, 2019 and 2018:

	<u>2019</u>	<u>2018</u>
Endowment net assets	\$ 22,004,533	\$ 20,086,349

The following table presents changes in endowments for the years ended December 31, 2019 and 2018:

Endowment net assets, 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	<u>406,046</u>
Endowment net assets, December 31, 2018	20,086,349
Change in net unrealized gains (losses) on investments	1,910,496
Net realized gains on investments	<u>7,688</u>
Endowment net assets, December 31, 2019	<u>\$ 22,004,533</u>

## Hunterdon Medical Center and Affiliates

Notes to Consolidated Financial Statements

December 31, 2019 and 2018

### 13. Liquidity and Availability of Resources

For the years ended December 31, 2019 and 2018, the Medical Center has working capital of \$89,389,059 and \$68,562,000, respectively, as well as days cash on hand of 151 and 125, respectively.

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

	<u>2019</u>	<u>2018</u>
Cash and cash equivalents	\$ 44,421,789	\$ 21,372,032
Accounts receivable	44,325,307	40,030,195
Investments	38,308,814	38,087,363
Assets whose use is limited, board designated	51,350,032	49,030,165
Total	<u>\$ 178,405,942</u>	<u>\$ 148,519,755</u>

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 lines of credit of \$6,000,000 and \$7,000,000, as discussed in more detail in Note 7. As of December 31, 2019, \$13,000,000 remained available on the Medical Center's lines of credit.

As part of the Medical Center's liquidity management it has a policy to structure its financial assets to be available as its general expenditures, liabilities and other obligations come due.

### 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, 2019 and 2018 are as follows:

	<u>2019</u>		
	<u>Healthcare Services</u>	<u>General and Administrative</u>	<u>Total</u>
Salaries and benefits	\$ 196,001,553	\$ 14,880,908	\$ 210,882,461
Physicians' fees	9,113,456	-	9,113,456
Supplies and services	83,011,182	20,082,869	103,094,051
Depreciation and amortization	11,583,946	8,462,386	20,046,332
Interest	2,660,727	-	2,660,727
Total	<u>\$ 302,370,864</u>	<u>\$ 43,426,163</u>	<u>\$ 345,797,027</u>

## Hunterdon Medical Center and Affiliates

Notes to Consolidated Financial Statements

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	<b>2018</b>		
	<b>Healthcare Services</b>	<b>General and Administrative</b>	<b>Total</b>
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	<u>\$ 294,827,840</u>	<u>\$ 40,962,807</u>	<u>\$ 335,790,647</u>

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.

### 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, 2019 and 2018:

	<b>2019</b>	<b>2018</b>
Medicare	26.6 %	24.9 %
Medicaid	2.8	3.0
Blue Cross	14.9	18.5
Aetna	16.0	12.7
HMO/PPO payors	18.4	20.6
Other third-party payors	8.2	8.2
Self-pay patients	13.1	12.1
	<u>100.0 %</u>	<u>100.0 %</u>