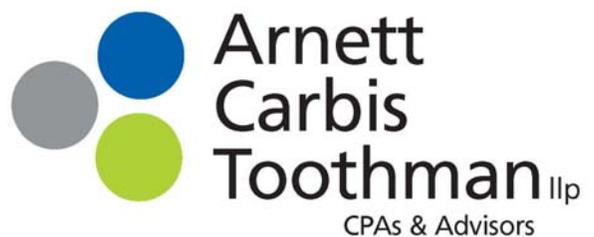




**Consolidated Financial Statements and
Supplemental Information
December 31, 2019**



CONTENTS

INDEPENDENT AUDITORS' REPORT	1 - 2
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FINANCIAL STATEMENTS:

Consolidated balance sheets	3
Consolidated statements of operations	4
Consolidated statements of changes in net assets	5
Consolidated statements of cash flows	6
Notes to consolidated financial statements	7 - 46

SUPPLEMENTARY INFORMATION:

Consolidated schedule – balance sheet information – 2019	47 - 48
Consolidating schedule – operating information – 2019	49
Consolidated schedule – balance sheet information – 2018	50 - 51
Consolidating schedule – operating information – 2018	52



INDEPENDENT AUDITORS' REPORT

To the Board of Trustees
Valley Health System and Subsidiaries
Winchester, Virginia

Report on the Consolidated Financial Statements

We have audited the accompanying consolidated financial statements of Valley Health System and its subsidiaries 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 financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Valley Health System and its subsidiaries as of December 31, 2019 and 2018, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matter

Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The consolidating information is presented for purposes of additional analysis rather than to present the financial position, results of operations, and cash flows of the individual companies and is not a required part of the consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The consolidating information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the consolidated financial statements as a whole.

Arnett Carbis Toothman LLP

Charleston, West Virginia
March 20, 2020

VALLEY HEALTH SYSTEM AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

December 31, 2019 and 2018

	2019	2018
	(In Thousands)	
ASSETS		
Current assets		
Cash and cash equivalents	\$ 73,206	\$ 53,142
Investments	580,584	359,204
Assets limited as to use	13,555	13,271
Patient accounts receivable	98,891	95,455
Inventory of supplies	19,893	20,008
Other current assets	28,207	21,772
Total current assets	814,336	562,852
Assets limited as to use, net of amount required to meet current liabilities	70,819	248,253
Property and equipment, net	707,716	655,759
Other assets		
Operating lease right-to-use assets	17,174	-
Goodwill	4,627	4,627
Other investments	23,117	21,501
Total other assets	44,918	26,128
Total assets	\$ 1,637,789	\$ 1,492,992
LIABILITIES AND NET ASSETS		
Current liabilities		
Current installments of long-term debt	\$ 8,090	\$ 7,800
Accounts payable and accrued expenses	66,193	50,824
Accrued salaries and wages	38,764	36,787
Third-party settlements	4,291	6,532
Other current liabilities	18,170	230
Total current liabilities	135,508	102,173
Long-term debt, excluding current installments	428,585	437,112
Operating leases liabilities, net of current portion	14,823	-
Accrued pension and postretirement obligations	72,466	69,800
Other liabilities	49,015	36,668
Total liabilities	700,397	645,753
Net assets		
Net assets without donor restrictions	906,315	821,348
Net assets with donor restrictions	31,077	25,891
Total net assets	937,392	847,239
Total liabilities and net assets	\$ 1,637,789	\$ 1,492,992

See accompanying notes to consolidated financial statements

VALLEY HEALTH SYSTEM AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

Years Ended December 31, 2019 and 2018

	2019	2018
	(In Thousands)	
Revenue, gains and other support		
Net patient service revenue	\$ 918,048	\$ 842,086
Other operating revenue	63,016	48,148
Investment income	72,169	82,069
Net assets released from restrictions	880	1,131
Total revenue, gains and other support	1,054,113	973,434
Expenses		
Salaries and wages	379,859	369,188
Payroll taxes and benefits	78,245	85,332
Supplies and other	408,450	367,990
Depreciation and amortization	73,340	67,837
Interest expense	14,474	14,365
Total expenses	954,368	904,712
Excess of operating revenue over operating expenses before loss on impairment of long-lived assets	99,745	68,722
Loss on impairment of long-lived assets	-	(10,479)
Excess of operating revenue over operating expenses after loss on impairment of long-lived assets	99,745	58,243
Nonoperating revenue		
Gain on sale of fixed assets	63	536
Other non-operating revenue	475	5,229
Excess of revenue over expenses	100,283	64,008
Other changes in net assets without donor restrictions		
Net change in unrealized gain (loss) on investments	9,099	(98,900)
Change in value of derivatives	(7,842)	5,034
Change in pension plan funded status	(15,385)	(1,152)
Other changes	(290)	-
Increase (Decrease) in net assets without donor restrictions	\$ 85,865	\$ (31,010)

See accompanying notes to consolidated financial statements

VALLEY HEALTH SYSTEM AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN NET ASSETS
Years Ended December 31, 2019 and 2018

	<u>2019</u>	<u>2018</u>
	<u>(In Thousands)</u>	
Net assets without donor restrictions		
Excess of revenue over expenses	\$ 100,283	\$ 64,008
Net change in unrealized gain (loss) on investments	9,099	(98,900)
Change in value of derivatives	(7,842)	5,034
Change in pension plan funded status	(15,385)	(1,152)
Other changes	(290)	-
	<u>85,865</u>	<u>(31,010)</u>
Net assets with donor restrictions		
Contributions	2,352	1,767
Net assets released from restrictions	(880)	(1,131)
Net realized and unrealized gain (loss) on investments	3,714	(1,057)
	<u>5,186</u>	<u>(421)</u>
Increase (Decrease) in net assets		
with donor restrictions	<u>91,051</u>	<u>(31,431)</u>
Net assets, beginning of year, as previously reported	847,239	878,670
Cumulative effect of change in accounting principle	(898)	-
Net assets, beginning of year, as restated	<u>846,341</u>	<u>878,670</u>
Net assets, end of year	<u>\$ 937,392</u>	<u>\$ 847,239</u>

See accompanying notes to consolidated financial statements

VALLEY HEALTH SYSTEM AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

Years Ended December 31, 2019 and 2018

	<u>2019</u>	<u>2018</u>
	<u>(In Thousands)</u>	
Cash flows from operating activities		
Change in net assets	\$ 91,051	\$ (31,431)
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Amortization of debt issuance costs and accretion of bond premium	(437)	(449)
Depreciation and amortization	73,340	67,837
Net realized and unrealized (gains) losses on investments	(74,622)	24,815
Unrealized (gains) on derivatives	7,842	(5,034)
Change in pension plan funded status	15,385	1,152
(Gain) on sale of property and equipment	(63)	(536)
Loss on impairment of long-lived assets	-	10,479
(Increase) decrease in:		
Patient accounts receivable	(3,436)	3,177
Inventory of supplies	115	(1,323)
Other current and long term assets	(7,952)	8,042
Increase (decrease) in:		
Accounts payable and accrued expenses	15,369	5,375
Accrued salaries and wages	1,977	1,523
Accrued pension and postretirement benefits	(12,719)	(15,287)
Third-party settlements	(2,241)	1,700
Other current and long term liabilities	13,061	1,216
Net cash provided by operating activities	<u>116,670</u>	<u>71,256</u>
Cash flows from investing activities		
Purchase of property and equipment	(116,452)	(83,754)
Proceeds from sale of property and equipment	185	1,010
Proceeds from sale of investments	265,114	1,279,396
Purchases of investments	(247,516)	(1,287,912)
Net cash used in investing activities	<u>(98,669)</u>	<u>(91,260)</u>
Cash flows from financing activities		
Principal payments on long-term debt	(7,800)	(7,500)
Payments on finance leases	(2,931)	-
Proceeds from the issuance of long-term debt, including premium	-	54,639
Payment of financing costs	-	(936)
Net cash provided by (used in) financing activities	<u>(10,731)</u>	<u>46,203</u>
Net increase (decrease) in cash, cash equivalents, and restricted cash	<u>7,270</u>	<u>26,199</u>
Cash, cash equivalents, and restricted cash, beginning of year	<u>123,284</u>	<u>97,625</u>
Cash, cash equivalents, and restricted cash, end of year	<u>\$ 130,554</u>	<u>\$ 123,824</u>
Supplemental disclosure of cash flow information		
Cash paid for interest, net of \$1,112 thousand and \$930 thousand capitalized in 2019 and 2018, respectively	<u>\$ 13,373</u>	<u>\$ 11,883</u>

The following table provides a reconciliation of cash, cash equivalents, and restricted cash reported within the balance sheets that sum to the total of the same such amounts shown in the statement of cash flows.

Cash and cash equivalents	\$ 73,206	\$ 53,142
Restricted cash	<u>57,348</u>	<u>70,142</u>
Total cash, cash equivalents, and restricted cash	<u>\$ 130,554</u>	<u>\$ 123,284</u>

Amounts included in restricted cash represent those required to be set aside by a contractual agreement with the bond holders. The restriction will lapse when the related long-term debt is paid off.

See accompanying notes to consolidated financial statements

VALLEY HEALTH SYSTEM AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1. Summary of Significant Accounting Policies

Organization: Valley Health System (VHS) was incorporated on November 4, 1983 as a not-for-profit holding company organized exclusively for charitable, benevolent, educational, and scientific purposes to support and encourage health care and related services through providing financial, management, and other assistance to its affiliates and other organizations. Subsidiaries of VHS, all of which are wholly owned, are as follows:

- Winchester Medical Center, Inc. (the Medical Center) — a 495 bed not-for-profit acute care hospital located in Winchester, Virginia.
- Winchester Medical Center Foundation (the Winchester Foundation) — an independent, not-for-profit non-stock corporation. The purpose of the Winchester Foundation is to fund educational, scientific, and charitable endeavors. The Medical Center is the sole corporate member of the Winchester Foundation. The accounts and activity of the Winchester Foundation are consolidated with those of the Medical Center.
- Warren Memorial Hospital, Inc. (Warren) — a not-for-profit corporation that owns and operates a 60 bed general short-term acute care hospital including a 120 bed long-term care facility located in Front Royal, Virginia.
- Warren Memorial Hospital Foundation (the Warren Foundation) — an independent, not-for-profit non-stock corporation. The purpose of the Warren Foundation is to fund educational, scientific, and charitable endeavors. Warren is the sole corporate member of the Warren Foundation. The accounts and activity of the Warren Foundation are consolidated with those of Warren.
- Shenandoah Memorial Hospital, Inc. (Shenandoah) — a not-for-profit corporation that owns and operates a 25 bed critical access hospital in Woodstock, Virginia.
- Shenandoah Memorial Hospital Foundation (the Shenandoah Foundation) — an independent, not-for-profit non-stock corporation. The purpose of the Shenandoah Foundation is to fund educational, scientific, and charitable endeavors. Shenandoah is the sole corporate member of the Shenandoah Foundation. The accounts and activity of the Shenandoah Foundation are consolidated with those of Shenandoah.
- Valley Regional Enterprises, Inc. (Valley Regional) — a for-profit organization which manages a home health care agency, operates an ambulance service, urgent care centers, a retail pharmacy and billing services for non-affiliated ambulance providers.
- East Mountain Health Advantage, Inc. (East Mountain) — a not-for-profit corporation that was organized on February 2, 2007, with VHS as its sole corporate member. East Mountain was organized for the primary purpose of owning and operating healthcare facilities in West Virginia, including Hampshire and War.
- Hampshire Memorial Hospital, Inc. (Hampshire) — a not-for-profit corporation that owns and operates a 14-bed critical access hospital, a 6 bed emergency room, and a 30-bed skilled nursing facility in Romney, West Virginia.

VALLEY HEALTH SYSTEM AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

- Hampshire Wellness Center, Inc. — On January 19, 2008, East Mountain Health Advantage entered into a long-term lease agreement to lease and operate a 60,000 square foot wellness center. The lease agreement with the Hampshire County Development Authority is for a period of 20 years.

In 2008, Hampshire Wellness Center, Inc., a not-for-profit corporation, was established to operate the wellness center and assume responsibility for the lease. East Mountain Health Advantage is the sole corporate member of Hampshire Wellness Center, Inc.

- War Memorial Hospital, Inc. (War) — a not-for-profit corporation that owns and operates a 25-bed critical access hospital, a 6 bed emergency room, and a 16-bed skilled nursing facility in Berkeley Springs, West Virginia.
- Page Memorial Hospital, Inc. (Page) — a not-for-profit corporation that owns and operates a 25-bed critical access hospital in Luray, Virginia.
- Valley Partners, LLC — a not-for-profit limited liability corporation organized in 2014 for the development of an accountable care organization to address population health of the communities served by VHS.
- Valley Physician Enterprise, Inc. (VPE) — a not-for-profit corporation formed for the purpose of employing physicians and providing office management services to non-employed physicians in the communities served by VHS.
- Northern WV Home Health, LLC — a not-for-profit limited liability corporation providing home health services owned one third each by the Medical Center, Hampshire, and War.

Principles of Consolidation: The consolidated financial statements include the accounts of Valley Health System and its subsidiaries (collectively referred to as VHS in the accompanying footnotes). All significant intercompany balances and transactions are eliminated in consolidation.

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

Cash and Cash Equivalents: Cash and cash equivalents are highly liquid interest-bearing bank deposits and repurchase agreements. The carrying amount of cash and cash equivalents approximates fair market value. For purposes of the statement of cash flows, VHS considers all highly liquid financial instruments purchased with an original maturity of three months or less to be cash equivalents.

Patient Accounts Receivable: Patient accounts receivable are carried at net realizable value based on certain assumptions determined by each payor. In evaluating accounts receivable, VHS analyzes its past history and identifies trends for each of its major payor sources of revenue to estimate the net realizable value. For receivables associated with self-pay patients (which includes both patients without insurance and patients with deductible and copayment balances due for which third-party coverage exists for part of the bill), VHS determines implicit price concessions based on its past historical collection experience, which indicates that many patients are unable or unwilling to pay the portion of their bill for which they are financially responsible. Management reviews patient accounts to determine collection potential. Accounts are written off when all reasonable internal and external collection efforts have been exhausted. Estimated implicit price concessions of \$49.9 million and \$54.7 million for the years ended December 31, 2019 and 2018, respectively, have been recorded as reductions to patient accounts receivable.

VALLEY HEALTH SYSTEM AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

VHS has entered into an agreement with a financing company to assist patients in setting up payment plans for self-pay balances. Payment plans are between the financing company and the patient. Once a payment plan is established with a patient, VHS transfers the outstanding self-pay balances to the financing company in exchange for upfront cash. A recourse payment to the financing company could result for those accounts that were not collected. An estimated recourse reserve is made based on past history and industry experience regarding self-pay collectability. The estimated recourse reserve is included in patient accounts receivable and is approximately \$2.3 million and \$1.7 million at December 31, 2019 and 2018, respectively.

Pledges Receivable: Pledges receivable represent unconditional promises to give and are carried at the original pledge less an estimate made for doubtful or uncollectible accounts. In evaluating the collectability of pledges receivable, VHS analyzed past history and industry experience regarding outstanding pledge balances. VHS's pledges receivable was \$1 million and \$1.1 million at December 31, 2019 and 2018, respectively. VHS's allowance for doubtful accounts of pledges receivable was \$53 thousand and \$72 thousand at December 31, 2019 and 2018, respectively. The carrying value of the pledges receivable approximates fair value.

Investments: Investments in equity securities with readily determinable fair values and all investments in debt securities are measured at fair value in the balance sheets. Investment income or loss (including realized gains and losses on investments, interest and dividends) is included in the excess of revenues over expenses unless the income or loss is restricted by donor. Unrealized gains and losses on investments are excluded from the excess of revenues over expenses unless the investments are trading securities. VHS does not require collateral to secure its investments.

Assets Limited as to Use: Assets limited as to use primarily include assets held by trustees under indenture agreements and 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. Amounts required to meet current liabilities of VHS have been classified as a current asset in the balance sheets at December 31, 2019 and 2018.

Inventory of Supplies: The inventory of supplies is maintained on a first-in, first-out basis and is stated at the lower of cost or market.

Property and Equipment: Property and equipment acquisitions are recorded at cost. Depreciation is provided over the estimated useful life of each class of depreciable asset and is computed using the straight-line method. Equipment under capital lease obligations is amortized on the straight-line method over the shorter period of the lease term or the estimated useful life of the equipment. Such amortization is included in depreciation and amortization in the financial statements. Interest cost incurred on borrowed funds during the period of construction of capital assets is capitalized as a component of the cost of acquiring those assets. Estimated useful lives of the assets are as follows:

Buildings	20 to 50 years
Fixed equipment	10 to 20 years
Major moveable equipment	5 to 10 years
Software	3 to 7 years

Gifts of long-lived assets such as land, buildings, or equipment are reported as increased in net assets without donor restrictions, and are excluded from the excess of revenues over expenses, unless explicit donor stipulations specify how the donated assets must be used. Gifts of long-lived assets with explicit restrictions that specify how the assets are to be used, and gifts of cash or other assets that must be used to acquire long-lived assets, are reported as 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.

VALLEY HEALTH SYSTEM AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Leases: VHS determines if an arrangement is a lease at inception. Operating leases are included in operating lease right-of-use (“ROU”) assets, other current liabilities, and operating leases liabilities on VHS’s balance sheets. Finance leases are included in property and equipment, other current liabilities, and other liabilities in the consolidated balance sheets.

ROU lease assets represent VHS’s right to use an underlying asset for the lease term and lease obligations represent VHS’s obligation to make lease payments arising from the lease. Operating ROU lease assets and obligations are recognized at the commencement date based on the present value of lease payments over the lease term. When VHS’s leases do not provide an implicit rate, VHS uses its incremental borrowing rate based on the information available at the commencement date in determining the present value of lease payments. The ROU lease asset also includes any lease payments made and excludes lease incentives. VHS’s lease terms may include options to extend or terminate the lease when it is reasonably certain that VHS will exercise that option. Lease expense for lease payments is recognized on a straight-line basis over the lease term.

VHS has lease agreements with lease and non-lease components, which are generally accounted for separately. For certain equipment leases, VHS accounts for the lease and non-lease components as a single lease component. Additionally, for certain equipment leases, VHS applies a portfolio approach to effectively account for the operating lease ROU assets and liabilities.

Deferred Financing Costs: Deferred financing costs are amortized over the period the obligation is outstanding using the straight-line method, which is not materially different than the effective interest method. Amortization expense related to the deferred financing costs was \$134 thousand and \$119 thousand for 2019 and 2018, respectively. Deferred financing fees have been netted against long-term debt in accordance with authoritative guidance.

Goodwill: VHS recorded goodwill as the excess of purchase price over the fair value of the identifiable assets acquired for various acquisitions. Authoritative guidance related to goodwill and other intangible assets prescribes the application of a two-step process for impairment testing of goodwill if adverse qualitative factors exist indicating that it is more likely than not that goodwill is impaired. This is performed annually, as well as when an event triggering impairment may have occurred. Upon determination that goodwill is more than likely to be impaired, the two-step process would be applied. The first step tests for impairment while the second step, if necessary, measures impairment. VHS has selected December 31 on which to perform its annual evaluation of goodwill for impairment.

Net Assets: Net assets, revenue, gains, and losses are classified based on the existence or absence of donor or grantor 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 (or certain grantor) restrictions. The governing board has designated, from net assets without donor restrictions, net assets for an operating reserve and board-designated endowment.
- Net assets with donor restrictions – Net assets subject to donor (or certain grantor) imposed restrictions. Some donor-imposed restrictions are temporary in nature, such as those that will be met by the passage of time or other events specified by the donor. Other donor-imposed restrictions are perpetual in nature, where the donor stipulates that resources be maintained in perpetuity. Donor-imposed restrictions are released when a restriction expires, that is, when the stipulated time has elapsed, when the stipulated purpose for which the resource was restricted has been fulfilled, or both.

VALLEY HEALTH SYSTEM AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Excess of Revenues over Expenses: The statements of operations include excess of revenues over expenses. Changes in net assets without donor restrictions which are excluded from excess of revenues over expenses, consistent with industry practice, include unrealized gains and losses on derivatives and investments other than trading securities, permanent transfers of assets to and from affiliates for other than goods and services, changes in pension plan funding status and contributions of long-lived assets (including assets acquired using contributions, which by donor restriction, were to be used for the purposes of acquiring such assets).

Net Patient Service Revenue: On January 1, 2018, VHS adopted the new revenue recognition accounting standard issued by the Financial Accounting Standards Board (FASB) using the full retrospective method. The adoption of the new standard did not have an impact on the recognition of net revenues for any periods prior to adoption. Provision for bad debts is no longer presented as a separate line item in the Consolidated Statements of Operations but included in net patient service revenue as an estimated implicit price concession deduction. Additionally, the estimated allowance for doubtful accounts was reclassified as a component of patient accounts receivable. Because all of its performance obligations relate to contracts with a duration of less than one year, VHS has elected to apply the optional exemption provided in FASB ASC 606-10-50-14(A) and, therefore, is not required to disclose the aggregate amount of the transaction prices 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. VHS has applied the practical expedient approach and all incremental customer contract acquisition costs are expensed as they are incurred, as the amortization period of the asset that VHS otherwise would have recognized is one year or less in duration.

Net patient service revenue is reported at the amount that reflects the consideration to which VHS expects to be entitled to in exchange for providing patient care and is recognized as performance obligations are satisfied. These amounts are due from patients, third-party payers (including health insurers and government programs) and others and includes variable consideration for retroactive adjustments due to settlement of audits, reviews and investigations. Generally, VHS bills the patients and third-party payors several days after the services are performed 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 VHS. Generally, performance obligations associated with inpatient services are satisfied over time and are recognized based on actual charges incurred in relation to total expected (or actual) charges. VHS measures the performance obligation from admission into the hospital to the point when it is no longer required to provide services to that patient, which is generally at the time of discharge. Revenue for performance obligations satisfied at a point in time is recognized when goods or services are provided and VHS does not believe it is required to provide additional goods or services to the patient. Generally, performance obligations associated with outpatient services are satisfied at a point in time.

VHS determines the transaction price based on standard charges for goods and services provided, reduced by contractual adjustments provided to third-party payors, discounts provided to uninsured patients in accordance with VHS's policy, and implicit price concessions provided to uninsured patients. VHS determines its estimates of contractual adjustments and discounts based on contractual agreements, its discount policies, and historical experience. VHS determines its estimate of implicit price concessions based on historical collection experience with this class of patients.

VHS has agreements with third-party payers that provide for reimbursement to VHS at amounts different from its established rates. Contractual adjustments under third party reimbursement programs represent the difference between VHS billings at established rates for services and amounts reimbursed by third-party payers.

VALLEY HEALTH SYSTEM AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

A summary of the payment arrangements with major third-party payers follows:

- **Medicare**

The Medical Center and Warren are reimbursed by Medicare under a prospective payment system (PPS). Under this methodology, inpatient acute care services rendered to Medicare program beneficiaries are paid at prospectively determined rates per discharge. These rates vary according to a patient classification system that is based on clinical, diagnostic and other factors. The majority of outpatient services are paid at prospectively determined rates per medical procedure. Classification of patients under the Medicare program and the appropriateness of their admission are subjected to an independent review by a peer review organization under contract.

Shenandoah, Hampshire, Page and War are licensed as Critical Access Hospitals. Inpatient services and most outpatient services rendered to Medicare program beneficiaries at Shenandoah, Hampshire, Page and War are paid based on a cost reimbursement methodology at 101% of allowable cost. Other outpatient services are paid based on fee schedules.

- **Medicaid**

Reimbursement for inpatients is based entirely on prospectively determined rates per discharge based on primary diagnosis code. The majority of outpatient services are paid at prospectively determined rates per medical procedure. Hampshire and War are located in West Virginia and are reimbursed for inpatient and most outpatient services under a cost reimbursement methodology.

The Commonwealth of Virginia expanded Medicaid effective January 1, 2019. The Commonwealth instituted a supplemental payment program to increase Medicaid payments to providers, as well as expand eligibility for Medicaid. A condition of the increase and expansion is that hospitals throughout the Commonwealth fund the cost to implement and manage the program. These changes impacted payer mix, net patient revenue and operating expenses of the clinical divisions of VHS.

- **Blue Cross**

Inpatient services are reimbursed based on a prospectively determined rate per discharge. These rates vary according to a patient classification system that is based on clinical, diagnostic and other factors. Outpatient services are reimbursed by percentage of charges or fee schedule based on diagnosis and are not subject to retroactive adjustment.

- **Managed Care and Other Commercial**

The Hospitals have also entered into payment agreements with certain commercial insurance carriers, health maintenance organizations, and preferred provider organizations. The basis for payment under these agreements includes prospectively determined rates per discharge, discounts from established charges and prospectively determined daily rates.

VALLEY HEALTH SYSTEM AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

- **Other**

Payment agreements with certain commercial insurance carriers, health maintenance organizations and preferred provider organizations provide for payment using 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 VHS'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 VHS. In addition, the contracts VHS has with commercial payors also provide for retroactive audit and review of claims.

Settlements with third-party payors for retroactive adjustments due to audits, review or investigations are considered variable consideration and are included in the determination of estimated transaction price for providing patient care. These settlements are estimated based on the terms of the payment agreement with the payor, correspondence from the payor, and VHS's historical settlement activity, including an assessment to ensure that it is probable that a significant reversal in the amount of cumulative revenue recognized will not occur when the uncertainty associated with the retroactive adjustment is subsequently resolved. Estimated settlements are adjusted in future periods as adjustments become known (that is, new information becomes available), or as years are settled or are no longer subject to such audits, reviews and investigations. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term. In 2019 and 2018, net patient service revenue decreased approximately \$306 thousand and increased approximately \$2.1 million, respectively, due to changes in previously recorded estimates.

Generally, patients who are covered by third-party payors are responsible for related deductibles and coinsurance, which vary in amount. VHS provides services to uninsured patients, and offers those uninsured patients a discount, either by policy or law, from standard charges. VHS estimates the transaction price for patients with deductibles and coinsurance and from those who are uninsured based on historical experience and current market conditions. The initial estimate of the transaction price is determined by reducing the standard charge by any contractual adjustments, discounts, and implicit price concessions. Subsequent changes that are determined to be the result of an adverse change in the patient's ability to pay are recorded as bad debt expense. Bad debt expense for the years ended December 31, 2019 and 2018 were considered immaterial. Patients who meet VHS's criteria for charity care are provided care without charge or at amounts less than established rates. Such amounts determined to qualify as charity care are not reported as revenue.

VHS 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 VHS's expectation that the period between the time the service is provided to a patient and the time that the patient or a third-party payor pays for that service will be one year or less. However, VHS does, in rare instances, enter into payment agreements with patients that allow payments in excess of one year. For those cases, the financing component is not deemed to be significant to the contract.

VHS has determined that the nature, amount, timing, and uncertainty of revenue and cash flows are primarily affected by the payor, geography, and service lines. The following tables provide details of these factors.

VALLEY HEALTH SYSTEM AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

VHS's net patient service revenue by major payor groups during the years ended December 31, 2019 and 2018 are as follows (in thousands):

	2019		2018	
Medicare	\$ 321,154	35%	\$ 288,118	34%
Managed Medicare	69,871	7%	56,766	7%
Medicaid	16,935	2%	11,160	1%
Managed Medicaid	65,071	7%	30,729	4%
Commerical insurers	440,345	48%	439,026	52%
Uninsured	4,673	1%	16,287	2%
	\$ 918,049	100%	\$ 842,086	100%

The composition of net patient service revenue based on the locations of VHS' facilities operates in and its lines of business for the years ended December 31, 2019 and 2018 are as follows:

2019	Virginia		West Virginia		Total	
Service lines:						
Hospital – inpatient	\$ 390,293	45%	\$ 10,874	20%	\$ 401,167	44%
Hospital – outpatient	357,366	41%	31,418	57%	388,784	43%
Skilled nursing services	15,060	2%	6,732	12%	21,792	2%
Physician services	79,271	9%	5,687	11%	84,958	9%
Other	21,347	3%	-	-%	21,347	2%
Total	\$ 863,337	100%	\$ 54,711	100%	\$ 918,048	100%

2018	Virginia		West Virginia		Total	
Service lines:						
Hospital – inpatient	\$ 351,654	44%	\$ 8,465	17%	\$ 360,119	43%
Hospital – outpatient	339,513	43%	28,847	57%	368,360	44%
Skilled nursing services	14,464	2%	6,450	12%	20,914	2%
Physician services	68,036	9%	7,102	14%	75,138	9%
Other	17,555	2%	-	-%	17,555	2%
Total	\$ 791,222	100%	\$ 50,864	100%	\$ 842,086	100%

Charity Care: VHS provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. VHS's policy is not to pursue collection of amounts determined to qualify as charity care if the patient qualifies (up to 200% of the Federal Poverty Guidelines). A sliding scale discount is applied for those patients that qualify between 200% and 300% of the Federal Poverty Guidelines. VHS's uninsured discount policy is 30% for patients with no third-party coverage and who did not qualify for charity care. Accordingly, VHS does not report these amounts in patient accounts receivable or net patient service revenue. VHS 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, the estimated cost of those services and supplies, and equivalent service statistics. VHS determined the costs associated with providing charity care by aggregating the applicable direct and indirect costs, including salaries, wages and benefits, supplies, and other operating expenses, based on data from its cost accounting system. The costs of caring for charity care patients for the years ended December 31, 2019 and 2018 were approximately \$14.1 million and \$23.2 million, respectively.

VALLEY HEALTH SYSTEM AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Mission Support: VHS agreed to partner with and support a local nonprofit corporation, which mission is to provide healthcare services to West Virginia residents. VHS is not liable for any operating losses associated with the nonprofit corporation. Total mission support was \$4.3 million and \$4.0 million in 2019 and 2018, respectively and is included in supplies and other expenses in the consolidated statement of operations.

Donor – Restricted Gifts: Unconditional promises to give cash and other assets to VHS are reported at fair value at the date the promise is received. Conditional promises to give and indications of intentions to give are reported at fair value at the date the gift is received. The gifts are reported as with donor restrictions if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires (that is, when a stipulated time restriction ends or a purpose restriction is accomplished), with donor restrictions net assets are reclassified as without donor restrictions net assets and reported in the statements of operations as net assets released from restrictions. Donor-restricted contributions whose restrictions are met within the same year as received are reflected as contributions in the accompanying consolidated financial statements.

Functional Allocation of Expenses: The costs of program and supporting services activities have been summarized on a functional basis in Note 14. The statement of functional expenses present the natural classification detail of expenses by function. Accordingly, certain costs have been allocated among the programs and supporting services benefited.

Income Taxes: VHS and its subsidiaries have been recognized by the Internal Revenue Service (IRS) as not-for-profit corporations as described in Section 501(c)(3) and Section 501(a), respectively, of the Internal Revenue Code (IRC), and similar sections of state statutes, and are exempt from Federal and State income taxes, except for Valley Regional, which is a for-profit corporation subject to income taxes at the statutory Federal and State rates.

Accounting principles generally accepted in the United States of America require VHS to evaluate tax positions taken by VHS and recognized a tax liability or asset if VHS has taken an uncertain position that more likely than not would be sustained upon examination by the Internal Revenue Services (IRS). VHS has concluded that as of December 31, 2019 and 2018, there are no uncertain positions taken or expected to be taken that would require recognition of a liability or asset or disclosure in the financial statements.

VHS is subject to routine audits by taxing jurisdictions. Management of VHS believes it is no longer subject to income tax examinations for years prior to the year ended December 31, 2016.

Derivative Instruments and Hedging Activities: VHS utilizes derivative financial instruments to reduce interest rate risk. VHS does not hold or issue derivative financial instruments for trading purposes. VHS recognizes all derivatives as either assets or liabilities and measures those instruments at fair value. The changes in the fair value of VHS derivative instruments are recorded as changes in net assets as they qualify for hedge accounting.

Reclassifications: Certain amounts in the 2018 consolidated financial statements have been reclassified to conform to the 2019 presentation.

Subsequent Events: Management has evaluated subsequent events through March 20, 2020, which is the date the consolidated financial statements were issued.

VALLEY HEALTH SYSTEM AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Change in Accounting Principle:

Leases

VHS adopted ASU No. 2016-02—Leases (Topic 842), as amended, as of January 1, 2019, using the modified retrospective approach and applied the new standard to all leases through a cumulative-effect adjustment to beginning net assets. As a result, comparative financial information has not been restated and continues to be reported under the accounting standards in effect for those periods. VHS elected the package of practical expedients permitted under the transition guidance within the new standard, which includes, among other things, the ability to carry forward the existing lease classification. On January 1, 2019, VHS recorded a cumulative effect of change in accounting principle to decrease net assets by \$898 thousand. Adoption of the new standard resulted in the recording of additional net lease assets and lease liabilities of approximately \$29 million and \$30 million respectively, as of January 1, 2019. The standard did not materially impact VHS's consolidated statements of operations and cash flows.

Financial Instruments

In 2019, VHS adopted ASU 2016-01, *Financial Instruments – Overall (Subtopic 825-10) – Recognition and Measurement of Financial Assets and Financial Liabilities*. This ASU requires certain equity securities to be reported at fair value with changes in fair value recognized within the net income, establishes a qualitative factor in evaluating impairment on equity investments without readily determinable fair values, and eliminates the requirement to disclose the fair value on financial instruments measured at amortized cost. Adoption of the new standard resulted in the recording of \$57 million of unrealized gains from equity investments to be recorded in investment income on the consolidated statements of operations as of December 31, 2019.

Statement of Cash Flow

VHS adopted ASU 2016-18, *Statement of Cash Flows (Topic 230): Restricted Cash* using the full retrospective approach. These amendments require that a statement of cash flows explain the change during the period in the total of cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents. As a result, amounts generally described as restricted cash and restricted cash equivalents should be included with cash and cash equivalents when reconciling the beginning-of-period and end-of-period total amounts shown on the statement of cash flows. Adoption of this guidance did not have a material impact on the VHS's consolidated financial statements.

Net Periodic Pension and Postretirement Benefit Cost

In 2019, VHS adopted ASU No. 2017-07— *Compensation - Retirement Benefits - Defined Benefit Plans - General (Subtopic 715-20): Disclosure Framework - Changes to the Disclosure Requirements for Defined Benefit Plans* using the full retrospective approach. The new standard requires employers to disaggregate and present separately the current service cost component from the other components of net benefit cost within the Consolidated Statement of Operations. For 2019 and 2018, VHS reclassified (\$475) thousand and (\$5,229) thousand, respectively, of non-service cost components of net benefit cost to Nonoperating revenue from expenses on our consolidated statements of operations.

VALLEY HEALTH SYSTEM AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

New or Recent Accounting Standards Updates:

Fair Value Measurement: In August 2018, the FASB issued ASU 2018-13, *Fair Value Measurement (Topic 820): Disclosure Framework - Changes to the Disclosure Requirements for Fair Value Measurement*. The amendments in this update modify the disclosure requirements on fair value measurements in *Topic 820, Fair Value Measurement*, based on the concepts in the Concepts Statement, including the consideration of costs and benefits. In addition, the amendments eliminate *at a minimum* from the phrase *an entity shall disclose at a minimum* to promote the appropriate exercise of discretion by entities when considering fair value measurement disclosures and to clarify that materiality is an appropriate consideration of entities and their auditors when evaluating disclosure requirements. The amendments on changes in unrealized gains and losses, the range and weighted average of significant unobservable inputs used to develop Level III fair value measurements, and the narrative description of measurement uncertainty should be applied prospectively for only the most recent interim or annual period presented in the initial fiscal year of adoption. All other amendments should be applied retrospectively to all periods presented upon their effective date. Early adoption is permitted. An entity is permitted to early adopt any removed or modified disclosures upon issuance of this update and delay adoption of the additional disclosures until their effective date. VHS is currently evaluating the impact, if any, that adoption will have on its December 31, 2020 consolidated financial statements.

Compensation - Retirement Benefits - Defined Benefit Plans - General: In August 2018, the FASB issued ASU 2018-14, *Compensation - Retirement Benefits - Defined Benefit Plans - General (Subtopic 715-20): Disclosure Framework - Changes to the Disclosure Requirements for Defined Benefit Plans*. These amendments modify the disclosure requirements for employers that sponsor defined benefit pension or other postretirement plans. The amendments in this update remove disclosures that no longer are considered cost beneficial, clarify the specific requirements of disclosures, and add disclosure requirements identified as relevant. Although narrow in scope, the amendments are considered an important part of the Board's efforts to improve the effectiveness of disclosures in the notes to financial statements by applying concepts in the Concepts Statement. An entity should apply the amendments in this Update on a retrospective basis to all periods presented. Early adoption is permitted. VHS is currently evaluating the impact, if any, that adoption will have on its December 31, 2022 consolidated financial statements.

Intangibles: In August 2018, the FASB issued ASU 2018-15, *Intangibles - Goodwill and Other - Internal-Use Software (Subtopic 350-40): Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract*. These amendments align the requirements for capitalizing implementation costs incurred in a hosting arrangement that is a service contract with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software (and hosting arrangements that include an internal use software license). The accounting for the service element of a hosting arrangement that is a service contract is not affected by these amendments. Early adoption is permitted. VHS is currently evaluating the impact, if any, that adoption will have on its December 31, 2021 consolidated financial statements.

Goodwill: In May 2019, the FASB issued ASU 2019-06, *Intangibles – Goodwill and Other (Topic 350), Business Combinations (Topic 805), and Not-for-Profit Entities (Topic 958)*. The amendments in this ASU provide not-for-profit entities the ability to apply private company alternatives from Topic 350 and Topic 805. Amendments to Topic 350 allow not-for-profit entities to amortize goodwill on a straight-line basis, test for impairment upon a triggering event, and elect to test for impairment at the entity level. Amendments to Topic 805 should allow not-for-profit entities to recognize fewer separate intangible assets in an acquisition. VHS plans to adopt this guidance during the year ended December 31, 2020. Adoption of this guidance will result in amortization expense of approximately \$450 thousand in VHS's consolidated financial statements.

VALLEY HEALTH SYSTEM AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 2. Patient Accounts Receivable Concentrations

VHS grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payor agreements. The mix of net receivables from patients and third-party payors at December 31 was as follows:

	2019	2018
Medicare	30%	29%
Medicaid	10%	7%
Blue Cross	29%	27%
Commercial and other	26%	28%
Self-pay	5%	9%
	100%	100%

Note 3. Cash Concentrations

VHS maintains cash and cash equivalents on deposit with financial institutions. At times the balance in these accounts may be in excess of Federally insured limits. However, management believes these financial institutions are financially sound and these concentrations do not present a significant risk to VHS.

Note 4. Investments and Commitments

The composition of the investments classified as unrestricted current assets as of December 31 are summarized as follows (in thousands):

	2019	2018
Investments		
Pooled investments	\$ 580,392	\$ 347,331
Common stock	192	11,873
Total	\$ 580,584	\$ 359,204

Assets Limited as to Use

The composition of assets limited as to use at December 31 is as follows (in thousands):

	2019	2018
By Board for capital improvements		
Pooled investments	\$ -	\$ 164,852
Restricted by Donors		
Pooled investment funds - WMC	11,733	12,025
Pooled investment funds - WMH	1,848	1,591
Pooled investment funds - SMH	3,077	2,929
Total	16,658	16,545
Total pooled investments	16,658	181,397
Held by trustee under indenture agreements		
Cash and cash equivalents	51,835	65,429
Total	51,835	65,429

VALLEY HEALTH SYSTEM AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

	2019	2018
Endowment Fund		
Beneficial interest in trusts – mutual funds	3,199	3,414
Total	3,199	3,414
Deferred Compensation plans		
Cash surrender value – life insurance	6,376	5,706
Cash and cash equivalents	5,513	4,713
Mutual funds	793	865
Total	12,682	11,284
Total assets limited as to use	84,374	261,524
Less assets limited as to use that are required for current liabilities	(13,555)	(13,271)
Noncurrent assets limited as to use	\$ 70,819	\$ 248,253

Pooled Investments: VHS has investments in pooled investment funds, investments held by a trustee under existing debt agreements, investments held by financial institutions, and individual investments in entities that provide related healthcare services.

The Medical Center, Warren, Shenandoah and their respective foundations, combine their investments in an investment pool which includes cash and cash equivalents, unrestricted investments, and assets limited as to use. The pooled investment funds are allocated to these categories based upon an allocation formula approved by the Board of Trustees. The investments in the pool, are stated at fair value at December 31 and are summarized as follows (in thousands):

	2019	2018
Unrestricted investments	\$ 580,392	\$ 347,331
Assets limited as to use	16,658	181,397
Total Pooled Investments	\$ 597,050	\$ 528,728

The composition of investments held in the investment pool at December 31 at fair value, is as follows (in thousands):

	2019	2018
Cash and cash equivalents	\$ 13,524	\$ 14,295
Common stock	161,608	128,962
Mutual funds	94,198	71,405
Fixed income	75,434	76,370
Alternative investments	252,286	237,696
	\$ 597,050	\$ 528,728

VALLEY HEALTH SYSTEM AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Investment Advisor Change

VHS had an agreement with its external investment advisor to provide discretionary investment advisory services for its operating and pension plan investments. This allowed the advisor full investment authority and discretion to allocate and rebalance assets at such times as it deems appropriate and without prior consultation from VHS, subject to investment policies and guidelines established by VHS. Effective December 2017, VHS entered into an agreement to change its external investment advisor. Due to the transition, a significant portion of the VHS's investments were reinvested in new funds in January 2018, which resulted in approximately \$53 million of previously recorded unrealized gains were realized. The new advisor has and will continue to provide discretionary investment advisory services for its operating and pension plan investments.

Other Investments

Other investments at December 31, 2019 and 2018 include (in thousands):

	2019	2018
Investments recorded on equity method	\$ 18,431	\$ 16,381
Investments recorded on cost basis	4,686	5,120
	\$ 23,117	\$ 21,501

Investments recorded on the equity method include \$9.6 million and \$8.9 million at December 31, 2019 and 2018, respectively, related to VHS's investment in Virginia Solution SPC LTD (the Captive) (Note 18). VHS is accounting for its investment in the Captive, a 69% owned affiliate as of December 31, 2019, by the equity method of accounting under which VHS's share of the net income of the Captive is recognized as income in VHS's statement of operations and added to the investment account, and dividends received, if any, from the Captive are treated as a reduction of the investment account. During 2019 and 2018, VHS received \$2.2 million and \$9 million, respectively, in dividends from the Captive and there was no related receivable for dividends declared but not received as of December 31, 2019 and 2018. VHS's majority interest in the Captive does not give it the ability to exercise control. Condensed, unaudited, financial information of the Captive for the years ending December 31, 2019 and 2018 is as follows (in thousands):

	2019	2018
Cash and investments	\$ 54,528	\$ 61,589
Receivables and other assets	\$ 4,956	\$ 5,536
Unearned premiums	\$ (2,045)	\$ (2,024)
Claims reserve	\$ (27,572)	\$ (29,428)
Accounts payable and other accrued liabilities	\$ (11,461)	\$ (22,903)
Shareholder's (equity)	\$ (18,406)	\$ (12,770)
Net income	\$ 8,637	\$ 688

Premier

The Medical Center had an investment in a group purchasing organization, Premier, L.P. (Premier). In October 2013, Premier converted from a privately held organization to publicly traded company. The ownership of Premier LP is divided between Class A and Class B common units, equaling the number of shares of Class A and Class B stock respectively outstanding. In 2018, VHS exercised the termination right of its Group Purchasing Organization Agreement with Premier. By exercising the terminations right, VHS has forfeited its remaining 125,369 Class B common units. During 2019, the Medical Center left the partnership and related organization. There was no investment remaining in the partnership at December 31, 2019.

VALLEY HEALTH SYSTEM AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Investment Income

Investment income and gains and losses for investments, cash equivalents and assets limited as to use are comprised of the following for the years ending December 31 (in thousands):

	2019	2018
Income		
Investment income	\$ 3,313	\$ 7,984
Net realized gain on sale of investments	11,979	74,085
Unrealized gain on equity investments	56,877	-
	<u>\$ 72,169</u>	<u>\$ 82,069</u>
Other Changes in Net Assets without donor restrictions		
Net change in unrealized gains (loss) on investments	\$ 9,099	\$ (98,900)

Interest and investment income is shown net of investment manager fees of \$2.1 million and \$1.7 thousand at December 31, 2019 and 2018, respectively.

Purchase Commitment

VHS has investment agreements with various venture capital funds, which contain investment commitments. Approximately \$84.9 million of investment commitments are outstanding at December 31, 2019. Future increases in the investments will be made as requested by the manager of these funds and is based upon planned acquisitions of investment funds.

Impairment

Impairment is evaluated using numerous factors, and their relative significance varies case to case. Factors considered include length of time and extent to which the market value has been less than cost; the financial condition and near-term prospects of the issuer; and the intent and ability to retain the security in order to allow for an anticipated recovery in market value. If, based on the analysis, it is determined that the impairment is other-than-temporary, the security is written down to fair value, and a loss would be recognized in the statement of operations. At December 31, 2019 and 2018, VHS determined that no write-downs were necessary.

Note 5. Fair Value Disclosures

Fair Value Measurements

The *Fair Value Measurements and Disclosures* Topic 820 of the FASB Accounting Standards Codification defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements.

VALLEY HEALTH SYSTEM AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Under the FASB's authoritative guidance on fair value measurements, fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. In determining fair value, VHS uses various methods including market, income and cost approaches. Based on these approaches, VHS often utilizes certain assumptions that market participants would use in pricing the asset or liability, including assumptions about risk and or the risks inherent in the inputs to the valuation technique. These inputs can be readily observable, market corroborated, or generally unobservable inputs. VHS utilizes valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs. Based on the observability of the inputs used in the valuation techniques VHS is required to provide the following information according to the fair value hierarchy. The fair value hierarchy ranks the quality and reliability of the information used to determine fair value. Financial assets and liabilities carried at fair value will be classified and disclosed in one of the following three categories:

- Level 1 – Quoted prices for identical assets and liabilities traded in active exchange markets, such as the New York Stock Exchange.
- Level 2 – Observable inputs other than Level 1 including quoted prices for similar assets or liabilities, quoted prices in less active markets, or other observable inputs that can be corroborated by observable market data. Level 2 also includes derivative contracts whose value is determined using a pricing model with observable market inputs or can be derived principally from or corroborated by observable market data.
- Level 3 – Unobservable inputs supported by little or no market activity for financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation; also includes observable inputs for nonbinding single dealer quotes not corroborated by observable market data.

The following is a description of the valuation methodologies used for instruments measured at fair value.

Equity Securities

The fair value of equity securities is the market value based on quoted market prices, when available, or market prices provided by recognized broker dealers. If listed prices or quotes are not available, fair value is based upon externally developed models that use unobservable inputs due to the limited market activity of the instrument.

Mutual and Other Funds

Valued at the quoted net asset value (NAV) of shares held at year end.

U.S. Government Obligations

Valuation inputs utilized by the independent pricing service for those U.S. Government securities under Level 2 include benchmark yields, reporting trades, broker/dealer quotes, issuer spreads, benchmark securities, bids, offers, and reference data including market research publications. Also included are data from the vendor trading platform.

Alternative Investments

Alternative investments are recorded under the equity method of accounting using net asset value (NAV). The NAV of alternative investments is based on valuations provided by the administrators of the specific financial instrument. The underlying investments in these financial instruments may include marketable debt and equity securities, commodities, foreign currencies, derivatives, and private equity investments. The underlying investments themselves are subject to various risks, including market, credit, liquidity, and foreign exchange risk. VHS believes the NAV is a reasonable estimate of its ownership interest in the alternative investments. VHS's risk of alternative investments is limited to its carrying value. Alternative

VALLEY HEALTH SYSTEM AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

investments can be divested only at specific times in accordance with terms of the subscription agreements. The underlying holdings of real estate investments are periodically valued by appraisers considering current market conditions. Because these financial instruments are not readily marketable, the estimated carrying value is subject to uncertainty, and, therefore, may differ from the value that would have been used had a market for such financial instruments existed.

Derivative Instruments

Derivatives are fair valued according to their classification as over-the-counter (“OTC”). OTC derivatives consist of interest rate swaps. These derivatives are fair valued under Level 2 using third-party services. Observable market inputs include yield curves (the LIBOR swap curve and applicable basis swap curves), foreign exchange rates, commodity prices, option volatilities, counterparty credit risk, and other related data. Credit valuation adjustments are required to reflect both our own nonperformance risk and the respective counterparty’s nonperformance risk. These adjustments are determined generally by applying a credit spread for the counterparty or VHS as appropriate to the total expected exposure of the derivative.

Fair Value on a Recurring Basis

The tables below present the recorded amount of assets measured at fair value on a recurring basis (in thousands):

	Total at December 31, 2019	Fair Value Measurements Using:		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
ASSETS				
Investments and Assets Limited as to Use:				
Cash and cash equivalents	\$ 70,872	\$ 70,872	\$ -	\$ -
Common stock	161,800	161,800	-	-
Fixed income				
Asset-backed securities	12,432	-	12,432	-
Collateralized mtg-backed	5,106	-	5,106	-
Corporate bonds and notes	23,141	-	23,141	-
Government and agencies	29,545	-	29,545	-
Municipal bonds	5,210	-	5,210	-
	75,434	-	75,434	-
Mutual funds				
International funds	14,061	14,061	-	-
Domestic funds	84,129	84,129	-	-
	98,190	98,190	-	-
Total assets in the fair value hierarchy	406,296	330,862	75,434	-
Investments measured at NAV	252,286	-	-	-
Total investments at fair value	\$ 658,582	\$ 330,862	\$ 75,434	\$ -
Investments not at fair value	6,376			
Total investments and assets limited as to use	\$ 664,958			
Liabilities:				
Derivative Financial Instruments	\$ (32,695)	\$ -	\$ (32,695)	\$ -

VALLEY HEALTH SYSTEM AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

ASSETS	Total at December 31, 2018	Fair Value Measurements Using:		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Investments and Assets Limited as to Use:				
Cash and cash equivalents	\$ 84,569	\$ 84,569	\$ -	\$ -
Common stock	140,835	140,835	-	-
Fixed income				
Asset-backed securities	13,347	-	13,347	-
Collateralized mtg-backed	4,142	-	4,142	-
Corporate bonds and notes	24,431	-	24,431	-
Government and agencies	31,069	-	31,069	-
Municipal bonds	3,381	-	3,381	-
	76,370	-	76,370	-
Mutual funds				
International funds	12,060	12,060	-	-
Domestic funds	63,492	63,492	-	-
	75,552	75,552	-	-
Total assets in the fair value hierarchy	377,326	300,956	76,370	-
Investments measured at NAV	237,696	-	-	-
Total investments at fair value	\$ 615,022	\$ 300,956	\$ 76,370	\$ -
Investments not at fair value	5,706			
Total investments and assets limited as to use	\$ 620,728			
Liabilities:				
Derivative Financial Instruments	\$ (24,853)	\$ -	\$ (24,853)	\$ -

Assets Recorded at Fair Value on a Nonrecurring Basis

VHS has no assets or liabilities that are recorded at fair value on a nonrecurring basis.

The following methods and assumptions were used by VHS in estimating the fair value of each class of its financial instruments for which it is practicable to estimate that value:

Cash and cash equivalents: The carrying amount approximates fair value because of the short-term maturity of those instruments.

Patient accounts receivable: The carrying amount approximates fair value.

Third-party payor settlement: The carrying amount approximates fair value.

Long-term debt: The fair values of bonds payable are based on quoted market prices for the same or similar issues.

Derivative financial instruments: The carrying amount of derivative financial instruments, interest rate swap agreements, are reported at fair value and recorded in other long-term liabilities.

VALLEY HEALTH SYSTEM AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The following table presents estimated fair values of VHS's financial instruments at December 31, 2019 and 2018 (in thousands):

	2019		2018	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Cash and cash equivalents	\$ 73,206	\$ 73,206	\$ 53,142	\$ 53,141
Patient accounts receivable	\$ 98,891	\$ 98,891	\$ 95,455	\$ 95,455
Other current assets	\$ 28,207	\$ 28,207	\$ 21,772	\$ 21,772
Investments and assets limited as to use	\$ 664,958	\$ 664,958	\$ 620,728	\$ 620,728
Third party settlements	\$ (4,291)	\$ (4,291)	\$ (6,532)	\$ (6,532)
Long-term debt	\$ (436,675)	\$ (443,755)	\$ (444,912)	\$ (445,835)
Derivative financial instruments	\$ (32,695)	\$ (32,695)	\$ (24,853)	\$ (24,853)

Fair Value of Investments that Calculate Net Asset Value

The following table summarizes investments measured at fair value based on net asset value (NAVs) per share as of December 31, 2019 and 2018, respectively (in thousands):

December 31, 2019	Fair Value	Unfunded Commitments	Redemption Frequency (if currently eligible)	Redemption Notice Period
Equity fund (a)	\$ 22,207	\$ -	Monthly	7 days
Equity fund (b)	\$ 58,565	\$ -	Monthly	5 days
Direct hedge funds (c)	\$ 17,856	\$ -	Monthly	30 days
Direct hedge funds (d)	\$ 108,692	\$ -	Quarterly	45-90 days
Other funds (f)	\$ 44,966	\$ 84,881	N/A	N/A
Total	\$ 252,286	\$ 84,881		

December 31, 2018	Fair Value	Unfunded Commitments	Redemption Frequency (if currently eligible)	Redemption Notice Period
Equity fund (a)	\$ 20,883	\$ -	Monthly	7 days
Equity fund (b)	\$ 47,431	\$ -	Monthly	5 days
Direct hedge funds (c)	\$ 8,364	\$ -	Monthly	30 days
Direct hedge funds (d)	\$ 107,569	\$ -	Quarterly	45-90 days
Managed hedge fund (e)	\$ 22,051	\$ -	Semiannual	90 days
Other funds (f)	\$ 31,398	\$ 52,827	N/A	N/A
Total	\$ 237,696	\$ 52,827		

VALLEY HEALTH SYSTEM AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

- (a) Equity fund is an emerging markets equity fund seeks to invest in high quality companies with an orientation towards absolute returns and capital preservation. The strategy is not focused on managing to an Index. The multi-advisor fund has monthly liquidity with a 7 day notice period.
- (b) Equity fund is an international strategy focused on long-term capital cycle, i.e., profitability is inversely proportional to competition. It assesses business strategy in the context of industry and competitive position within industry. The fund has monthly liquidity with a 5 day notice period. daily liquidity.
- (c) Direct hedge funds are 2 separate funds. One is a systematic alternative risk premia strategy and the other is a multi-strategy equity fund with a diversified portfolio. Both funds have monthly liquidity with 30 day notice periods.
- (d) Direct hedge funds are 13-14 different hedge funds that invest in a variety of strategies. Strategies include relative value, event-driven, equity long/short, and global macro funds. The funds have quarterly liquidity with notice periods ranging from 45 to 90 days.
- (e) Managed hedge fund is a hedge fund of funds with a concentrated bias to long/short hedge funds, but will also make opportunistic investments when opportunities arise. The fund has semiannual liquidity with 90 days notice.
- (f) Other funds are 16-18 separate funds that invest in a variety of strategies. Strategies include in commercial and residential real estate, oil and natural gas exploration and production, timberland, venture, leveraged buyout, middle market, and international private equity funds. The funds have terms from 8 to 20 years.

Note 6. Net Assets With Donor Restrictions

Net assets with donor restrictions are restricted for the following purposes or periods ending December 31:

	2019	2018
Subject to expenditure for specified purposes:		
Indigent care	\$ 2,426	\$ 2,107
Capital purchases	3,769	2,544
Health outreach & education	5,842	4,701
General fund / equipment	13,517	10,802
Total subject to expenditure for specified purposes	25,554	20,154
Investments in perpetuity, which once appropriated, is expended to support:		
Indigent care	629	563
General fund / equipment	4,894	5,174
	5,523	5,737
Total net assets with donor restrictions	\$ 31,077	\$ 25,891

VALLEY HEALTH SYSTEM AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Net assets were released from donor restrictions by incurring expenses satisfying the restricted purpose or by occurrence of the passage of time or other events specified by the donors as follows for the years ended December 31:

	2019	2018
Satisfaction of purpose restrictions		
General fund / equipment	\$ 525	\$ 242
Indigent care	216	651
Health outreach & education	139	238
Distributions (proceeds are not restricted by donors)	\$ 880	\$ 1,131

Note 7. Property and Equipment and Commitments

A summary of property and equipment at December 31 follows (in thousands):

	2019	2018
Land	\$ 20,288	\$ 20,992
Land improvements	50,871	49,988
Buildings and leasehold improvements	661,908	651,625
Fixed equipment	211,507	192,043
Major movable equipment	495,853	454,411
	1,440,427	1,369,059
Less accumulated depreciation and amortization	830,390	757,915
	610,037	611,144
Land held for future construction	5,936	3,552
Construction in progress	91,743	41,063
	107,679	44,615
Property and equipment, net	\$ 707,716	\$ 655,759

Construction in Progress

Estimated costs to complete construction projects that have been in progress are approximately \$84.2 million as of December 31, 2019. \$64.8 million of the total estimated costs to complete are related to construction of the new Warren Memorial Hospital. The hospital is estimated to be completed in the first quarter 2021.

Impairment of Long-Lived Assets

VHS evaluates the recoverability of long-lived assets and the related estimated remaining lives when indicators of impairment are present. VHS records an impairment charge or changes the useful life if events or changes in circumstances indicate that the carrying amount may not be recoverable or the useful life has changed. For purposes of impairment analysis, assets are grouped with other assets and liabilities at the lowest level for which cash flows are identifiable.

During 2018, VHS recognized \$10.5 in impairment loss for a hospital classified as "Held and Used". A new hospital is being constructed as a replacement for Warren Memorial Hospital and the operations are intended to move in first quarter 2021. Management evaluated the current hospital using discounted cash flows and determined that the fair value is less than the current carrying cost. In 2019, VHS did not have any impairment on long-lived assets.

VALLEY HEALTH SYSTEM AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 8. Long-Term Debt

A summary of long-term debt as of December 31, 2019 and 2018 follows:

	2019	2018
2018 Series Bonds, Hospital Revenue Bonds See terms below – Warren	\$ 54,365	\$ 54,365
2015 Series Bonds, Hospital Revenue Refunding Bonds See terms below – Medical Center, Warren, Shenandoah, and Hampshire	116,955	118,285
2014 Series Bonds, Hospital Revenue Refunding Bonds See terms below – Hampshire	17,365	17,820
2014A Series Bonds, Hospital Revenue Refunding Bonds See terms below – Medical Center	40,040	40,835
2014B Series Bonds, Hospital Revenue Bonds See terms below – Shenandoah	12,000	12,000
2013A Series Bonds, Hospital Revenue Bonds See terms below – Page	31,630	32,380
2013B Series Bonds, Hospital Revenue Bonds See terms below – Medical Center	56,320	60,050
2009 Series Bonds, Hospital Revenue Bonds See terms below – Medical Center	97,165	97,905
	425,840	433,640
Add bond premium	14,153	14,725
Less deferred financing costs	(3,318)	(3,453)
Less current portion	(8,090)	(7,800)
Long-term debt	\$ 428,585	\$ 437,112

Aggregate maturities of long-term obligations are as follows:

Year Ending December 31,	Long-Term Debt
2020	\$ 8,090
2021	8,408
2022	8,807
2023	9,183
2024	9,573
Thereafter	<u>381,779</u>
	<u>\$ 425,840</u>

VALLEY HEALTH SYSTEM AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

A detail description of the bond indebtedness follows:

2018 Series Bond, Hospital Revenue Bonds

In July 2018, the Industrial Development Authority of the Town of Front Royal and the County of Warren, Virginia (The Authority) issued \$54.4 million Hospital Revenue Bonds, Series 2018. The bonds were issued to Warren Memorial Hospital (Borrower). Proceeds of the Series 2018 Bonds are to be used by the Borrower to pay a portion of the costs of constructing, equipping, and furnishing a new three story, 175,000 square foot general acute care hospital to be located in the County of Warren, Virginia. The Series 2018 Bonds will be limited obligations of the Authority and will be payable solely from and secured by a pledge of certain payment to be made by the Borrower pursuant to the Loan Agreement and Obligation issues by the Borrower under the Master Trust Indenture Dated as of September 1986, as amended and supplemented. Payments of principal and interest are made directly to the Bond trustees for the account of the Authority. Interest rates are fixed, and the bonds mature January 2046 and January 2050. At December 31, 2019, the rates for the 2018 bonds were 3.75%-4.00%.

2015 Series Bonds, Hospital Revenue Refunding Bonds

In July 2015, the West Virginia Hospital Finance Authority (the Authority) issued \$5.24 million Hospital Revenue Refunding Bonds, Series 2015. The bonds were issued for the purpose of refinancing a portion of the Series 2009 bonds. In accordance with the trust indenture, the Authority assigned the promissory notes and the payment thereon to the Bond Trustee. Payments of principal and interest are made directly to the Bond trustees for the account of the Authority. The bonds are secured by a pledge of payment pursuant to the Loan Agreement under the Master Trust Indenture dated as of September 1, 1986.

In July 2015, The Economic Development Authority of The City of Winchester (the Winchester Authority) issued \$114.9 million Hospital Revenue Refunding Bonds, Series 2015. The bonds were issued for the purpose of refinancing a portion of the Series 2007 bonds related to Winchester Medical Center, Shenandoah Memorial Hospital and Warren Memorial Hospital as well as refinancing the remaining balance of the 2009E bonds. In accordance with the trust indenture, the Winchester Authority assigned the promissory notes and the payment thereon to the Bond Trustee. Payments of principal and interest are made directly to the Bond trustees for the account of the Authority. The bonds are secured by a pledge of payment pursuant to the Loan Agreement under the Master Trust Indenture dated as of September 1, 1986. Interest rates are fixed, and the bonds mature January 2019 through January 2044. At December 31, 2019, the rates for the 2015 bonds were 4.00% to 5.00%.

2014 Series Bonds, Hospital Revenue Refunding Bonds

In October 2014, the West Virginia Hospital Finance Authority (the West Virginia Authority) issued \$19.1 million Hospital Revenue Refunding Bonds, Series 2014. The bonds were issued for the purpose of refinancing a portion of the Series 2009 bonds. In accordance with the trust indenture, the West Virginia Authority assigned the promissory notes and the payment thereon to the Bond Trustee. Payments of principal and interest are made directly to the Bond trustees for the account of the Authority. The bonds are secured by a pledge of payment pursuant to the Loan Agreement under the Master Trust Indenture dated as of September 1, 1986. Interest rates are fixed, and the bonds mature January 2019 through January 2044. At December 31, 2019, the rates for the 2014 bonds were 4.00% to 5.00%.

VALLEY HEALTH SYSTEM AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

2014A Series Bonds, Hospital Revenue Refunding Bonds

In October 2014, the Economic Development Authority of the City of Winchester (the Winchester Authority) issued \$43.1 million Economic Development Authority of the City of Winchester Hospital Revenue Refunding Bonds, Series 2014A. The bonds were issued for the purpose of refinancing a portion of the Series 2009E bonds. In accordance with the trust indenture, the Winchester Authority assigned the promissory notes and the payment thereon to the Bond Trustee. Payments of principal and interest are made directly to the Bond trustees for the account of the Authority. The bonds are secured by a pledge of payment pursuant to the Loan Agreement under the Master Trust Indenture dated as of September 1, 1986. Interest rates are fixed, and the bonds mature January 2019 through January 2044. At December 31, 2019, the rates for the 2014A bonds were 4.00% to 5.00%.

2014B Series Bonds, Hospital Revenue Bonds

In October 2014, the Economic Development Authority of the City of Winchester (the Winchester Authority) issued \$12.1 million Economic Development Authority of the City of Winchester Hospital Revenue Bonds, Series 2014B. The bonds were issued for the purpose of building a medical office building at Shenandoah Memorial Hospital, Woodstock, VA. Total proceeds were not issued at the time of closing. Distribution is based on receipt of bond requisition for the funds. In accordance with the trust indenture, the Winchester Authority assigned the promissory notes and the payment thereon to the Bond Trustee. Payments of principal and interest are made directly to the Bond trustees for the account of the Authority. The bonds are secured by a pledge of payment pursuant to the Loan Agreement under the Master Trust Indenture dated as of September 1, 1986. The 2014B bonds bear interest at a variable rate, which resets to market weekly, and have a maturity date of January 2047. At December 31, 2019, the rate on the 2014B bonds was 1.97%.

In November 2017, a first supplemental tax certificate and agreement between the Economic Development Authority of the city of Winchester (Issuer) and Shenandoah Memorial Hospital (Borrower) reissued Series 2014B (\$12 million). This reissuance changed bank investors, reduced interest rates and extended the mandatory purchase date of the bonds (5 year or longer).

2013A Series Bonds, Hospital Revenue Bonds

In December 2013, the Economic Development Authority of the City of Winchester (the Winchester Authority) issued \$35.1 million Economic Development Authority of the City of Winchester Hospital Revenue Bonds, Series 2013A. The Series 2013A bonds were issued for the construction of a new hospital in Page County. Total proceeds were not issued at the time of closing. Distribution is based on receipt of bond requisition for the funds. In accordance with the trust indenture, the Winchester Authority assigned the promissory notes and the payment thereon to the Bond Trustee. Payments of principal and interest are made directly to the Bond holder for the account of the Authority. The bonds are secured by a pledge of payment pursuant to the Loan Agreement under the Master Trust Indenture dated as of September 1, 1986. Page is now part of the Obligated Group. The 2013A bonds bear interest at a variable rate, which resets to market weekly, and have a maturity date of January 2045. The rate for the Series 2013A bonds was 2% at December 31, 2019.

In December 2017, a first supplemental tax certificate and agreement between the Economic Development Authority of the City of Winchester (Issuer) and the Winchester Medical Center (Borrower) and Page Memorial Hospital (Borrower) reissued Series 2013A (\$35.135 million). This reissuance changed bank investors, reduced interest rates, and extended the mandatory purchase date of the bonds (5 year or longer).

VALLEY HEALTH SYSTEM AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

2013B Series Bonds, Hospital Revenue Bonds

In December 2013, the Economic Development Authority of the City of Winchester (the Winchester Authority) issued \$70.1 million Economic Development Authority of the City of Winchester Hospital Revenue Bonds, Series 2013B. The bonds were issued for the purpose of refinancing the Series 2000 bonds. In accordance with the trust indenture, the Winchester Authority assigned the promissory notes and the payment thereon to the Bond Trustee. Payments of principal and interest are made directly to the Bond trustees for the account of the Authority. The bonds are secured by a pledge of payment pursuant to the Loan Agreement under the Master Trust Indenture dated as of September 1, 1986. The 2013B bonds bear interest at a variable rate, which resets to market weekly, and have a maturity date of January 2030. The rate for the Series 2013B bonds was 2% at December 31, 2019.

In December 2017, a first supplemental tax certificate and agreement between the Economic Development Authority of the City of Winchester (Issuer) and the Winchester Medical Center (Borrower) and Page Memorial Hospital (Borrower) reissued Series 2013A Series 2013B (\$70.53 million). This reissuance changed bank investors, reduced interest rates and extended the mandatory purchase date of the bonds (5 year or longer).

2009 Series Bonds, Hospital Revenue Bonds

In November and December 2009, the Industrial Development Authority of the City of Winchester (the Winchester Authority) issued \$175 million Industrial Development Authority of the City of Winchester Hospital Revenue Bonds, Series 2009. In December 2009, the West Virginia Hospital Finance Authority (the West Virginia Authority) issued \$25 million Hospital Revenue Bonds, Series 2009. The Series 2009 Bonds were used for the purposes of financing certain capital needs of the Winchester Medical Center, Shenandoah Memorial Hospital, Warren Memorial Hospital, and for construction of a new facility at Hampshire Memorial Hospital, (collectively the Obligated Group), and to reimburse the Obligated Group for certain past capital expenditures. The bonds are secured by a pledge of payment pursuant to the Loan Agreement under the Master Trust Indenture dated as of September 1, 1986. Each member of the Obligated Group has recorded their respective portion of the obligation. The bonds are secured by a pledge of payment pursuant to Loan Agreements between the Obligated Group, the Winchester Authority and the West Virginia Authority, respectively. In accordance with the respective trust indentures, the Winchester Authority and the West Virginia Authority assigned the promissory notes and the payment thereon to the Bond Trustees. Payments of principal and interest are made directly to the Bond trustees for the account of the Authorities. The 2009 bonds bear interest at a variable rate, which resets to market weekly, and have a maturity date of January 2043. The 2009 bonds bear interest at rates of 1.94% to 2.03%.

In December 2017, a fourth supplemental tax certificate and agreement between the Economic Development Authority of The City of Winchester (Issuer) and the Winchester Medical Center (Borrower) reissued Series 2009A (\$25 million), Series 2009B (\$25 million), Series 2009C (\$25 million), and Series 2009D (\$25 million). These reissuances changed bank investors, reduced interest rates, and extended the mandatory purchase date of the bonds (5 year or longer).

Debt Covenants

The trust indentures include various restrictive covenants, one of which requires the Medical Center to maintain a debt service coverage ratio of 1.1 to 1.0 (defined in the indentures as the ratio of income available for debt service to annual debt service commitments). The Series 2009 Bonds include additional covenants, including a debt services coverage ratio of 1.25 to 1, a debt to capitalization ratio of not greater than .65, and requires the day's cash on hand to be not less than 100 days. Upon the occurrence of events of noncompliance with such covenants, the principal of the bonds could be declared due and payable immediately by the Bond Trustees. As of and for the year ended, December 31, 2019 and 2018, Valley Health System was in compliance with such covenants.

VALLEY HEALTH SYSTEM AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 9. Other Current Assets

Other current assets consist of the following at December 31, 2019 and 2018 (in thousands):

	2019	2018
Prepaid service contracts	\$ 8,238	\$ 7,827
Security deposits	545	545
Prepaid insurance	471	828
Rent receivable	27	27
Other non-patient receivables	6,699	8,887
Deferred tax asset	207	403
Malpractice receivable – Note 17	9,793	-
Other	2,227	3,255
Total other current assets	\$ 28,207	\$ 21,772

Note 10. Other Noncurrent Liabilities

Other noncurrent liabilities consist of the following at December 31, 2019 and 2018 (in thousands):

	2019	2018
Interest rate swap agreements	\$ 32,695	\$ 24,853
Deferred compensation – attending faculty plan	12,134	10,264
Deferred tax liability	141	608
Finance leases, net current portion – Note 15	3,073	-
Other	972	943
Total other noncurrent liabilities	\$ 49,015	\$ 36,668

Note 11. Interest Rate Risk Management and Contingency

Medical Center, Shenandoah, Warren, Page and Hampshire (the Hospitals)

The Hospitals have interest rate related derivative instruments to manage interest rate exposure on their debt instruments. The Hospitals do not enter into derivative instruments for any purpose other than interest rate management purposes. That is, the Hospitals do not speculate using derivative instruments.

By using derivative financial instruments to hedge exposures to changes in interest rates, the Hospitals expose themselves to credit risk and market risk. Credit risk is the failure of the counter-party to perform under the terms of the derivative contract. When the fair value of a derivative contract is positive, the counter-party owes the Hospitals, which creates credit risk for the Hospitals. When the fair value of a derivative contract is negative, the Hospitals owe the counter-party and, therefore, it does not possess credit risk. The Hospitals minimize the credit risk in derivative instruments by entering into transactions with high-quality counter-parties.

Market risk is the adverse effect on the value of a financial instrument that results from a change in interest rates. The market risk associated with interest rates is managed by establishing and monitoring parameters that limit the types and degree of market risk that may be undertaken.

The Hospitals use variable-rate debt to finance their operational and capital needs. The debt obligations expose the Hospitals to variability in interest payments due to changes in interest rates. Conversely, fixed-rate debt obligations can be more expensive to the Hospitals in times of declining interest rates. Management believes it is prudent to monitor and manage its cost of capital on a regular basis. To meet this objective, management from time to time may enter into interest rate swap agreements to manage fluctuations in cash flows resulting from interest rate risk.

VALLEY HEALTH SYSTEM AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The Hospitals have entered into interest rate swap agreements in the notional amount of approximately \$191.8 million related to the Series 2009, 2014 and 2015 bonds. The purpose of the swaps were to convert the variable-rate cash flow exposure on the debt obligations to fixed rate cash flows. Under the terms of the interest rate swaps, the Hospitals receive a variable interest rate payment based on the Bond Rate, or if certain triggering events occur, an alternative floating rate in exchange for making fixed interest rate payments to the swap counter-party, thereby creating the equivalent of fixed-rate debt.

In November 2006, the Medical Center entered into an interest rate swap agreement in the notional amount of \$91.8 million related to the Series 2014 and 2015 bonds. Current notional amounts as of December 31, 2019 and 2018 were \$75.5 million and \$77.7 million, respectively. Under the terms of the interest rate swap, the Medical Center receives a floating interest rate payment monthly based on the BMA Municipal Bond Index, or if this index is no longer published, Merrill Lynch will set the rate based on prevailing rates, or if certain triggering events occur, an alternative floating rate of 67% of 3 month LIBOR plus .33%. As of December 31, 2019 and 2018, a \$8.7 million unrealized loss and \$4.95 million unrealized gain was recorded, respectively. In 2019 and 2018, the Medical Center received \$320 thousand and \$330 thousand, respectively, for this swap.

On February 7, 2008, the Medical Center entered into an interest rate swap agreement in the notional amount of \$100 million related to the financing arrangements incurred in 2009. Current notional amounts as of December 31, 2019 and 2018 were \$97.2 million and \$97.9 million, respectively. Under the terms of the interest rate swap, the Medical Center will receive a floating interest rate payment based on 67% of 1 month LIBOR. The purpose of this swap was to lock into current bond rates for the 2009 Bonds (Note 8). As of December 31, 2019 and 2018, unrealized gains of \$860 thousand and \$84 thousand, respectively, were recorded. For 2019 and 2018, the Medical Center paid \$1.9 million and \$2.1 million, respectively, for this swap.

Fair Value of Derivative Instruments designated as hedging instruments are as follows (in thousands):

Balance Sheet Location	Fair Value	
	2019	2018
<u>Cash Flow Hedges:</u>		
Interest rate contracts - other long-term liabilities	\$ (32,695)	\$ (24,853)
Total derivative designated as hedging instruments	\$ (32,695)	\$ (24,853)

The following table summarizes the effect of Derivative Instruments on the Statement of Changes in Net Assets for the years ended December 31, 2019 and 2018 (in thousands).

Derivatives designated as Hedging Instruments for the Year Ending December 31	Location of Gain Recognized in Income	Amount of Gain Recognized in Other Changes in Net Assets (Effective Portion)	
		2019	2018
<u>Cash Flow Hedges:</u>			
Interest rate contracts	Change in value of derivatives	\$ (7,842)	\$ 5,034

For the years ended December 31, 2019 and 2018, no amounts related to derivative financial instruments were recorded in excess of revenues over expenses, and no amounts were moved out of other changes in nets assets and reclassified into excess of revenues over expenses.

VALLEY HEALTH SYSTEM AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 12. Liquidity and Availability

As of December 31, 2019, VHS has working capital of approximately \$678.8 million, and approximately 271.7 days cash on hand. As of December 31, 2018, VHS has working capital of approximately \$460.7 million, and approximately 253.3 days cash on hand.

Financial assets available for general expenditure within one year of the balance sheet date, consist of the following at December 31:

	2019	2018
Cash and cash equivalents	\$ 73,206	\$ 53,142
Patient accounts receivable, net	98,891	95,455
Assets limited as to use:		
Board Designated Funds	-	65,127
Investments	580,583	319,063
Other receivable	6,842	8,914
	<u>\$ 759,522</u>	<u>\$ 541,701</u>

VHS estimates that approximately 71% and 73% as of December 31, 2019 and 2018, respectively, of the board designated funds and investments are available for general expenditure within one year in the normal course of operations. VHS has other assets whose use is limited for debt service, for donor-restricted purposes, and deferred compensation plans. These assets whose use is limited are not available for general expenditure within the next year and are not reflected in the amounts above.

As part of VHS's liquidity management plan, VHS maintains a policy to structure financial assets to be available as general expenditures, liabilities, and other obligations come due.

Note 13. Pension Plans

Defined Benefit Pension Plans:

Valley Health System Plan

VHS has a defined benefit pension plan covering substantially all of its employees and the employees of its subsidiaries. Benefits under the pension equity formula are expressed in terms of a lump sum based on final average earnings and pension credits earned for years of service. Some employees' benefits are grandfathered using a prior formula that based annuity amounts on final average earnings and service. The pension plan has been amended to allow for supplemental pension benefits under a one-time early retirement program (the Program) for employees meeting certain age and length of service requirements. VHS makes annual contributions to the Valley Health System Employees Retirement Plan (the Plan) in accordance with funding requirements determined by an actuary. 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. Contributions of \$11.2 million and \$9.1 million were made in 2019 and 2018, respectively.

Effective January 1, 2011, Valley Health System elected to soft-freeze the Valley Health System Employees Retirement Plan. Participation is frozen such that there shall be no new participants in the Plan after January 2, 2011. Participants as of January 1, 2011 will continue to participate with no change to the years of services rules or the benefits calculation. The System elected to hard-freeze the Valley Health System Employees Retirement Plan effective January 1, 2014. The Valley Health System contributory 403(b) plan will remain in place.

VALLEY HEALTH SYSTEM AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The reconciliation of the Plan's funded status to amounts recognized in VHS's consolidated financial statements at December 31 is as follows (in thousands):

Obligations and funded status:

	2019	2018
Change in benefit obligation:		
Benefit obligation at beginning of year	\$ 304,440	\$ 325,277
Interest cost	12,725	12,031
Actuarial (gain) loss	50,728	(24,369)
Benefits paid	(13,423)	(8,499)
Benefit obligation at end of year	354,470	304,440
Change in plan assets:		
Fair value of plan assets at beginning of year	238,182	246,471
Actual return on plan assets	49,317	(8,890)
Employer contributions	11,184	9,100
Benefits paid	(13,423)	(8,499)
Fair value of plan assets at end of year	285,260	238,182
Funded status at end of year	\$ (69,210)	\$ (66,258)

Amounts recognized on balance sheet consist of:

	2019	2018
Noncurrent liabilities	\$ (69,210)	\$ (66,258)
	\$ (69,210)	\$ (66,258)

Amounts recognized in other changes in net assets:

	2019	2018
Net actuarial loss	\$ 128,835	\$ 114,376
	\$ 128,835	\$ 114,376

The accumulated benefit obligation was \$354.5 million and \$304.4 million at December 31, 2019 and 2018, respectively. The balance sheet amount also includes the noncurrent liability for Shenandoah Memorial Hospital.

Net periodic benefit cost and other amounts recognized in other changes in net assets (in thousands):

	2019	2018
Components of net periodic pension cost:		
Interest cost	\$ 12,725	\$ 12,031
Expected return on plan assets	(15,002)	(19,145)
Amortization of actuarial loss	1,954	2,359
Net periodic benefit cost	\$ (323)	\$ (4,755)

VALLEY HEALTH SYSTEM AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Other changes in amounts recognized in other changes in net assets:

Net loss (gain) added during year	\$ 16,413	\$ 3,666
Amortization of (gain) loss	(1,954)	(2,359)
Total change in net assets without donor restrictions at end of current year	\$ 14,459	\$ 1,307
Total recognized in net periodic benefit cost and other changes in net assets	\$ 14,136	\$ (3,448)

Estimated net loss of \$3.65 million and prior service cost of \$0 for the defined benefit pension plan will be amortized from net assets without donor restrictions into periodic benefit cost in the next fiscal year.

Additional Information - Assumptions

The assumptions used to determine benefit obligations in the actuarial valuations were as follows:

	2019	2018
Discount rate	3.25%	4.25%
Rate of increase in compensation levels	N/A	N/A

The assumptions used to determine net periodic pension cost were as follows:

	2019	2018
Discount rate	4.25%	3.75%
Expected long-term rate of return on assets	5.75%	7.75%
Rate of increase in compensation levels	N/A	N/A

The SOA RP-2014 Mortality Tables with mortality probability increased by 40% using Scale MP-2019 were utilized to determine the financial disclosure information for the year ended December 31, 2019.

The long-term rate of return on plan assets of 5.75% is based upon management's estimate of future long-term rates of return on similar assets and is consistent with historical returns on such assets.

Plan Assets

Valley Health System's overall investment strategy is to generate a return, which is sufficient to meet its current and expected future financial requirements. The Plan Assets will be structured in a manner that most efficiently matches Valley's investment risk and return characteristics with the long-term objectives. Short-term uncertainties of investment results are recognizable risks, and will be managed appropriately through specific asset allocation strategies and diversification based upon the Plan's investment time horizon. The Plan Asset's target return will be based upon the fund's actuarial review which calculates the "minimum required return" for Valley Health System's and Shenandoah's pension portfolio as well as its investment time horizon.

Cash flows - Contributions

VHS expects to contribute \$10.2 million to its pension plan in 2020.

VALLEY HEALTH SYSTEM AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Estimated Future Benefit Payments

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid (in thousands):

	Pension Benefits
2020	\$ 10,788
2021	\$ 11,507
2022	\$ 12,148
2023	\$ 12,885
2024	\$ 13,586
Years 2025 - 2029	\$ 75,548

Tax Sheltered Annuity Plan

In addition, VHS also offers an option allowing employees to contribute to a tax sheltered annuity plan (the Annuity Plan) under Internal Revenue Code section 403(b). Under the Annuity Plan, VHS match is based on years of service as follows:

- 1 – 7 years of service 25% salary deferral of up to 4% of base compensation.
- 8 – 14 years of service 50% salary deferral of up to 4% of base compensation.
- 15+ years of service 75% salary deferral of up to 4% of base compensation.

In addition, all employees who have satisfied the initial eligibility requirements receive a flat 3% employer contribution regardless of whether they are participants in either of the frozen defined benefit plans. VHS's contributions to the Annuity Plan totaled \$12.6 million and \$12.1 million for the years ended 2019 and 2018, respectively.

Shenandoah Memorial Hospital Plan

Defined Benefit Retirement Plan

Shenandoah has a noncontributory defined benefit retirement plan. Effective January 1, 2003, the Plan was frozen. Participation in the Plan was frozen such that there shall be no new participants in the Plan after December 31, 2002. Shenandoah elected to hard-freeze the Plan effective January 1, 2014. New employees were eligible to participate in the Valley Health System plans. The Plan was amended effective January 1, 1991 to pay benefits based upon the five highest years' salaries out of the last ten years of service. Prior to this change, benefits were based upon employees' years of service and compensation. Shenandoah makes annual contributions to the Plan in accordance with funding requirements determined by an actuary.

VALLEY HEALTH SYSTEM AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The reconciliation of the Plan's funded status to amounts recognized in Shenandoah's financial statements as of December 31 is as follows (in thousands):

Obligations and funded status:

	<u>2019</u>	<u>2018</u>
Fair value of plan assets	\$ 21,283	\$ 17,701
Benefit obligations	<u>24,539</u>	<u>21,243</u>
Funded status	<u>(3,256)</u>	<u>(3,542)</u>
Funded status at end of year	\$ (3,256)	\$ (3,542)

Amounts recognized on balance sheet consist of:

	<u>2019</u>	<u>2018</u>
Noncurrent liabilities	<u>\$ (3,256)</u>	<u>\$ (3,542)</u>
	<u>\$ (3,256)</u>	<u>\$ (3,542)</u>

Amounts recognized in other changes in net assets:

	<u>2019</u>	<u>2018</u>
Net actuarial loss	<u>\$ 6,390</u>	<u>\$ 5,464</u>
	<u>\$ 6,390</u>	<u>\$ 5,464</u>

The accumulated benefit obligation was \$24.5 million and \$21.2 million at December 31, 2019 and 2018, respectively.

Net periodic benefit cost and other amounts recognized in other changes in net assets in thousands:

	<u>2019</u>	<u>2018</u>
Net periodic benefit cost	<u>\$ (152)</u>	<u>\$ (472)</u>
Other changes in amounts recognized in other changes in net assets:		
Net loss (gain) during the year	1,006	(20)
Settlement recognition		-
Amortization of (gain) loss	<u>(80)</u>	<u>(135)</u>
Total change in net assets without donor restrictions at the end of the current year	<u>926</u>	<u>(155)</u>
Total recognized in net periodic benefit cost and other changes in net assets	<u>\$ 774</u>	<u>\$ (627)</u>

VALLEY HEALTH SYSTEM AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The estimated net loss and prior service cost for the defined benefit pension plan that will be amortized from net assets without donor restrictions into periodic benefit cost over the next fiscal year are \$245 thousand and \$80 thousand, respectively.

Additional Information - Assumptions

The assumptions used to determine benefit obligations in the actuarial valuations were as follows:

	2019	2018
Discount rate	3.00%	4.25%
Rate of increase in compensation levels	N/A	N/A

The assumptions used to determine net periodic pension cost were as follows:

	2019	2018
Discount rate	4.25%	3.50%
Expected long-term rate of return on plan assets	5.75%	7.75%
Rate of increase in compensation levels	N/A	N/A

The SOA RP-2014 Mortality Tables with mortality probability increased by 40% using Scale MP-2019 were utilized to determine the financial disclosure information for the year ended December 31, 2019.

The long-term rate of return on plan assets of 5.75% is based upon management's estimate of future long-term rates of return on similar assets and is consistent with historical returns on such assets.

Contributions of \$1.1 million and \$960 million were made in 2019 and 2018, respectively. SMH plans to contribute \$1.1 million to the Plan in 2019.

Estimated Future Benefit Payments

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid (in thousands):

	Pension Benefits
2020	\$ 1,117
2021	\$ 1,151
2022	\$ 1,199
2023	\$ 1,244
2024	\$ 1,326
Years 2025 - 2029	\$ 6,709

VALLEY HEALTH SYSTEM AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The following table sets forth by level with the fair value hierarchy, pension plan assets of VHS and SMH at their fair value as of December 31, 2019 and 2018 (in thousands):

Plan Asset	Total at December 31, 2019	Fair Value Measurements Using:		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Cash and cash equivalents	\$ 6,332	\$ 6,332	\$ -	\$ -
Total assets in the fair value Hierarchy	6,332	6,332	-	-
Investments measured at NAV	300,157	-	-	-
Total investments at fair value	\$ 306,489	\$ 6,332	\$ -	\$ -

Plan Asset	Total at December 31, 2018	Fair Value Measurements Using:		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Cash and cash equivalents	\$ 4,340	\$ 4,340	\$ -	\$ -
Mutual and other funds: Balanced funds	19,053	19,053	-	-
Total assets in the fair value Hierarchy	23,393	23,393	-	-
Investments measured at NAV	232,490	-	-	-
Total investments at fair value	\$ 255,883	\$ 23,393	\$ -	\$ -

Fair Value of Investments that Calculate Net Asset Value

The following table summarizes investments measured at fair value based on net asset value (NAVs) per share as of December 31, 2019 and 2018, respectively.

December 31, 2019	Fair Value	Unfunded Commitments	Redemption Frequency (if currently eligible)	Redemption Notice Period
Equity funds (a)	\$ 18,844	\$ -	Daily	0 - 2 days
Fixed income funds (b)	\$ 271,734	\$ -	Daily	0 - 1 days
Other funds (c)	\$ 9,579	\$ 6,891	N/A	N/A
Total	\$ 300,157	\$ 6,891		

VALLEY HEALTH SYSTEM AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2018	Fair Value	Unfunded Commitments	Redemption Frequency (if currently eligible)	Redemption Notice Period
Equity funds (d)	\$ 91,599	\$ -	Daily	0 - 2 days
Fixed income funds (b)	\$ 109,868	\$ -	Daily	0 - 1 days
Real estate fund (e)	\$ 6,051	\$ -	Quarterly	45 days
Managed hedge fund (f)	\$ 13,893	\$ -	Semiannual	90 days
Other funds (c)	\$ 11,079	\$ 6,381	N/A	N/A
Total	\$ 232,490	\$ 6,381		

- (a) Equity funds are a commingled funds with exposure to global high quality, low volatility equities. The funds have daily liquidity.
- (b) Fixed income funds are 4 commingled funds with exposure to U.S. long-term corporate credit, high yield, and long-term STRIPS. The funds have daily liquidity.
- (c) The other funds are funds that invest in a variety of strategies including timber, distressed debt, distressed control situations, commercial real estate debt and equity, residential real estate debt and equity, bank capital, and energy related companies. The funds have a term of 8-20 years.
- (d) Equity funds are 3 commingled funds with exposure to U.S., developed non-U.S., and emerging markets equities. The funds have daily liquidity.
- (e) Real estate fund invests indirectly in commercial real estate investments (commingled real estate funds, equity and debt securities, and other real estate related investments, including index derivatives, cash, and cash equivalents). The fund has quarterly liquidity with a 90 day notice period.
- (f) Managed hedge fund is a hedge fund of funds with a concentrated bias to long/ short hedge funds, but will also make opportunistic investments when opportunities arise. The fund has semiannual liquidity with 90 days' notice.

Note 14. Functional Expenses

VHS provides general health care services to residents within its geographic location. Expenses related to providing these services by functional category are as follows (in thousands):

2019	Healthcare Services	Fund Raising	Administrative and General Services	Total
Salaries	\$ 282,348	\$ 507	\$ 97,004	\$ 379,859
Payroll Taxes and Benefits	54,075	123	24,047	78,245
Supplies & Other	252,458	319	155,673	408,450
Depreciation	55,005	-	18,335	73,340
Interest Expense	10,810	-	3,664	14,474
Total	\$ 640,718	\$ 949	\$ 312,701	\$ 954,368

VALLEY HEALTH SYSTEM AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

2018	Healthcare Services	Fund Raising	Administrative and General Services	Total
Salaries	\$ 269,985	\$ 673	\$ 98,530	\$ 369,188
Fringe Benefits	61,422	162	23,748	85,332
Supplies & Other	244,824	415	122,751	367,990
Depreciation	50,878	-	16,959	67,837
Interest Expense	10,777	-	3,588	14,365
Total	\$ 637,886	\$ 1,250	\$ 265,576	\$ 904,712

Expenses in the consolidated financial statements that are associated with more than one function require an allocation on a reasonable basis. Costs not directly associated to a specific function, including interest and depreciation and amortization, are allocated to a function based on a square footage basis.

Note 15. Leases

VHS adopted ASU 2016-02, Leases (Topic 842) (“ASC 842”) on January 1, 2019 on a modified retrospective basis. As a result, VHS’s lease disclosures as of and for the year ended December 31, 2019 are reported under ASC 842. Comparative financial information for prior periods has not been restated and continues to be reported under ASC 840, the lease accounting standard in effect for those periods. Total rental expense for all operating leases was \$5.0 million for 2018.

VHS leases office and medical space and equipment. Leases with an initial term of 12 months or less are not recorded on the balance sheet; VHS recognizes lease expense for these leases on a straight-line basis over the lease term. For lease agreements entered into or reassessed after the adoption of Topic 842, VHS combine lease and nonlease components.

Most leases include one or more options to renew, with renewal terms that can extend the lease term from one to 26 years or more. The exercise of lease renewal options is at management’s sole discretion. Certain leases also include options to purchase the leased property. The depreciable life of assets and leasehold improvements are limited by the expected lease term, unless there is a transfer of title or purchase option reasonably certain of exercise. VHS’s lease agreements do not contain any material residual value guarantees or material restrictive covenants.

Maturities of lease liabilities were as follows:

	Finance Leases	Operating Lease	Total
2020	\$ 3,022	\$ 4,323	\$ 7,345
2021	1,785	2,776	4,561
2022	841	2,260	3,101
2023	453	1,937	2,390
2024	113	1,731	1,844
Thereafter	-	10,813	10,813
Total lease payments	\$ 6,214	\$ 23,840	\$ 30,054
Less: Interest	\$ (190)	\$ (5,658)	
Present value of lease liabilities	<u>\$ 6,024</u>	<u>\$ 18,182</u>	

VALLEY HEALTH SYSTEM AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The components of lease expense were as follows:

	2019
Lease cost	
Operating lease cost	\$ 4,401
Finance lease cost:	
Amortization of leased assets	2,865
Interest on lease liabilities	125
Variable lease cost	1,176
Total lease cost	\$ 8,567

Supplemental balance sheet information related to leases were as follows:

Leases (thousands)	Classification	2019
Asset		
Operating	Operating lease right-to-use assets	\$ 17,174
Finance	Property and equipment, gross	8,804
Finance	Accumulated depreciation	<u>(2,828)</u>
Total lease assets		\$ 23,150
Liabilities		
Current		
Operating	Other current liabilities	\$ 3,359
Finance	Other current liabilities	2,952
Noncurrent		
Operating	Operating leases payable	14,823
Finance	Other liabilities	<u>3,072</u>
Total lease liabilities		\$ 24,206

Lease Term and Discount Rate

Weighted average remaining lease term (years)		
Operating leases		13.3
Finance leases		2.7
Weighted average discount rate		
Operating leases		3.95%
Finance leases		1.92%

Supplemental cash flow information related to leases was as follows:

	2019
Other Information	
Cash paid for amounts included in the measurement of lease liabilities	
Operating cash flows for operating leases	\$ 3,823
Operating cash flows for finance leases	125
Financing cash flows for finance leases	2,931
Right-of-use assets obtained in exchanged for lease obligations:	
Operating leases	21,354
Finance leases	8,956

VALLEY HEALTH SYSTEM AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 16. Related Party Transactions

Medical Circle, LLC

VHS is a 51% member of Medical Circle, LLC t/a Valley Open MRI, a company formed to provide imaging services. Valley Health System is accounting for its investment under the equity method of accounting. Valley Health System's interest in the Company was \$279 thousand and \$461 thousand, at December 31, 2019 and 2018, respectively. Included in other operating revenue in the Consolidated Statement of Operations are equity earnings on the investment of approximately \$1 million and \$426 thousand for the years ended December 31, 2019 and 2018, respectively. Total cash distributions received from the investment by VHS in 2019 and 2018 were approximately \$1.2 million and \$569 thousand, respectively. Medical Circle's financial statements were not consolidated in the financial statements of VHS due to immateriality.

Winchester Open MRI, LLC

VHS is a member, owning a 50% interest, in Winchester Open MRI, LLC (Open MRI), a company formed to benefit the community by providing more accessible imaging services. Valley Health System is accounting for its investment under the equity method of accounting. Valley Health System's interest in Open MRI was \$795 thousand and \$425 thousand at December 31, 2019 and 2018, respectively. Included in other operating revenue in the Consolidated Statement of Operations are equity earnings on the investment of approximately \$4.3 million and \$4.5 million for the years ended December 31, 2019 and 2018, respectively. Total cash distributions received from the investment by VHS in 2019 and 2018 were approximately \$3.7 million and \$4.4 million, respectively. Open MRI's financial statements were not consolidated in the financial statements of VHS since it does not have a controlling ownership.

Winchester Endoscopy Services, LLC

VHS is a member, owning a 51% interest, in Winchester Endoscopy, LLC, a company formed to provide outpatient endoscopy services. Valley Health System is accounting for its investment under the equity method of accounting. Valley Health System's interest in Winchester Endoscopy was \$253 thousand and \$265 thousand, at December 31, 2019 and 2018, respectively. Included in other operating revenue in the Consolidated Statement of Operations are equity earnings on the investment of approximately \$2.2 million for the years ended December 31, 2019 and 2018, respectively. Total cash distributions received from the investment by VHS in 2019 and 2018 were approximately \$2 million and \$2.2 million, respectively. Winchester Endoscopy's financial statements were not consolidated in the financial statements of VHS due to immateriality.

Tri-State Surgical Center, LLC

Valley Regional is a member in Tri-State Surgical Center, LLC (Tri-State). A 34% interest was purchased for \$2.9 million. Tri-State is an ambulatory surgical facility in Martinsburg, West Virginia. Valley Health System is accounting for its investment under the equity method of accounting. Valley Health System's interest in Tri State was \$3.5 million and \$3.4 million for the years ended December 31, 2019 and 2018. Included in other operating revenue in the Consolidated Statement of Operations are equity earnings on the investment of approximately \$301 thousand and \$239 thousand for the years ended December 31, 2019 and 2018, respectively. Total cash distributions received from the investment by VHS for the years ended 2019 and 2018 were approximately \$272 and \$136 thousand, respectively.

VALLEY HEALTH SYSTEM AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Advanced Home Care, Inc.

Valley Health has an investment under the cost method of accounting in Advanced Home Care, Inc. of approximately \$4.6 million and \$5 million at December 31, 2019 and 2018, respectively. Included in other operating revenue in the Consolidated Statement of Operations are membership distributions of \$171 thousand and \$54 thousand for the years ended December 31, 2019 and 2018, respectively. Advanced Home Care, Inc.'s fair market value is not readily ascertainable and VHS based the initial investment in Advanced Home Care, Inc. on independent valuation information. Management will review the investment on an annual basis for potential impairment. An impairment of \$433 thousand was recognized for the year ended December 31, 2019. No impairment was identified during the year ended December 31, 2018.

Valley Health Surgery Center, LLC

VHS is a member, owning a majority interest, in Valley Health Surgery Center, LLC, a company formed in 2017 to benefit the community by providing more access to ambulatory surgery services. Valley Health System is accounting for its investment under the equity method of accounting. Valley Health System's interest in Valley Health Surgery Center, LLC was \$2.3 million and \$1.1 million at December 31, 2019 and 2018, respectively. Included in other operating revenue in the Consolidated Statement of Operations is an equity gain on the investment of approximately \$1.2 million for the year ended December 31, 2019 and an equity loss of \$1.2 million for the year ended December 31, 2018. Due to the structure of the board and voting rights, VHS's majority interest in Valley Health Surgery Center, LLC's does not give it the ability to exercise control. Valley Health Surgery Center, LLC's financial statements were not consolidated in the financial statements of VHS.

Botanical ASC Real Estate, LLC

VHS is a minority member in Botanical ASC Real Estate, LLC. The company was formed in 2016 to construct and hold a facility to serve as the Valley Health Surgery Center. Valley Health System is accounting for its investment under the equity method of accounting. Valley Health System's interest in Botanical ASC Real Estate, LLC was \$302 thousand and \$208 thousand at December 31, 2019 and 2018, respectively. Included in other operating revenue in the Consolidated Statement of Operations are equity earnings in the investment of \$197 thousand and \$165 at December 31, 2019 and 2018.

Note 17. Commitments and Contingencies

Malpractice Insurance

VHS and other healthcare organizations participate in Virginia Solutions SPC LTD (the Captive), an insurance company located in the Cayman Islands. The Captive qualifies as a captive insurance company in the domicile where it operates and provides certain insurance coverage to its members. The Captive has established trusts for professional and general liability insurance. Under this program, the Captive provides \$2,350 thousand per individual claim and an annual aggregate limit of \$7,050 thousand. VHS professional liability policy is on a claims-made basis. The coverage under the existing policy extends to June 1, 2020. The Captive has purchased reinsurance contracts to provide for claims in excess of \$750 thousand, subject to a maximum amount of the lower of 500% of the maximum adjusted premiums and \$6.5 million. VHS is charged periodic premiums by the Captive. Premiums are determined based on actuarial calculations, and information provided by risk managers, legal counsel and past experience.

VALLEY HEALTH SYSTEM AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Management estimates malpractice losses from asserted claims and claims incurred but not reported based on actuarial estimates that incorporate historical data, including the nature of each claim or incident and relevant trend factors. The estimated malpractice liability at December 31, 2019 is \$10.2 million and is included in other current liabilities in the accompanying consolidated balance sheets. The discount rate utilized was 5.2% at December 31, 2019. The insurance recoverable receivable at December 31, 2019 is \$9.8 million and is reflected in the accompanying consolidated balance sheets within other current assets.

Litigation

VHS is involved in litigation arising in the ordinary course of business. Claims alleging malpractice have been asserted against VHS and are currently in various stages of litigation. It is the opinion of management, however, that estimated malpractice costs accrued at December 31, 2019 are adequate to provide for potential losses resulting from pending or threatened litigation as well as claims arising from unknown incidents from services provided to patients that may be asserted.

Medical Staff Deferred Compensation Plan

VHS has a nonqualified deferred compensation plan under Internal Revenue Service Code Section 457 and 409(a), to provide compensation for unassigned call services provided by participating physicians at the Medical Center. VHS, as the Plan sponsor, is responsible for funding the Plan based upon predetermined levels of payment which was \$1.5 million in 2019 and \$2.1 million in 2018. VHS is also responsible for maintaining a trust in which the contributions to the Plan will be maintained and from which qualifying disbursements will be made. Contributions to the Plan vest to the benefit of the participating physicians under various methods based upon years in the Plan and/or age. VHS recognizes, for financial reporting purposes, the related trust assets and a corresponding liability. The Plan allows VHS to modify future payments to the Plan based on a variety of operating factors at the discretion of the Board of VHS.

Asset Retirement Obligation

The *Asset Retirement and Environmental Obligations* Topic 410 of the FASB Accounting Standards Codification, clarifies when an entity is required to recognize a liability for a conditional asset retirement obligation. Management has considered this Topic, specifically as it relates to its legal obligations to perform asset retirement activities, such as asbestos removal, on its existing properties. Management of VHS believes that there is an indeterminate settlement date for the asset retirement obligations because the range of time over which VHS may settle the obligations is unknown and cannot be estimated. As a result, management cannot reasonably estimate a liability related to these potential asset retirement activities. However, management does not believe that remediation of such obligations will have a material effect on the consolidated financial statements.

Note 18. Alliance Agreement

Valley Health System and Inova Health System Foundation (Inova) entered into an Alliance Agreement (the Agreement) on May 31, 2013. VHS and Inova have entered into this collaborative alliance as preferred strategic partners whereby they will work together to advance their joint commitment to improving the continuity of care to the patients they serve, through closer operational, technological and clinical integration. As part of the Agreement, Inova is allowing VHS to access and implement Inova's EpicCare (electronic medical records) software.

VALLEY HEALTH SYSTEM AND SUBSIDIARIES

**CONSOLIDATED SCHEDULE – BALANCE SHEET INFORMATION (IN THOUSANDS)
December 31, 2019**

	Valley Health System	Winchester Medical Center and Subsidiary	Valley Regional Enterprises	Valley Partners	Warren Memorial Hospital and Subsidiary	Shenandoah Memorial Hospital and Subsidiary
ASSETS						
Current assets						
Cash and cash equivalents	\$ 25,454	\$ 19,800	\$ 1,333	\$ -	\$ 5,102	\$ 7,185
Investments	-	530,896	-	-	29,020	20,668
Assets limited as to use	-	10,327	-	-	1,390	-
Patient accounts receivable	-	68,369	5,534	-	8,584	5,201
Due from related entities	29,063	4,435	109	-	-	300
Inventory of supplies	1,833	13,420	722	-	1,577	1,105
Other current assets	12,594	9,712	1,051	-	1,529	1,085
Total current assets	68,944	656,959	8,749	-	47,202	35,544
Assets limited as to use, noncurrent	5,405	22,091	-	-	39,595	3,292
Property and equipment, net	-	452,067	7,730	-	69,560	47,002
Other assets						
Operating lease right-to-use assets	1,663	1,906	3,764	-	270	3,643
Goodwill	-	-	-	-	-	227
Other investments	17,834	869	3,472	-	-	-
Investments in wholly-owned subsidiaries	921,028	-	-	-	-	-
Total other assets	940,525	2,775	7,236	-	270	3,870
Total assets	\$ 1,014,874	\$ 1,133,892	\$ 23,715	\$ -	\$ 156,627	\$ 89,708

East Mountain Health Advantage and Subsidiaries	Hampshire Memorial Hospital	War Memorial Hospital	Page Memorial Hospital	Valley Physician Enterprise	Subtotal	Eliminations	Consolidated
\$ 27	\$ 3,233	\$ 5,800	\$ 3,845	\$ 1,427	\$ 73,206	\$ -	\$ 73,206
-	-	-	-	-	580,584	-	580,584
-	1,006	-	832	-	13,555	-	13,555
-	2,623	2,426	2,651	3,503	98,891	-	98,891
-	-	-	-	-	33,907	(33,907)	-
1	411	498	326	-	19,893	-	19,893
23	733	583	552	345	28,207	-	28,207
51	8,006	9,307	8,206	5,275	848,243	(33,907)	814,336
-	14	324	98	-	70,819	-	70,819
25,033	29,341	32,093	41,420	3,470	707,716	-	707,716
735	-	267	1,361	3,565	17,174	-	17,147
-	4,400	-	-	-	4,627	-	4,627
-	471	471	-	-	23,117	-	23,117
-	-	-	-	-	921,028	(921,028)	-
735	4,871	738	1,361	3,565	965,946	(921,028)	44,918
\$ 25,819	\$ 42,232	\$ 42,462	\$ 51,085	\$ 12,310	\$ 2,592,724	\$ (954,935)	\$ 1,637,789

VALLEY HEALTH SYSTEM AND SUBSIDIARIES

CONSOLIDATING SCHEDULE – BALANCE SHEET INFORMATION (IN THOUSANDS), Continued
December 31, 2019

LIABILITIES AND NET ASSETS	Valley Health System	Winchester Medical Center and Subsidiary	Valley Regional Enterprises	Valley Partners	Warren Memorial Hospital and Subsidiary	Shenandoah Memorial Hospital and Subsidiary
Current liabilities						
Current installments of long-term debt	\$ -	\$ 6,401	\$ 3,290	\$ -	\$ 317	\$ 127
Accounts payable and accrued expenses	36,610	17,692	1,233	22	3,593	1,255
Accrued salaries and wages	38,764	-	-	-	-	-
Third-party settlements	-	4,294	-	-	(1,088)	(968)
Due to related entities	-	12,882	155	4,878	9,168	1,083
Other current liabilities	718	9,720	712	-	1,711	1,564
Total current liabilities	76,092	50,989	5,390	4,900	13,701	3,061
Long-term debt, excluding current installments	-	275,017	-	-	77,718	21,652
Operating leases liabilities, net of current portion	1,173	1,178	3,332	-	105	4,199
Accrued pension and post retirement obligations	-	69,210	-	-	-	3,256
Other liabilities	217	47,333	246	-	(56)	66
Total liabilities	77,482	443,727	8,968	4,900	91,468	32,234
Net assets:						
Net assets without donor restrictions	906,315	667,072	14,747	(4,900)	61,646	53,905
Net assets with donor restrictions	31,077	23,093	-	-	3,513	3,569
Total net assets	937,392	690,165	14,747	(4,900)	65,159	57,474
Total liabilities and net assets	\$ 1,014,874	\$ 1,133,892	\$ 23,715	\$ -	\$ 156,627	\$ 89,708

East Mountain Health Advantage and Subsidiaries	Hampshire Memorial Hospital	War Memorial Hospital	Page Memorial Hospital	Valley Physician Enterprise	Subtotal	Eliminations	Consolidated
\$ -	\$ 470	\$ -	\$ 775	\$ -	\$ 11,380	\$ (3,290)	\$ 8,090
956	998	520	537	2,777	66,193	-	66,193
-	-	-	-	-	38,764	-	38,764
-	1,448	1,631	(1,026)	-	4,291	-	4,291
17	891	274	948	321	30,617	(30,617)	-
119	889	601	619	1,329	18,170	-	18,170
1,092	4,696	3,214	1,853	4,427	169,415	(33,907)	135,508
-	23,445	-	30,753	-	428,585	-	428,585
646	-	195	1,404	2,591	14,823	-	14,823
-	-	-	-	-	72,466	-	72,466
-	123	238	90	758	49,015	-	49,015
1,738	28,264	3,647	34,100	7,776	734,304	(33,907)	700,397
24,081	13,763	38,530	16,573	4,534	1,796,266	(889,951)	906,315
-	205	285	412	-	62,154	(31,077)	31,077
24,081	13,968	38,815	16,985	4,534	1,858,420	(921,028)	937,392
\$ 25,819	\$ 42,232	\$ 42,462	\$ 51,085	\$ 12,310	\$ 2,592,724	\$ (954,935)	\$ 1,637,789

VALLEY HEALTH SYSTEM AND SUBSIDIARIES

CONSOLIDATING SCHEDULE – OPERATING INFORMATION (IN THOUSANDS)

Year Ended December 31, 2019

	Valley Health System	Winchester Medical Center and Subsidiary	Valley Regional Enterprises	Valley Partners	Warren Memorial Hospital and Subsidiary	Shenandoah Memorial Hospital and Subsidiary
Revenue, gains and other support						
Net patient service revenue	\$ -	\$ 627,512	\$ 33,466	\$ 10	\$ 76,934	\$ 63,083
Other operating revenue	148,941	11,109	1,688	665	1,592	3,119
Investment income, net	818	65,287	1	-	3,498	2,637
Net assets released from restrictions	-	459	-	-	56	86
Total revenues, gains and other support	149,759	704,367	35,155	675	82,080	68,925
Expenses						
Salaries and wages	65,777	181,342	12,778	977	30,005	25,917
Payroll taxes and benefits	16,018	38,218	2,356	202	6,050	5,359
Supplies and other	54,242	239,923	15,103	113	27,014	17,884
Corporate management fees	-	77,940	3,032	-	8,906	6,667
VPE allocation	-	20,291	-	-	2,429	1,377
Depreciation and amortization	-	54,183	1,899	-	5,187	4,442
Interest expense	-	10,875	158	-	1,034	701
Total expenses	136,037	622,772	35,326	1,292	80,605	62,347
Excess (deficit) of operating revenue over operating expenses before loss on impairment of long-lived assets	13,722	81,595	(171)	(617)	1,455	6,578
Loss on impairment of long-lived assets	-	-	-	-	-	-
Excess (deficit) of operating revenue over operating expenses after loss on impairment of long-lived assets	13,722	81,851	(171)	(617)	1,455	6,578
Nonoperating revenue (expense)						
Gain (loss) on sale of fixed assets	-	39	31	-	9	1
Other non-operating revenue	56	217	9	1	20	159
Excess of revenue over expenses	13,778	81,851	(141)	(616)	1,484	6,738
Other changes in net assets						
Intercompany transfers, net	(15,708)	(19,430)	(2,404)	(426)	15,629	1,978
Net unrealized loss on investments	-	8,322	-	-	455	322
Net assets released from restrictions used for acquisition of fixed assets	-	-	-	-	-	-
Change in value of derivatives	-	(8,184)	-	-	243	99
Change in pension plan funded status	-	(14,459)	-	-	-	(926)
Earnings in equity of wholly-owned subsidiaries	88,085	-	-	-	-	-
Other changes	(290)	-	-	-	-	-
Increase (decrease) in net assets without donor restrictions	\$ 85,865	\$ 48,100	\$ (2,545)	\$ (1,042)	\$ 17,811	\$ 8,211

East Mountain Health Advantage and Subsidiaries	Hampshire Memorial Hospital	War Memorial Hospital	Page Memorial Hospital	Valley Physician Enterprise	Subtotal	Eliminations	Consolidated
\$ -	\$ 27,367	\$ 27,334	\$ 30,630	\$ 31,712	\$ 918,048	\$ -	\$ 918,048
1,361	947	950	2,812	31,550	204,734	(141,718)	63,016
-	44	2	39	1	72,327	(158)	72,169
-	-	26	253	-	880	-	880
1,361	28,358	28,312	33,734	63,263	1,195,989	(141,876)	1,054,113
416	11,360	10,401	15,109	25,777	379,859	-	379,859
77	2,304	2,059	2,848	3,362	78,853	(608)	78,245
4,854	9,043	8,882	9,547	29,506	416,111	(7,661)	408,450
-	2,868	2,620	3,303	2,850	108,186	(108,186)	-
-	244	262	660	-	25,263	(25,263)	-
429	1,773	1,862	2,494	1,071	73,340	-	73,340
-	1,021	4	799	40	14,632	(158)	14,474
5,776	28,613	26,090	34,760	62,606	1,096,244	(141,876)	954,368
(4,415)	(255)	2,222	(1,026)	657	99,745	-	99,745
-	-	3	1	(11)	63	-	63
-	3	2	2	6	475	-	475
(4,415)	(252)	2,227	(1,023)	652	100,283	-	100,283
-	-	-	-	-	-	-	-
-	-	-	-	-	-	-	-
18,538	2,169	262	660	(1,268)	-	-	-
-	-	-	-	-	9,099	-	9,099
-	-	-	-	-	-	-	-
-	-	-	-	-	(7,842)	-	(7,842)
-	-	-	-	-	(15,385)	-	(15,385)
-	-	-	-	-	88,085	(88,085)	-
-	-	-	-	-	(290)	-	(290)
\$ 14,123	\$ 1,917	\$ 2,489	\$ (363)	\$ (616)	\$ (173,950)	\$ (88,085)	\$ (85,865)

VALLEY HEALTH SYSTEM AND SUBSIDIARIES

CONSOLIDATED SCHEDULE – BALANCE SHEET INFORMATION (IN THOUSANDS)

December 31, 2018

	Valley Health System	Winchester Medical Center and Subsidiary	Valley Regional Enterprises	Valley Partners	Warren Memorial Hospital and Subsidiary	Shenandoah Memorial Hospital and Subsidiary
ASSETS						
Current assets						
Cash and cash equivalents	\$ 15,536	\$ 24,219	\$ 418	\$ -	\$ 2,422	\$ 2,292
Investments	-	316,701	-	-	24,987	17,516
Assets limited as to use	-	10,230	-	-	1,220	-
Patient accounts receivable	-	65,405	5,592	-	7,890	5,946
Due from related entities	31,876	5,630	-	-	-	600
Inventory of supplies	1,771	13,628	673	-	1,526	1,049
Other current assets	13,010	5,189	1,147	-	439	297
Total current assets	62,193	441,002	7,830	-	38,484	27,700
Assets limited as to use, noncurrent	4,991	186,480	-	-	53,104	3,171
Property and equipment, net	-	441,938	11,777	-	38,128	47,457
Other assets						
Right to use assets	-	-	-	-	-	-
Goodwill	-	-	-	-	-	227
Other investments	16,279	799	3,443	-	-	-
Investments in wholly-owned subsidiaries	828,646	-	-	-	-	-
Total other assets	844,925	799	3,443	-	-	227
Total assets	\$ 912,109	\$ 1,070,219	\$ 23,050	\$ -	\$ 129,716	\$ 78,555

East Mountain Health Advantage and Subsidiaries	Hampshire Memorial Hospital	War Memorial Hospital	Page Memorial Hospital	Valley Physician Enterprise	Subtotal	Eliminations	Consolidated
\$ 35	\$ 1,822	\$ 2,398	\$ 2,475	\$ 1,525	\$ 53,142	\$ -	\$ 53,142
-	-	-	-	-	359,204	-	359,204
-	1,000	-	821	-	13,271	-	13,271
-	2,479	2,640	2,587	2,916	95,455	-	95,455
-	-	-	-	-	38,106	(38,106)	-
2	447	478	434	-	20,008	-	20,008
42	145	940	472	91	21,772	-	21,772
79	5,893	6,456	6,789	4,532	600,958	(38,106)	562,852
-	-	238	269	-	248,253	-	248,253
10,319	28,856	32,073	42,070	3,141	655,759	-	655,759
-	-	-	-	-	-	-	-
-	4,400	-	-	-	4,627	-	4,627
-	490	490	-	-	21,501	-	21,501
-	-	-	-	-	828,646	(828,646)	-
-	4,890	490	-	-	854,774	(828,646)	26,128
\$ 10,398	\$ 39,639	\$ 39,257	\$ 49,128	\$ 7,673	\$ 2,359,744	\$ (866,752)	\$ 1,492,992

VALLEY HEALTH SYSTEM AND SUBSIDIARIES

CONSOLIDATING SCHEDULE – BALANCE SHEET INFORMATION (IN THOUSANDS), Continued
December 31, 2018

LIABILITIES AND NET ASSETS	Valley Health System	Winchester Medical Center and Subsidiary	Valley Regional Enterprises	Valley Partners	Warren Memorial Hospital and Subsidiary	Shenandoah Memorial Hospital and Subsidiary
Current liabilities						
Current installments of long-term debt	\$ -	\$ 6,188	\$ 3,440	\$ -	\$ 291	\$ 116
Current portion of leases payable	-	-	-	-	-	-
Accounts payable and accrued expenses	27,578	16,585	1,029	-	1,762	900
Accrued salaries and wages	36,787	-	-	-	-	-
Third-party settlements	-	4,744	-	9	627	275
Due to related entities	-	20,393	595	3,849	3,263	2,322
Other current liabilities	198	-	-	-	-	-
Total current liabilities	64,563	47,910	5,064	3,858	5,943	3,611
Long-term debt, excluding current installments	-	281,831	-	-	78,015	21,773
Operating leases payable, net of current portion	-	-	-	-	-	-
Accrued pension and post retirement obligations	-	66,258	-	-	-	3,542
Other liabilities	307	35,635	616	-	(105)	78
Total liabilities	64,870	431,634	5,680	3,858	83,853	29,006
Net assets:						
Net assets without donor restrictions	821,348	618,987	17,370	(3,858)	43,835	46,382
Net assets with donor restrictions	25,891	19,598	-	-	2,028	3,167
Total net assets	847,239	638,585	17,370	(3,858)	45,863	49,549
Total liabilities and net assets	\$ 912,109	\$ 1,070,219	\$ 23,050	\$ -	\$ 129,716	\$ 78,555

East Mountain Health Advantage and Subsidiaries	Hampshire Memorial Hospital	War Memorial Hospital	Page Memorial Hospital	Valley Physician Enterprise	Subtotal	Eliminations	Consolidated
\$ -	\$ 455	\$ -	\$ 750	\$ -	\$ 11,240	\$ (3,440)	\$ 7,800
-	-	-	-	-	-	-	-
386	727	457	297	1,103	50,824	-	50,824
-	-	-	-	-	36,787	-	36,787
-	1,375	1,599	(2,097)	-	6,532	-	6,532
20	1,069	802	960	1,393	34,666	(34,666)	-
32	-	-	-	-	230	-	230
438	3,626	2,858	(90)	2,496	140,279	(38,106)	102,173
-	23,969	-	31,524	-	437,112	-	437,112
-	-	-	-	-	-	-	-
-	-	-	-	-	69,800	-	69,800
2	-	72	63	-	36,668	-	36,668
440	27,595	2,930	31,497	2,496	683,859	(38,106)	645,753
9,958	11,846	36,041	17,017	5,177	1,624,103	(802,755)	821,348
-	198	286	614	-	51,782	(25,891)	25,891
9,958	12,044	36,327	17,631	5,177	1,675,885	(828,646)	847,239
\$ 10,398	\$ 39,639	\$ 39,257	\$ 49,128	\$ 7,673	\$ 2,359,744	\$ (866,752)	\$ 1,492,992

VALLEY HEALTH SYSTEM AND SUBSIDIARIES

CONSOLIDATING SCHEDULE – OPERATING INFORMATION (IN THOUSANDS)

Year Ended December 31, 2018

	Valley Health System	Winchester Medical Center and Subsidiary	Valley Regional Enterprises	Valley Partners	Warren Memorial Hospital and Subsidiary	Shenandoah Memorial Hospital and Subsidiary
Revenue, gains and other support						
Net patient service revenue	\$ -	\$ 580,363	\$ 31,616	\$ 168	\$ 66,085	\$ 57,810
Other operating revenue	137,678	10,911	1,069	605	1,626	1,955
Investment income, net	254	75,341	1	-	3,911	2,729
Net assets released from restrictions	-	941	-	-	49	131
Total revenues, gains and other support	137,932	667,556	32,686	773	71,671	62,625
Expenses						
Salaries and wages	59,874	177,312	14,362	1,105	26,483	25,675
Payroll taxes and benefits	15,263	42,442	3,056	303	6,804	5,827
Supplies and other	55,026	217,398	12,121	152	24,520	18,140
Corporate management fees	-	77,277	3,043	-	8,829	6,574
VPE allocation	-	17,269	-	-	4,136	1,556
Depreciation and amortization	-	49,917	2,107	-	4,280	4,315
Interest expense	-	10,865	163	-	1,044	684
Total expenses	130,163	592,480	34,852	1,560	76,096	62,771
Excess (deficit) of operating revenue over operating expenses before loss on impairment of long-lived assets	7,769	75,076	(2,166)	(787)	(4,425)	(146)
Loss on impairment of long-lived assets	-	-	-	-	(10,479)	-
Excess (deficit) of operating revenue over operating expenses after loss on impairment of long-lived assets	7,769	75,076	(2,166)	(787)	(14,904)	(146)
Nonoperating revenue (expense)						
Gain (loss) on sale of fixed assets	-	628	8	-	(58)	(15)
Other non-operating revenue	834	3,182	135	15	289	565
Excess of revenue over expenses	8,603	78,886	(2,023)	(772)	(14,673)	404
Other changes in net assets						
Intercompany transfers, net	(10,911)	(13)	1,805	(89)	9,050	(1,057)
Net unrealized loss on investments	-	(90,667)	-	-	(4,865)	(3,368)
Net assets released from restrictions used for acquisition of fixed assets	-	-	-	-	-	-
Change in value of derivatives	-	5,000	-	-	24	10
Change in pension plan funded status	-	(1,308)	-	-	-	156
Change in accounting policy	-	-	-	-	-	-
Earnings in equity of wholly-owned subsidiaries	(28,702)	-	-	-	-	-
Other Changes	-	-	-	-	-	-
Increase (decrease) in net assets without donor restrictions	\$ (31,010)	\$ (8,102)	\$ (218)	\$ (861)	\$ (10,464)	\$ (3,855)

East Mountain Health Advantage and Subsidiaries	Hampshire Memorial Hospital	War Memorial Hospital	Page Memorial Hospital	Valley Physician Enterprise	Subtotal	Eliminations	Consolidated
\$ -	\$ 26,685	\$ 24,179	\$ 29,719	\$ 25,461	\$ 842,086	\$ -	\$ 842,086
1,126	767	667	2,666	29,557	188,627	(140,479)	48,148
-	13	3	(19)	2	82,235	(166)	82,069
-	-	3	7	-	1,131	-	1,131
1,126	27,465	24,852	32,373	55,020	1,114,079	(140,645)	973,434
489	10,879	10,204	14,586	28,219	369,188	-	369,188
94	2,443	2,368	3,056	3,976	85,632	(300)	85,332
4,619	8,805	8,127	8,811	19,091	376,810	(8,820)	367,990
-	2,793	2,573	3,211	2,645	106,945	(106,945)	-
-	302	286	865	-	24,414	(24,414)	-
491	1,652	1,679	2,535	861	67,837	-	67,837
-	1,036	-	739	-	14,531	(166)	14,365
5,693	27,910	25,237	33,803	54,792	1,045,357	(140,645)	904,712
(4,567)	(445)	(385)	(1,430)	228	68,722	-	68,722
-	-	-	-	-	(10,479)	-	(10,479)
(4,567)	(445)	(385)	(1,430)	228	64,008	-	64,008
-	(27)	-	-	-	536	-	536
2	46	38	35	88	5,229	-	5,229
(4,565)	(426)	(347)	(1,395)	316	64,008	-	64,008
8,239	(5,422)	(4,986)	1,572	1,812	-	-	-
-	-	-	-	-	(98,900)	-	(98,900)
-	-	-	-	-	5,034	-	5,034
-	-	-	-	-	(1,152)	-	(1,152)
-	-	-	-	-	-	-	-
-	-	-	-	-	(28,702)	28,702	-
-	-	-	-	-	-	-	-
\$ 3,674	\$ (5,848)	\$ (5,333)	\$ 177	\$ 2,128	\$ (59,712)	\$ 28,702	\$ (31,010)