



Consolidated Financial Statements,  
Supplementary Information and Report of  
Independent Certified Public Accountants

**Virtua Health, Inc.**

December 31, 2018 and 2017



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## **Report of Independent Certified Public Accountants**

Board of Trustees  
Virtua Health, Inc.

We have audited the accompanying consolidated financial statements of Virtua Health, Inc., (“Virtua”), which comprise the consolidated balance sheets as of December 31, 2018 and 2017, and the related consolidated statements of operations and changes in net assets and cash flows for the years then ended, and the related notes to the consolidated financial statements.

### **Management’s responsibility for the financial statements**

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

### **Auditors’ responsibility**

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the 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 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 internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

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

**Opinion**

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

**Emphasis of matters**

As discussed in Note B.3 to the consolidated financial statements, in 2018 Virtua adopted the following Accounting Standards Updates: 2014-09, *Revenue from Contracts with Customers*; 2017-07, *Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost*; 2016-14, *Presentation of Financial Statements of Not-for-Profit Entities*. Our opinion is not modified with respect to these matters.

**Supplementary information**

Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The accompanying supplementary information on pages \_\_\_ - \_\_\_ is presented for the purpose of additional analysis and is not a required part of the consolidated financial statements. Such supplementary 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 information has been subjected to the auditing procedures applied in our audits of the consolidated financial statements and certain additional procedures. These additional procedures included comparing and reconciling the 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 supplementary information is fairly stated, in all material respects, in relation to the consolidated financial statements as a whole.



Philadelphia, Pennsylvania

May 6, 2019

**CONSOLIDATED BALANCE SHEETS**

December 31,

(In thousands)

	<u>2018</u>	<u>2017</u>
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 44,109	\$ 72,233
Assets limited as to use	24,510	16,265
Patient accounts receivable (net of estimated uncollectibles of \$48,202 at December 31, 2017)	143,641	130,271
Other current assets	<u>57,386</u>	<u>52,524</u>
Total current assets	269,646	271,293
ASSETS LIMITED AS TO USE:		
By Board of Trustees' designation	1,019,812	1,087,617
Other designated funds	273,322	283,126
Under debt agreements	26,617	26,325
Trust funds	5,116	13,471
Donor-restricted funds	<u>14,075</u>	<u>17,867</u>
	1,338,942	1,428,406
PROPERTY, PLANT, AND EQUIPMENT, NET	883,932	850,138
OTHER LONG-TERM ASSETS:		
Investment in unconsolidated joint ventures	162,949	148,882
Other assets	26,090	28,141
Goodwill and other intangibles	25,980	15,113
Beneficial interest in perpetual trust	<u>7,459</u>	<u>8,530</u>
	<u>222,478</u>	<u>200,666</u>
TOTAL	<u>\$ 2,714,998</u>	<u>\$ 2,750,503</u>

(Continued)

**CONSOLIDATED BALANCE SHEETS - CONTINUED**

December 31,

(In thousands)

	<u>2018</u>	<u>2017</u>
LIABILITIES AND NET ASSETS		
CURRENT LIABILITIES:		
Current maturities of long-term debt	\$ 11,780	\$ 11,395
Accounts payable and accrued expenses	137,150	122,317
Accrued compensation and related liabilities	71,099	60,839
Accrued interest payable	9,841	9,977
Estimated settlements due to third-party payers	<u>2,119</u>	<u>7,355</u>
Total current liabilities	231,989	211,883
LONG-TERM LIABILITIES:		
Estimated settlements due to third-party payers	4,355	3,256
Self-insurance liabilities	36,006	27,153
Accrued retirement benefits	27,622	31,071
Long-term debt, net of current maturities	582,119	594,245
Other liabilities	<u>22,263</u>	<u>22,874</u>
Total liabilities	904,354	890,482
NET ASSETS:		
Without donor restrictions:		
Virtua Health, Inc.	1,744,932	1,798,206
Noncontrolling interests	<u>40,483</u>	<u>31,429</u>
	1,785,415	1,829,635
With donor restrictions	<u>25,229</u>	<u>30,386</u>
Total net assets	<u>1,810,644</u>	<u>1,860,021</u>
TOTAL	<u>\$ 2,714,998</u>	<u>\$ 2,750,503</u>

The accompanying notes are an integral part of these statements.

**CONSOLIDATED STATEMENTS OF OPERATIONS AND CHANGES IN NET ASSETS**

Years ended December 31,

(In thousands)

	<u>2018</u>	<u>2017</u>
NET ASSETS WITHOUT DONOR RESTRICTIONS:		
Revenue:		
Net patient service revenue before provision for bad debts		\$ 1,280,508
Less: Provision for bad debts		<u>(52,960)</u>
Net patient service revenue	\$ 1,228,836	1,227,548
Other revenue	64,591	70,906
Equity in income of unconsolidated joint ventures	<u>49,477</u>	<u>46,362</u>
Total revenue	1,342,904	1,344,816
Expenses:		
Salaries and wages	599,161	571,792
Professional fees	19,830	19,081
Employees' fringe benefits	135,021	133,185
Other operating expenses	448,155	434,697
Interest	21,291	19,596
Depreciation	<u>95,583</u>	<u>89,675</u>
Total expenses	<u>1,319,041</u>	<u>1,268,026</u>
INCOME FROM OPERATIONS (includes \$13,083 in 2018 and \$10,445 in 2017 attributed to noncontrolling interests)	23,863	76,790
NONOPERATING GAINS AND LOSSES:		
Investment return, net	(67,627)	153,415
Other accrued retirement costs	<u>658</u>	<u>310</u>
Total nonoperating (losses) gains, net	<u>(66,969)</u>	<u>153,725</u>
(DEFICIT IN) EXCESS OF REVENUE AND NONOPERATING GAINS (LOSSES), NET OVER EXPENSES	(43,106)	230,515
EXCESS OF REVENUE AND NONOPERATING GAINS, NET OVER EXPENSES ATTRIBUTED TO NONCONTROLLING INTERESTS	<u>(13,083)</u>	<u>(10,445)</u>
(DEFICIT IN) EXCESS OF REVENUE AND NONOPERATING GAINS (LOSSES), NET OVER EXPENSES ATTRIBUTED TO VIRTUA HEALTH, INC.	(56,189)	220,070

The accompanying notes are an integral part of these statements.

**CONSOLIDATED STATEMENTS OF OPERATIONS AND CHANGES IN NET ASSETS - CONTINUED**

Years ended December 31,

(In thousands)

	<u>2018</u>	<u>2017</u>
(DEFICIT IN) EXCESS OF REVENUE AND NONOPERATING GAINS (LOSSES), NET OVER EXPENSES ATTRIBUTED TO VIRTUA HEALTH, INC.	\$ (56,189)	\$ 220,070
OTHER CHANGES IN NET ASSETS WITHOUT DONOR RESTRICTIONS - Virtua Health, Inc.:		
Net assets released for property, plant, and equipment	7,163	862
Other changes in accrued retirement benefits	(4,111)	(8,535)
Other	<u>(3)</u>	<u>-</u>
(Decrease) increase in net assets without donor restrictions - Virtua Health, Inc.	(53,140)	212,397
NONCONTROLLING INTERESTS:		
Excess of revenues and nonoperating gains, net over expenses attributable to noncontrolling interests	13,083	10,445
Distributions	(12,899)	(10,138)
Membership interest transfer	<u>8,871</u>	<u>3,679</u>
Increase in net assets without donor restrictions - noncontrolling interests	9,055	3,986
CHANGE IN NET ASSETS WITH DONOR RESTRICTIONS:		
Contributions	3,646	5,579
Investment return net	(108)	271
(Decrease) increase in beneficial interest in perpetual trust	(1,071)	591
Net assets released from restrictions for operations	(596)	(597)
Net assets released from restrictions for property, plant, and equipment	<u>(7,163)</u>	<u>(862)</u>
(Decrease) increase in net assets with donor restrictions	(5,292)	4,982
(DECREASE) INCREASE IN NET ASSETS	(49,377)	221,365
NET ASSETS - beginning of year	<u>1,860,021</u>	<u>1,638,656</u>
NET ASSETS - end of year	<u>\$ 1,810,644</u>	<u>\$ 1,860,021</u>

The accompanying notes are an integral part of these statements.

**CONSOLIDATED STATEMENTS OF CASH FLOWS**

Years ended December 31,

(In thousands)

	<u>2018</u>	<u>2017</u>
<b>OPERATING ACTIVITIES:</b>		
(Decrease) increase in net assets	\$ (49,377)	\$ 221,365
Adjustments to reconcile (decrease) increase in net assets to net cash provided by operating activities:		
Other changes in accrued retirement benefits	4,111	8,535
Equity in income of unconsolidated joint ventures	(49,477)	(46,362)
Distributions to noncontrolling interests	12,899	10,138
Membership interest transfer	(8,871)	(3,679)
Restricted contributions, including change in beneficial interest in perpetual trust	(2,575)	(6,170)
Depreciation	95,237	89,345
Provision for bad debts	-	52,960
Net realized and unrealized losses (gains) on investments	62,832	(159,059)
Realized gain from sale of consolidated joint venture	-	(12,717)
Changes in certain assets and liabilities:		
Patient accounts receivable	(12,874)	(50,080)
Distributions from unconsolidated joint ventures	48,086	45,138
Other assets	(207)	(1,083)
Accounts payable and accrued expenses	6,963	7,962
Other liabilities	(2,111)	6,556
Accrued compensation and related liabilities	10,249	1,852
Accrued interest payable	(136)	(102)
Self-insurance liabilities	13,589	(1,323)
Accrued retirement benefits	(7,271)	(11,544)
Estimated settlements due to third-party payers	<u>(4,137)</u>	<u>(7,764)</u>
Net cash provided by operating activities	116,930	143,968
<b>INVESTING ACTIVITIES:</b>		
Purchases of property, plant, and equipment	(127,621)	(138,428)
Purchases of investments	(155,492)	(327,550)
Sales of investments	173,605	345,031
Investment in unconsolidated joint ventures	(7,609)	(6,589)
Proceeds from sale of managed care organization	14	106
Acquisition of licenses	-	(3,590)
Acquisition under SCSJ and other physician services and dissolution of RADONC, net	<u>(4,837)</u>	<u>(3,490)</u>
Net cash used in investing activities	(121,940)	(134,510)

The accompanying notes are an integral part of these statements.

**CONSOLIDATED STATEMENTS OF CASH FLOWS - CONTINUED**

Years ended December 31,

(In thousands)

	<u>2018</u>	<u>2017</u>
FINANCING ACTIVITIES:		
Repayment of long-term debt	\$ (11,395)	\$ (11,240)
Distributions to noncontrolling interests	(12,899)	(10,138)
Net restricted contributions and pledge payments	<u>1,180</u>	<u>3,521</u>
Net cash used in financing activities	<u>(23,114)</u>	<u>(17,857)</u>
DECREASE IN CASH AND CASH EQUIVALENTS	(28,124)	(8,399)
CASH AND CASH EQUIVALENTS - beginning of year	<u>72,233</u>	<u>80,632</u>
CASH AND CASH EQUIVALENTS - end of year	<u>\$ 44,109</u>	<u>\$ 72,233</u>
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:		
Cash paid for interest, net of capitalized interest	<u>\$ 22,147</u>	<u>\$ 21,179</u>
Change in accrued capital expenditures in accounts payable and accrued expenses	<u>\$ 1,583</u>	<u>\$ (1,718)</u>
Non-cash components of acquisition under SCSJ and other physician services and dissolution of RADONC, net:		
Patient accounts receivable	<u>\$ 496</u>	<u>\$ (579)</u>
Other assets	<u>\$ (33)</u>	<u>\$ (1,788)</u>
Property, plant and equipment	<u>\$ 173</u>	<u>\$ 1,139</u>
Accounts payable	<u>\$ (1,522)</u>	<u>\$ (1,067)</u>
Accrued compensation and related liabilities	<u>\$ (11)</u>	
Other liabilities	<u>\$ (1,500)</u>	

The accompanying notes are an integral part of these statements.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

December 31, 2018 and 2017

(Dollars in thousands)

NOTE A - ORGANIZATION

Virtua Health, Inc., is a nonprofit corporation incorporated in New Jersey to establish, operate, maintain, and conduct a regional health network serving Burlington, Camden, Mercer, Ocean, and Gloucester counties in New Jersey, and Philadelphia, Pennsylvania. The consolidated financial statements include the accounts of Virtua Health, Inc., and its controlled entities (collectively, "Virtua"). Virtua is composed of the following controlled entities:

*Hospital Group*

Virtua-Memorial Hospital of Burlington County ("Virtua-Memorial") is a 383-licensed-bed, tax-exempt acute care hospital in Mount Holly, New Jersey. Virtua-Memorial provides general health care services to residents within its geographic location for a wide range of inpatient and outpatient services, including medical, surgical, cardiac, obstetrical, gynecological, oncological, pediatric, emergency, and ambulatory care. Virtua-Memorial also provides a variety of outpatient services in space leased from a third-party developer in the Virtua Health and Wellness Center in Moorestown, New Jersey.

Virtua-West Jersey Health System ("Virtua-West Jersey") is a 600-licensed-bed, tax-exempt health system that operates two general acute care hospitals, which are located in Marlton, and Voorhees, New Jersey. Virtua-West Jersey provides general health care services to residents within its geographic location for a wide range of inpatient and outpatient services, including medical, surgical, cardiac, obstetrical, gynecological, oncological, pediatric, emergency, and ambulatory care. Virtua-West Jersey owns and operates facilities in Berlin and Camden, New Jersey, which provide emergent care and other outpatient services; and in the Camden facility rents available space primarily to outside social services programs. Virtua-West Jersey also provides a variety of outpatient services, in space leased from a third-party developer, in two Virtua Health and Wellness Centers, one in Voorhees, New Jersey and one in Washington Township, New Jersey, as well as in a fitness center located in Voorhees, New Jersey.

Virtua-West Jersey and an unrelated corporation own Voorhees Endoscopy Holding Co., LLC ("Voorhees Endo Holding") in which Virtua-West Jersey maintains a 51% ownership interest. The purpose of Voorhees Endo Holding is to own a majority equity interest in The Voorhees NJ Endoscopy ASC, LLC, an ambulatory surgical center located in Voorhees, New Jersey.

Virtua-Memorial and an unrelated corporation own Virtua-SCA Holdings, LLC ("SCA Holdings") in which Virtua-Memorial maintains a 51% ownership interest. SCA Holdings consolidates its 100% ownership interest of SCA-South Jersey, which owns 61.85% of Surgical Center of South Jersey, LLC ("SCSJ"). The purpose of SCA Holdings is to acquire, own and operate ambulatory surgical centers and to maintain a majority equity in such owned centers.

Virtua-Memorial and an unrelated corporation own Emmaus Holdings, LLC ("Emmaus Holdings") in which Virtua-Memorial maintains a 50.10% ownership interest. The purpose of Emmaus Holdings is to hold a majority interest in Emmaus Surgical Center, LLC, a multi-specialty ambulatory surgery center in Hackettstown, New Jersey.

(Continued)

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED**

December 31, 2018 and 2017

(Dollars in thousands)

NOTE A - ORGANIZATION - Continued

Virtua-Memorial and an unrelated corporation own Virtua-USP Princeton, LLC (“Virtua-USP Princeton”) in which Virtua-Memorial maintains a 68.2% ownership interest. The purpose of Virtua-USP Princeton is to hold a majority interest in Surgical Specialists at Princeton, LLC, a multi-specialty ambulatory surgery center in Princeton, New Jersey.

Virtua-West Jersey is the sole corporate member of West Jersey RENEW, Inc., a nonprofit corporation, which is inactive.

*Virtua Medical Group*

Virtua Medical Group, PA (“VMG”) is a not-for-profit professional association consisting of 518 clinicians, primarily specialty and primary care physicians. VMG provides services to Virtua’s hospitals and also at many owned and leased physician-practice sites located throughout southern New Jersey.

*Ambulatory and Long-Term Care*

Virtua Health and Rehabilitation Center at Berlin, Inc., is a not-for-profit health care organization, which operates a 128-bed skilled nursing facility in Berlin, New Jersey.

Virtua Health and Rehabilitation Center at Mount Holly, Inc., is a not-for-profit health care organization, which operates a 180-bed skilled nursing facility in Mount Holly, New Jersey.

Virtua Home Care-Community Nursing Services (“CNS”) is a not-for-profit corporation, which provides home care services in Virtua’s service area.

VRI, Inc. (“VRI”), is a for-profit organization whose sole shareholder is CNS. VRI primarily consists of fitness centers and spas that are located in the Virtua Health and Wellness Centers in Moorestown and Washington Township, retail shops, management of a bioidentical hormone replacement therapy practice and private home health aide and companion services. The fitness center and spa located in the Washington Township Health and Wellness Center closed as of December 31, 2018. VRI was also the sole shareholder of Radiation Therapy Rentals, LLC, which provided rentals of medical equipment and real estate. Radiation Therapy Rentals was closed on December 31, 2017.

*Foundation*

Virtua Health Foundation, Inc. (“VHF”), is a not-for-profit corporation established to promote and support Virtua, its sole corporate member and affiliated corporations, and the health care of the population of southern New Jersey, by developing the resources necessary to attain these goals.

(Continued)

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED**

December 31, 2018 and 2017

(Dollars in thousands)

NOTE A - ORGANIZATION - Continued

In 2003, Memorial Hospital of Burlington County Foundation (“MHBCF”), a not-for-profit corporation established to promote the scientific, educational, and charitable activities and policies of Virtua-Memorial, and West Jersey Health & Hospital Foundation, Inc. (“WJHHF”), a not-for-profit corporation, which raised funds for the benefit of Virtua-West Jersey, its subsidiaries, and the community, combined their operations and transferred their net assets into VHF. The restricted funds of MHBCF and WJHHF are administered in a manner consistent with the original donors’ intentions.

*Insurance Captive*

Virtua Assurance, Inc. (“VAI”) is a for-profit captive insurance company in the state of Vermont whose sole shareholder is Virtua Health, Inc.

*Population Health Management Group*

Summit Health-Virtua, Inc. (“Summit”) is a not-for-profit health care organization, which operated VirtuaCare, an accountable care organization that was an approved participant in the Medicare Shared Savings Program. Summit ceased operation on December 31, 2017.

VirtuaPhysicianPartner, LLC (“VPP”) is a for-profit clinically integrated network that enhances the access, quality, cost-efficiency and experience of healthcare for patients, and whose sole owner is Virtua Health, Inc.

On June 4, 2018, Virtua and Maxis Health System (“Maxis”), a wholly-controlled subsidiary of Trinity Health, executed a Membership Transfer agreement to transfer the membership interests of Our Lady of Lourdes Health Care Services, Inc. (“Lourdes”) from Maxis to Virtua. The agreement includes substantially all of the healthcare operations and certain assets and working capital of Lourdes. Lourdes includes Our Lady of Lourdes Medical Center (Camden, New Jersey) and Lourdes Medical Center of Burlington County (Willingboro, New Jersey) and most of their affiliated operations. The transaction is expected to close in mid-2019, with the final consideration pending working capital adjustments and final settlement resolutions. The transaction also remains subject to regulatory approvals as well as other customary closing conditions.

NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

1. Principles of Consolidation

Virtua, through Virtua-West Jersey and Virtua-Memorial, owns interests in several companies that are included in the consolidated financial statements. The noncontrolling interests of these companies, Voorhees Endo Holding, SCA Holdings, Emmaus Holdings and Virtua-USP Princeton are reported as a component of net assets. Significant intercompany balances and transactions have been eliminated. Ventures in which Virtua has financial interest and shares control equally with unrelated investors are accounted for under the equity method as discussed in Note H. As disclosed in Note J for the Obligated Group, the assets of any member of Virtua may not be available to meet the obligations of other members in Virtua.

(Continued)

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED**

December 31, 2018 and 2017

(Dollars in thousands)

NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

2. Basis of Accounting

The consolidated financial statements have been prepared on the accrual basis of accounting in conformity with accounting principles generally accepted in the United States of America (“U.S. GAAP”) consistent with the Financial Accounting Standards Board (“FASB”) Accounting Standards Codification (“ASC”) 954, *Health Care Entities*, and other pronouncements applicable to health care organizations.

3. Recently Adopted Accounting Pronouncements

Effective January 1, 2018, Virtua adopted FASB Accounting Standards Update (“ASU”) 2014-09, *Revenue from Contracts with Customers (Topic 606)* (“ASU 2014-09”), using a modified retrospective method of application to all contracts existing on January 1, 2018. The core principle of the standard is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The adoption of the standard had no impact on Virtua’s current or historical financial position, results of operations or cash flows. Additionally, management does not anticipate that the standard will have an impact on the amount or timing of when Virtua recognizes revenue prospectively. However, in accordance with the standard, Virtua now recognizes its previously reported provision for bad debts, primarily related to its self-pay patient population, as a direct reduction to revenues as an implicit pricing concession, instead of separately as a discrete deduction to arrive at net patient service revenue. Virtua’s revenue recognition and accounts receivable policies are more fully described in Notes B7, B17 and E.

Effective January 1, 2018, Virtua adopted retrospectively and applied the practical expedient for FASB ASU 2017-07, *Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost*. This standard intends to make changes to employers that sponsor defined benefit pension and/or other postretirement benefit plans to present the net periodic benefit cost in the income statement. Employers will present the service cost component of net periodic benefit cost in the same statement of operations line item as other employee compensation costs arising from services rendered during the period. Employers will present the other components of the net periodic benefit cost separately from the line item that includes the service cost and outside of any subtotal of operating income. This change resulted in a reclassification of the other components of the net periodic benefit cost for its pension plan for the year ended December 31, 2017. The other components of the net periodic benefit cost for its pension plan, gains of \$658 and \$301 for the years ended December 31, 2018 and 2017, respectively, are recorded within nonoperating gains and losses in the consolidated statements of operations and changes in net assets.

In 2018, Virtua adopted FASB ASU 2016-14, *Presentation of Financial Statements of Not-for-Profit Entities*. This standard makes certain improvements to the previous reporting requirements for not-for-profit entities including: (1) the presentation for two classes of net assets at the end of the period, rather than the previously required three classes, as well as the annual change in each of the two classes; (2) information about liquidity and the availability of resources; and (3) addresses the lack of consistency with expenses and investment return. Virtua’s consolidated financial statements have been adjusted to reflect the new requirements. The standard has been applied retrospectively to all years presented, except for the disclosure around liquidity and availability of resources and, as such, this disclosure has been presented for 2018 only.

(Continued)

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED**

December 31, 2018 and 2017

(Dollars in thousands)

NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

4. Use of Estimates

The preparation of consolidated financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Significant estimates are used in recording net patient service revenue, estimated settlements with third-party payers, useful lives of property, plant and equipment, goodwill, self-insurance program liabilities, accrued retirement benefits, and the reported fair values of certain assets and liabilities. Actual results could differ from those estimates.

5. Fair Value of Financial Instruments

Financial instruments consist of cash and cash equivalents, patient accounts receivable, assets limited as to use, investments, accounts payable and accrued expenses, estimated settlements with third-party payers and long-term debt. The carrying amounts reported in the consolidated balance sheets for cash and cash equivalents, patient accounts receivable, assets limited as to use, investments, accounts payable and accrued expenses and estimated settlements with third-party payers approximate fair value. Management's estimates of the fair value of other financial instruments are described elsewhere in the notes to the consolidated financial statements.

6. Cash and Cash Equivalents

Cash and cash equivalents include various checking, savings, time deposits, and money market accounts with initial maturities of three months or less. At December 31, 2018 and 2017, Virtua had cash balances in financial institutions that exceeded federal depository insurance limits. Management believes that credit risk related to these deposits is minimal.

7. Patient Accounts Receivable

Patient accounts receivable for which Virtua receives payment under cost reimbursement, prospective payment formulas, or negotiated rates, which cover the majority of patient services, are stated at the estimated net amounts receivable from payers, which are generally less than the established billing rates of Virtua.

For patient accounts receivable resulting from patient service revenue recognized prior to January 1, 2018, an allowance for doubtful accounts was established to reduce the carrying value of such receivables to their estimated net realizable value. Generally, this allowance was based on the aging of accounts receivable, historical collection experience for each type of payer, and other relevant factors. Under the provisions of ASU 2014-09, which was adopted effective January 1, 2018, when there is an unconditional right to payment, subject only to the passage of time, the right is treated as a receivable. Patient accounts receivable, including billed accounts and unbilled accounts, which have the unconditional right to payment, and estimated amounts due from third-party payers for retroactive adjustments, are receivables if the right to consideration is unconditional and only the passage of time is required before payment of that consideration is due. For patient accounts receivable subsequent to January 1, 2018, the estimated uncollectible amounts are generally considered implicit price concessions that are a direct reduction to patient accounts receivable rather than an allowance for doubtful accounts.

(Continued)

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED**

December 31, 2018 and 2017

(Dollars in thousands)

NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

8. Assets Limited as to Use, Investments, and Investment Income

Investments in marketable equity and debt securities are presented at fair value in the consolidated balance sheets as disclosed in Note F. Certain other investments are accounted for under the equity method of accounting as disclosed in Note H.

Assets limited as to use by the Board of Trustees' designation are resources arising from results of operations and investment returns that have been designated by the Board of Trustees for specific purposes. These securities are classified as trading securities.

Assets limited as to use - other designated funds are resources arising from results of operations that have been designated for specific purposes, such as strategic initiatives and self-funded professional liabilities. These investments are classified as trading securities.

Assets limited as to use - under debt agreements are held by a trustee under bond indenture agreements and consist of those assets designated for the payments of principal and interest due on indebtedness, construction projects, and certain security provisions. These investments are accounted for as available for sale.

Assets limited as to use - trust funds include funds that are held by a trustee for Virtua's self-insurance workers' compensation program and assets for vested employee benefits. These investments are classified as trading securities.

Assets limited as to use - donor restricted funds are assets to be held by Virtua in accordance with the donor's intentions. Donor restricted investment income is recognized as a direct increase or decrease to net assets with restrictions.

Investment income or losses (including realized and unrealized gains and losses on investments, interest, and dividends) designated as trading, are included in nonoperating gains and losses as investment returns, unless the income or losses are restricted by donor or law. Investment income or losses (including realized and unrealized gains and losses on investments, interest, and dividends) designated as available for sale, are included in other revenue, except for interest income capitalized during construction, which is included in property, plant, and equipment, net.

Investments, in general, are exposed to various risks, such as interest rate, credit, and overall market volatility. As such, it is reasonably possible that changes in the values of investments will occur in the near term and that such changes could materially affect the amounts reported in the consolidated balance sheets and consolidated statements of operations and changes in net assets.

(Continued)

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED**

December 31, 2018 and 2017

(Dollars in thousands)

## NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

9. Property, Plant, and Equipment

Property, plant, and equipment acquisitions are recorded at cost. Depreciation is provided over the estimated useful life of each class of depreciable asset and are computed on the straight-line method based on the following estimated useful lives:

Land improvements	5-25 years
Building and improvements	10-40 years
Fixed equipment	5-20 years
Furniture and fixtures	3-20 years

Construction in progress represents amounts expended or incurred toward property and equipment projects that have not been completed. No depreciation or amortization has been recorded for these items. Interest cost incurred, net of investment income earned on borrowed funds, during the period of construction is capitalized as a component of the cost of acquiring those assets. In cases where internal cash reserves are used to fund construction, interest is capitalized based on average accumulated expenditures multiplied by the weighted-average interest rate on existing debt. Virtua had capitalized interest of \$720 and \$1,481 for the years ended December 31, 2018 and 2017, respectively.

Gifts of long-lived assets such as land, buildings, or equipment are reported as other changes in net assets without restrictions, 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.

10. Impairment of Long-Lived Assets

Long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. If long-lived assets are deemed to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value. Assets to be disposed of are reported at the lower of the carrying amount or the fair value less costs to sell. As of December 31, 2018, management believes that no revisions to the remaining useful lives or write-down of long-lived assets are required.

(Continued)

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED**

December 31, 2018 and 2017

(Dollars in thousands)

## NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

11. Donor-Restricted Gifts

Unconditional promises to give cash and other assets are reported at fair value at the date the promise is received, which is then treated as cost. The gifts are reported as net assets with donor restrictions if they are received with donor stipulations that limit the use of the donated assets. As the donors' intentions are met, the net assets are reclassified to net assets without donor restrictions and reported in the consolidated statements of operations and changes in net assets as other revenue for operating purposes and as other changes in net assets without donor restrictions for acquisitions of property, plant, and equipment.

12. Self-Insurance

Virtua is self-insured with regard to health insurance offered to its employees. A third-party administrator is utilized to process the health insurance claims. Virtua is also self-insured for workers' compensation. An estimated liability for incurred but not reported employee medical benefits and workers' compensation claims is included in accounts payable and accrued expenses.

13. Goodwill and Other Intangibles

Goodwill represents the excess of the purchase price over the estimated fair value of the net assets of businesses acquired. Other intangibles represent a certificate of need and a license to operate long-term care beds, which was acquired for future use and has an indefinite useful life. For the years ended December 31, 2018 and 2017, Virtua added goodwill of \$10,867 and \$7,607, respectively. These additions related to the acquisition of a surgical center and a physical therapy practice, respectively.

Goodwill and other intangibles at December 31, 2018 and 2017, are as follows:

	<u>2018</u>	<u>2017</u>
Goodwill	\$ 21,922	\$ 11,523
Other intangibles	<u>4,058</u>	<u>3,590</u>
	<u>\$ 25,980</u>	<u>\$ 15,113</u>

Goodwill and other intangibles are not amortized but are tested for impairment at least annually and whenever events or circumstances change that indicate impairment may have occurred. Virtua first assesses qualitative factors to determine whether it is necessary to perform quantitative impairment tests for goodwill. If the result of the qualitative assessment conclude that it is more likely than not that goodwill is not impaired, a quantitative impairment test is not required. If a quantitative impairment test is required, Virtua's testing consists of performing an internal valuation analysis and considering other publicly available market information. If the carrying amount of goodwill exceeds the estimated fair value, an impairment charge to current operations is recorded to reduce the carrying value to the estimated fair value. Virtua completed the quantitative impairment test of its goodwill and other intangibles and determined there was no impairment for the years ended December 31, 2018 and 2017.

(Continued)

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED**

December 31, 2018 and 2017

(Dollars in thousands)

NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

14. Other Assets

Other assets at December 31, 2018 and 2017, are as follows:

	<u>2018</u>	<u>2017</u>
Advanced rental payments	\$ 11,580	\$ 18,296
Insurance recoveries	12,014	7,042
Other	<u>2,496</u>	<u>2,803</u>
	<u>\$ 26,090</u>	<u>\$ 28,141</u>

Advance rental payments are being expensed over the term of the lease agreements.

15. Beneficial Interest in Perpetual Trust

Virtua has recorded its portion of the fair value of a trust. The trust is perpetual in nature, and the original corpus cannot be violated. The trust is recorded as a net asset with donor restrictions.

16. Net Assets With Donor Restrictions

Net assets with donor restrictions represent those net assets whose use has been limited by donors to a specific time period, purpose, or to be maintained in perpetuity. The income from net assets that are to be maintained in perpetuity may be used to support nursing scholarships and to support various other needs, in accordance with donor stipulations. Income from net assets with donor restrictions is expended according to donor intent.

Virtua follows the requirements of the Uniform Prudent Management of Institutional Funds Act (“UPMIFA”). Virtua’s endowments consist of numerous individual funds established for a variety of purposes and consist solely of donor-restricted endowment funds. As required, net assets associated with endowment funds are classified and reported based on the existence or absence of donor-imposed restrictions.

Virtua has interpreted UPMIFA as requiring the preservation of the fair value of the original gift as of the gift date of the donor-restricted endowment funds absent explicit donor stipulations to the contrary. As a result of this interpretation, Virtua classifies net assets with donor restrictions related to endowment funds at the original value of gifts donated to the permanent endowment, the original value of subsequent gifts donated to the permanent endowment, and accumulations to the permanent endowment made in accordance with the directions of the applicable donor gift instruments.

(Continued)

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED**

December 31, 2018 and 2017

(Dollars in thousands)

## NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Virtua's investment policies for its endowment assets are consistent with the policies and objectives of its overall investments. The assets are invested in a manner that is intended to produce a positive rate of return while assuming a low level of risk. From time to time, the fair value of assets associated with the donor-restricted endowment funds may fall below the level that the donor requires Virtua to maintain in perpetual duration. Deficiencies of this nature would be reported in net assets without restrictions, however, none existed at December 31, 2018 or 2017.

Changes in donor restricted funds related to endowments for the years ended December 31, 2018 and 2017, are as follows:

	<u>2018</u>	<u>2017</u>
Endowment net assets - beginning of year	\$ 1,733	\$ 1,677
Investment return - net realized and unrealized (losses) gains	<u>(23)</u>	<u>56</u>
Endowment net assets - end of year	<u>\$ 1,710</u>	<u>\$ 1,733</u>

17. Net Patient Service Revenue

Virtua has negotiated agreements with third-party payers including health insurance companies and has rates set by government regulations (for payers such as Medicare and Medicaid) that provide for reimbursement at amounts different from established charges. Reimbursement methodologies include prospectively determined rates per discharge, per diem rates, reimbursed costs, and discounted charges.

Prior to January 1, 2018, net patient service revenue was reported at the estimated net realizable amounts from patients, third-party payers, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payers. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined.

Effective January 1, 2018, in accordance with ASU 2014-09, net patient service revenues are recorded at the amounts that reflect the consideration to which Virtua expects to be entitled in exchange for providing patient care. These amounts are due from patients, third-party payers (including managed care payers and government programs, i.e., Medicare and Medicaid) and others, and they include variable consideration for retroactive revenue adjustments due to settlement of audits, reviews and investigations. Generally, patients and third-party payers are billed several days after the services are performed or shortly after discharge. Net patient service revenue is recognized in the period in which the performance obligations are satisfied under contracts by transferring services to customers.

(Continued)

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED**

December 31, 2018 and 2017

(Dollars in thousands)

NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Performance obligations are determined based on the nature of the services provided. Virtua recognizes revenues for performance obligations satisfied over time based on actual charges incurred in relation to total expected charges. Virtua believes that this method provides an appropriate depiction of the transfer of services over the term of performance obligations based on the inputs needed to satisfy the obligations. Generally, performance obligations satisfied over time relate to patients receiving inpatient acute care services. Virtua measures performance obligations from admission to the point when there are no further services required for the patient, which is generally the time of discharge. Virtua recognizes revenues for performance obligations satisfied at a point in time, which generally relate to patients receiving outpatient services, when: (1) services are provided; and (2) when it is believed the patient does not require additional services.

Virtua determines estimates of contractual adjustments and discounts based on government regulations, contractual agreements, discount policies and historical experience, as applicable. Virtua determines its estimate of implicit price concessions based on historical collection experience within each class of patients using a portfolio approach as a practical expedient to account for patient contracts as collective groups rather than individually. The financial statement effects of using this practical expedient are not materially different from an individual contract approach.

18. Performance Indicator

The consolidated statements of operations and changes in net assets include as the performance indicator the (deficit in) excess of revenue and nonoperating gains (losses), net over expenses. Transactions deemed by management to be ongoing, major, or central to the provision of health care services are reported as revenue and expenses. Other transactions, including investment income, realized gains and losses on the sale of investments, and changes in unrealized gains and losses on investments designated as trading, are reported as investment return. Changes in net assets without donor restrictions that are excluded from the (deficit in) excess of revenue and nonoperating gains (losses), net over expenses include net assets released from restrictions for property, plant, and equipment, and other changes in accrued retirement benefits.

19. Advertising Costs

Virtua expenses advertising costs as incurred. For the years ended December 31, 2018 and 2017, Virtua incurred advertising costs of \$5,994 and \$10,821, respectively, which are included in other operating expenses in the accompanying consolidated statements of operations and changes in net assets.

20. Tax Status

Virtua, excluding VAI, VPP, VRI, Voorhees Endo Holding, SCA Holdings, Virtua-USP Princeton and Emmaus Holdings, are not-for-profit corporations as described in Section 501(c)(3) of the Internal Revenue Code (the "Code") and are exempt from federal income taxes on related income pursuant to Section 501(a) of the Code. The not-for-profit affiliates of Virtua, except for VMG, are also exempt from state income taxes. Income taxes are not material to the consolidated financial statements.

(Continued)

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED**

December 31, 2018 and 2017

(Dollars in thousands)

NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

21. Pending Accounting Pronouncement

In February 2016, the FASB issued ASU No. 2016-02, *Leases*, as amended, which requires (1) most leases to be recognized on the balance sheet and (2) disclosure about leasing arrangements. The new standard is effective for fiscal years beginning after December 15, 2018. The new standard establishes a right-of-use (“ROU”) model that requires a lessee to recognize a ROU asset and lease liability on the balance sheet for all leases with a term longer than 12 months. Leases will be classified as finance or operating, with classification affecting the pattern and classification of expense recognition in the statement of operations.

Virtua adopted the new standard on January 1, 2019 and elected the option to apply the transition requirements in the standard. Consequently, financial information will not be updated and the disclosures required under the standard will not be provided for dates and periods before January 1, 2019.

The new standard provides a number of optional practical expedients in transition. Virtua has elected the “package of practical expedients,” which permits entities to not reassess conclusions prior to the implementation of the new standard about lease identification, lease classification and initial direct costs.

The new standard will have a material effect on Virtua’s consolidated financial statements. The most significant effects of adoption relate to: (1) the recognition of new ROU assets and lease liabilities on the consolidated balance sheet for existing real estate and equipment operating leases; (2) the reclassification of existing liabilities for deferred rent related to the straight-line expense of rent payments for leases previously recorded as operating leases; (3) the reclassification of advance rental payments; and (4) providing significant new disclosures about leasing activities.

The impact on the consolidated balance sheet upon adoption is as follows:

- Recognize operating lease liabilities of approximately \$124,000 based on the present value of the remaining minimum rental payments for existing operating leases.
- Recognize corresponding ROU assets of approximately \$110,000 based on the operating lease liabilities, net of the reclassification of \$14,138 of deferred straight-line rent liabilities.
- Reclassify from other assets the advanced rental payments of \$11,580 to the ROU asset category.

The new standard also provides practical expedients for an entity’s ongoing accounting. Virtua has elected the short-term lease recognition exemption for all leases that qualify. This means, for those leases that qualify, Virtua will not recognize ROU assets or lease liabilities, and this includes not recognizing ROU assets or lease liabilities for existing short-term leases of those assets in transition.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED**

December 31, 2018 and 2017

(Dollars in thousands)

**NOTE C - LIQUIDITY AND AVAILABILITY OF RESOURCES**

As of December 31, 2018, the adjusted working capital was \$1,057,469 and the adjusted average days' cash on hand was 317 days, both of which include the assets limited as to use by Board of Trustees' designation.

Financial assets available for general expenditure within one year of the consolidated balance sheet date consist of the following at December 31, 2018:

Cash	\$ 44,109
Patient accounts receivable	143,641
Assets limited as to use by Board of Trustees' designation	<u>1,019,812</u>
	<u>\$ 1,207,562</u>

Excess cash is invested in accordance with the Board of Trustees' investment policy and there are no investments with purchase commitments at December 31, 2018.

In addition to its liquid resources and cash provided by operating activities, Virtua has \$75,967, of unused lines of credit (Note J) for future operating needs.

**NOTE D - CHARITY CARE AND STATE SUBSIDY**

Virtua provides care to all in need of medical assistance, irrespective of their ability to pay. Many patients cared for at Virtua do not have health insurance or the ability to pay for the cost of their care. A portion of Virtua's operating expense is associated with providing care to these community members, for which Virtua is not directly compensated. Uninsured patients may qualify for financial assistance under the provisions of two separate programs. Some will qualify for assistance under the State of New Jersey's Hospital Care Payment Assistance Program ("Charity Care Assistance"). The eligibility criterion for this program includes both an income and an asset test. Individuals with incomes up to 300% of the federal poverty guidelines can qualify for assistance. Virtua recognized that some uninsured patients will not qualify for assistance under the state program or will not go through the process of applying for assistance under this program. With the goal of being able to provide financial assistance to a larger population of uninsured patients, Virtua established its own reduced-fee Charity Assistance Program ("CAP"). The qualification criterion for CAP is substantially less restrictive than the state program, having no asset test and providing assistance to those with incomes up to 500% of the federal poverty guidelines. Patients qualifying for these programs receive services without charge or at amounts less than established charges. Virtua maintains records to identify and monitor the level of financial assistance provided under both programs. Included in the records is the amount of forgone patient service revenue furnished as charity care.

Under a provision of the Affordable Care Act, the State of New Jersey opted to accept federal government funding to expand the eligibility for enrolling in the state's Medicaid program.

(Continued)

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED**

December 31, 2018 and 2017

(Dollars in thousands)

## NOTE D - CHARITY CARE AND STATE SUBSIDY - Continued

Cost of providing charity care, based on Virtua's estimated cost-to-charge ratios, for the years ended December 31, 2018 and 2017, is as follows:

	<u>2018</u>	<u>2017</u>
State of New Jersey Program	\$ 10,300	\$ 12,436
Virtua Charity Assistance Program	<u>8,001</u>	<u>6,303</u>
	<u>\$ 18,301</u>	<u>\$ 18,739</u>

Virtua received \$1,151 and \$893 of State of New Jersey Charity Care Subsidy Funds for the years ended December 31, 2018 and 2017, respectively, which is recorded in net patient service revenue in the consolidated statements of operations and changes in net assets.

## NOTE E - NET PATIENT SERVICE REVENUE

Net patient service revenue recognized from major payer sources based on primary insurance designation for the years ended December 31, 2018 and 2017, is as follows:

	<u>2018</u>	<u>2017</u>
Managed care	68%	69%
Medicare and Medicaid	25	26
Other third-party payers	5	4
Self-pay	<u>2</u>	<u>1</u>
	<u>100%</u>	<u>100%</u>

Inpatient acute care services for Medicare and Medicaid program beneficiaries and outpatient services for Medicare beneficiaries are paid at prospectively determined rates per discharge or outpatient service. These rates vary according to a patient classification system that is based on clinical, diagnostic and other factors.

Outpatient services for Medicaid beneficiaries, defined Medicare program pass-through items, and certain other costs provisionally reimbursed by Medicare, are paid based on a cost reimbursement methodology or tentative rate. These are ultimately subjected to certain cost limitations or contingent on actual data for the year, with final settlement determined after submission of annual cost reports by Virtua and audits thereof, by the programs' fiscal intermediaries.

(Continued)

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED**

December 31, 2018 and 2017

(Dollars in thousands)

NOTE E - NET PATIENT SERVICE REVENUE - Continued

The Centers for Medicare and Medicaid Services (“CMS”) previously approved the State of New Jersey’s proposal under Section 1115 of the Social Security Act to implement a mandatory Medicaid managed care program, which requires certain Medicaid beneficiaries to enroll in approved managed care plans. In addition, certain Medicare beneficiaries may opt for coverage through federally approved managed care plans. Payments to Virtua for these Medicaid and Medicare beneficiaries are based upon the rates negotiated with these plans.

The Medicare cost reports have been audited and finalized through December 31, 2015, except for December 31, 2011 and 2015 for Virtua-Memorial. The Medicaid cost reports have been audited and finalized through December 31, 2015. Virtua also has outstanding appeal issues relating to prior-year settled cost reports. Differences between the estimated settlements and the amounts settled are recorded in the year of settlement.

Estimated favorable results of appeal items are recorded when realization is reasonably assured. These estimates are included in estimated settlements due to third-party payers in the consolidated balance sheets. Effective January 1, 2018, management has elected to use the expected-value method when determining these amounts. In the opinion of management, adequate provision has been made for any adjustment, which may result from the final settlement of these cost reports, and any appeal issues. For the years ended December 31, 2018 and 2017, net patient service revenue includes net favorable settlements and adjustments for cost reports, audit and appeal items from prior years of \$7,077 and \$10,182, respectively.

Laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation, and noncompliance could result in significant regulatory action, including fines and penalties. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term. Virtua believes that it is in compliance with applicable laws and regulations and is not aware of any pending or threatened investigations involving allegations of potential wrongdoing. While no such regulatory inquiries have been made, compliance with such laws and regulations can be subjected to future government review and interpretations as well as significant regulatory action, including fines, penalties, and exclusion from the Medicare and Medicaid programs. Virtua has a corporate compliance program to monitor compliance with these laws and regulations.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED**

December 31, 2018 and 2017

(Dollars in thousands)

## NOTE F - ASSETS LIMITED AS TO USE

Investments and assets limited as to use, stated at fair value as of December 31, 2018 and 2017, consist of the following:

	<u>2018</u>	<u>2017</u>
By Board of Trustees' designation:		
Cash and short-term investments	\$ -	\$ 1
Mutual and private placement funds - fixed income	514,097	525,416
Mutual and private placement funds - equity	<u>505,715</u>	<u>562,200</u>
	<u>\$ 1,019,812</u>	<u>\$ 1,087,617</u>
Other designated funds:		
Cash and short-term investments	\$ -	\$ 11
Mutual and private placement funds - fixed income	142,792	139,961
Mutual and private placement funds - equity	<u>140,473</u>	<u>149,690</u>
	283,265	289,662
Less assets limited as to use that are required for current liabilities	<u>(9,943)</u>	<u>(6,536)</u>
	<u>\$ 273,322</u>	<u>\$ 283,126</u>
	<u>2018</u>	<u>2017</u>
Under debt agreements:		
Cash and short-term investments	\$ 27,504	\$ 10,085
U.S. government obligations	<u>13,680</u>	<u>25,969</u>
	41,184	36,054
Less assets limited as to use that are required for current liabilities	<u>(14,567)</u>	<u>(9,729)</u>
	<u>\$ 26,617</u>	<u>\$ 26,325</u>
Under debt agreements, assets are maintained for the following purposes:		
Debt service reserve fund	\$ 26,513	\$ 26,286
Debt service interest fund	9,620	9,745
Debt service principal fund	<u>5,051</u>	<u>23</u>
	<u>\$ 41,184</u>	<u>\$ 36,054</u>

(Continued)

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED**

December 31, 2018 and 2017

(Dollars in thousands)

NOTE F - ASSETS LIMITED AS TO USE - Continued

Trust funds:

Cash and short-term investments	\$ 604	\$ 990
Mutual and private placement funds - fixed income	2,111	3,003
Mutual and private placement funds - equity	1,510	6,633
Investment contract	<u>891</u>	<u>2,845</u>
	<u>\$ 5,116</u>	<u>\$ 13,471</u>

Donor-restricted funds:

Cash and short-term investments	\$ 81	\$ 107
Mutual and private placement funds - fixed income	6,920	8,379
Mutual and private placement funds - equity	<u>7,074</u>	<u>9,381</u>
	<u>\$ 14,075</u>	<u>\$ 17,867</u>

Investment income and realized and unrealized gains and losses, net of fees for assets limited as to use and cash equivalents for the years ended December 31, 2018 and 2017, are composed of the following:

	<u>2018</u>	<u>2017</u>
Other revenue - investment returns	<u>\$ 61</u>	<u>\$ 90</u>
Nonoperating (losses) gains, net:		
Investment income:		
Interest and dividend income	\$ 197	\$ 137
Net realized gains and losses on sales of investments	26,020	126,911
Net change in unrealized gains and losses on trading securities	(88,735)	31,880
Investment management fees	<u>(5,109)</u>	<u>(5,513)</u>
	<u>\$ (67,627)</u>	<u>\$ 153,415</u>
Net assets with donor restrictions - net realized and unrealized loss	<u>\$ (108)</u>	<u>\$ 271</u>

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED**

December 31, 2018 and 2017

(Dollars in thousands)

NOTE G - FAIR VALUE MEASUREMENTS

Fair Value Measurements

Virtua classifies its investments into: Level 1, which refers to securities valued using quoted prices from active markets for identical assets; Level 2, which refers to securities not traded on an active market, but for which observable market inputs are readily available; and Level 3, which refers to securities valued based on significant unobservable inputs. Assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement.

Asset Valuation Techniques

Valuation techniques maximize the use of relevant observable inputs and minimize the use of unobservable inputs. The following is a description of the valuation methodologies used for assets measured at fair value. There have been no changes in the methodologies used at December 31, 2018 and 2017.

*Mutual Funds* - Fair value estimates for publicly traded mutual funds are based on quoted market prices and/or other market data for the same or comparable instruments and transactions in establishing the prices. Such mutual funds are actively traded and are classified as Level 1.

*U.S. Government Obligations* - The fair value of the U.S. government obligations reported as Level 2 has been determined using quoted market prices for similar instruments.

*Investment Contract* - The fair value of the investment contract is provided by the respective insurance company and is equal to the funds deposited by Virtua and accrued income. The investment contract is reported as Level 3.

*Beneficial Interest in Perpetual Trust* - The estimated fair value of the beneficial interest in perpetual trust is determined based upon information provided by the trustee. Such information is based on the pro rata interest in the net assets of the trust. The assets held in the trust consist primarily of cash equivalents and marketable securities. The fair value of the perpetual trust is measured using the fair value of the underlying investments and is reported as Level 3.

*Private Placement Funds* - The fair value of private placement funds has been determined using the net asset value ("NAV") of the funds as provided by the respective fund managers. The NAV is used as a practical expedient to estimate fair value and is excluded from the fair value hierarchy. The underlying investments of these funds consist of securities with readily determinable market values.

The valuation methods as described above may produce a fair value that may not be indicative of what management would realize upon disposition or reflective of future fair values. Furthermore, although management believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different fair value measurement at the reporting date.

(Continued)

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED**

December 31, 2018 and 2017

(Dollars in thousands)

## NOTE G - FAIR VALUE MEASUREMENTS - Continued

As of December 31, 2018 and 2017, there were no withdrawal restrictions or unfunded commitments on investments reported at NAV and the investment contract.

The information as of December 31, 2018 and 2017, about Virtua's financial assets that are measured at fair value on a recurring basis using the market approach, is as follows:

	2018			
	<u>Total</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Assets				
Cash and short-term investments	\$ 28,189	\$ 28,189	\$ -	\$ -
Mutual funds:				
U.S. equity	2,307	2,307	-	-
International equity	441	441	-	-
U.S. fixed income	1,826	1,826	-	-
International fixed income	165	165	-	-
Real estate	105	105	-	-
U.S. government obligations	13,680	-	13,680	-
Investment contract	891	-	-	891
Beneficial interest in perpetual trust	<u>7,459</u>	<u>-</u>	<u>-</u>	<u>7,459</u>
	<u>55,063</u>	<u>\$ 33,033</u>	<u>\$ 13,680</u>	<u>\$ 8,350</u>
Private placement funds (at NAV):				
Fixed income <sup>(a)</sup>	663,328			
Domestic equity <sup>(b)</sup>	351,422			
International equity <sup>(c)</sup>	<u>301,098</u>			
	<u>1,315,848</u>			
	<u>\$ 1,370,911</u>			

(Continued)

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

December 31, 2018 and 2017

(Dollars in thousands)

## NOTE G - FAIR VALUE MEASUREMENTS - Continued

	2017			
	Total	Level 1	Level 2	Level 3
Assets				
Cash and short-term investments	\$ 11,194	\$ 11,194	\$ -	\$ -
Mutual funds:				
U.S. equity	6,001	6,001	-	-
International equity	1,025	1,025	-	-
U.S. fixed income	3,433	3,433	-	-
International fixed income	80	80	-	-
Real estate	479	479	-	-
U.S. government obligations	25,969	-	25,969	-
Investment contract	2,845	-	-	2,845
Beneficial interest in perpetual trust	<u>8,530</u>	<u>-</u>	<u>-</u>	<u>8,530</u>
	<u>59,556</u>	<u>\$ 22,212</u>	<u>\$ 25,969</u>	<u>\$ 11,375</u>
Private placement funds (at NAV):				
Fixed income <sup>(a)</sup>	673,246			
Domestic equity <sup>(b)</sup>	393,754			
International equity <sup>(c)</sup>	<u>326,645</u>			
	<u>1,393,645</u>			
	<u>\$ 1,453,201</u>			

- (a) Fixed income - Seeks favorable returns comparable to the broad fixed-income market by investing in bonds representing diverse sectors and maturities.
- (b) Domestic equity - Seeks to provide long-term capital growth, by investing in common stocks of U.S. companies with various capitalizations, while managing volatility and maintaining diversification.
- (c) International equity - Seeks high, long-term returns comparable to the broad international stock market by investing in companies from developed and emerging countries around the world.

(Continued)

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED**

December 31, 2018 and 2017

(Dollars in thousands)

## NOTE G - FAIR VALUE MEASUREMENTS - Continued

Transfers Between Levels

The availability of observable market data is monitored to assess the appropriate classification of financial instruments within the fair value hierarchy. Changes in economic conditions or model-based valuation techniques may require the transfer of financial instruments from one fair value level to another. In such instances, the transfer is reported during the reporting period.

There were no transfers into or out of the levels per the tables above, for the years ended December 31, 2018 and 2017.

The table below sets forth the change in the fair value of investments measured using significant unobservable inputs (Level 3) for the years ended December 31, 2018 and 2017, as follows:

	Investment contract	Beneficial interest in perpetual trusts	Total
Balance - December 31, 2016	\$ 2,964	\$ 7,939	\$ 10,903
Net realized gains	28	-	28
Net unrealized gains	63	591	654
Purchases	302	-	302
Sales	<u>(512)</u>	<u>-</u>	<u>(512)</u>
Balance - December 31, 2017	2,845	8,530	11,375
Net realized gains	141	-	141
Net unrealized losses	(116)	(1,071)	(1,187)
Purchases	172	-	172
Sales	<u>(2,151)</u>	<u>-</u>	<u>(2,151)</u>
Balance - December 31, 2018	<u>\$ 891</u>	<u>\$ 7,459</u>	<u>\$ 8,350</u>

## NOTE H - INVESTMENT IN UNCONSOLIDATED JOINT VENTURES

Virtua and physicians located throughout New Jersey have joined together, along with other non-related for-profit investors, to expand surgical and certain other services within the physicians' local communities through jointly owned ventures. These ventures are for-profit organizations. Virtua also has ownership in a medical revenue cycle joint venture that provides billing services to physician practices.

(Continued)

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

December 31, 2018 and 2017

(Dollars in thousands)

## NOTE H - INVESTMENT IN UNCONSOLIDATED JOINT VENTURES - Continued

Specifically related to the Voorhees Endo Holding, SCA Holdings, Virtua-USP Princeton and Emmaus Holdings joint ventures, the operating agreements do not allow Virtua, Voorhees Endo Holding, SCA Holdings, Virtua-USP Princeton and Emmaus Holdings to control operating or financial decisions related to the ventures. Virtua does, however, consolidate Voorhees Endo Holdings, SCA Holdings, Virtua-USP Princeton and Emmaus Holdings with a non-controlling interest. Regardless of the proportionate ownership of capital investment in these physician ventures, all decisions are made by the respective venture's operating board. In each case, the operating board is composed equally of members appointed by Virtua and the physician investors as a group. Accordingly, Virtua, Voorhees Endo Holding, SCA Holdings, Virtua-USP Princeton and Emmaus Holdings account for their interest in these ventures on the equity method of accounting.

The balances for these statements are as follows:

	Membership percentage		Investment in unconsolidated affiliates		Equity earnings in unconsolidated affiliates	
	December 31,		December 31,		Year ended December 31,	
	2018	2017	2018	2017	2018	2017
Virtua-Memorial:						
Memorial Ambulatory Surgery Center, LLC	55.59%	55.59%	\$ 547	\$ 473	\$ 616	\$ 864
Vantage Surgical Center, LLC	51.00%	51.00%	1,742	1,010	755	935
Burlington County Endoscopy Center, LLC	52.00%	52.00%	6,869	6,891	3,121	3,394
SCA Holdings:	51.00%	51.00%				
Seashore Surgical Institute, LLC <sup>(a)</sup>	-	-	7,273	7,159	1,770	947
Surgicare of Central Jersey, LLC <sup>(a)</sup>	-	-	14,568	15,234	1,966	2,855
Bergen-Passaic Eye Surgery Center <sup>(a)</sup>	-	-	5,620	5,861	2,537	2,390
Virtua-USP Princeton	68.20%	68.20%				
Surgical Specialist at Princeton, LLC <sup>(b)</sup>	-	-	10,594	10,567	2,913	2,190
Emmaus Holdings, LLC <sup>(d)</sup>	50.10%	-				
Emmaus Surgical Center, LLC			7,086	-	176	-
Virtua-West Jersey:						
Summit Surgical, LLC	62.30%	62.80%	9,678	9,860	2,415	2,815
South Jersey Musculoskeletal Institute, LLC	52.60%	51.53%	1,530	1,273	3,735	3,615
Ambulatory Surgery Center at Virtua						
Washington Township, LLC	62.06%	62.91%	1,077	1,337	890	1,169
Jersey Shore, LLC	51.26%	51.00%	11,052	11,212	2,025	2,526
Ramapo Valley Surgical	53.91%	53.91%	9,321	9,289	1,375	1,079
Virtua Adult Imaging Services	50.00%	50.00%	5,091	4,956	2,454	2,564
Center for Ambulatory and Minimally Invasive Surgery, LLC	55.11%	56.13%	12,969	13,426	3,229	3,596
Freehold Endoscopy Associates, LLC	60.00%	62.75%	8,188	8,737	2,612	2,649
Gastro-Surgi Center of New Jersey, LLC	51.00%	51.00%	12,333	12,354	2,867	2,745
Presenius Medical Care, LLC	30.00%	30.00%	951	877	74	(92)
Virtua Penn Radiation Oncology Leasing, LLC	50.00%	-	6,730	-	489	-
Virtua Penn Radiation Oncology Partners, LLC	51.00%	51.00%	15,597	15,241	1,325	732
Voorhees Endo Holding:						
The Voorhees NJ Endoscopy ASC, LLC <sup>(c)</sup>	51.00%	51.00%	12,853	12,805	9,074	9,444
VRI:						
Acentus Practice Management, LLC	50.00%	50.00%	1,280	320	3,059	(55)
			<u>\$ 162,949</u>	<u>\$ 148,882</u>	<u>\$ 49,477</u>	<u>\$ 46,362</u>

(Continued)

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED**

December 31, 2018 and 2017

(Dollars in thousands)

**NOTE H - INVESTMENT IN UNCONSOLIDATED JOINT VENTURES - Continued**

- (a) As of December 31, 2018, SCA Holdings owns 52.11% of Seashore Surgical Institute, LLC, 55.00% of Surgicare of Central Jersey, LLC, and 56.13% of Bergen-Passaic Eye Surgery Center. Virtua-Memorial holds a 51.00% membership percentage of SCA Holdings and effectively owns a 26.58% interest in Seashore Surgical Institute, LLC, a 28.05% interest in Surgicare of Central Jersey, LLC, and a 28.63% interest in Bergen-Passaic Eye Surgery Center. As of December 31, 2017, SCA Holdings owned 52.00% of Seashore Surgical Institute, LLC, 55.00% of Surgicare of Central Jersey, LLC, and 57.00% of Bergen-Passaic Eye Surgery Center. Virtua-Memorial held a 51.00% membership percentage of SCA Holdings and effectively owned a 26.52% interest in Seashore Surgical Institute, LLC, a 28.05% interest in Surgicare of Central Jersey, LLC, and a 29.07% interest in Bergen-Passaic Eye Surgery Center.
- (b) Virtua-USP Princeton owns 55% of Surgical Specialists at Princeton, LLC as of December 31, 2018 and 2017. Virtua-Memorial holds a 68.2% membership percentage of Virtua-USP Princeton and thus effectively owns a 37.51% interest in Surgical Specialists at Princeton, LLC.
- (c) Voorhees Endo Holding owns 51% of The Voorhees NJ Endoscopy ASC, LLC as of December 31, 2018 and 2017. Virtua-West Jersey holds a 51% membership percentage in The Voorhees Endo Holding and thus effectively owns a 26% interest in the Voorhees NJ Endoscopy ASC, LLC.
- (d) Emmaus Holdings, LLC owns 50.10% of the Emmaus Surgical Center, LLC as of December 31, 2018. Virtua-West Jersey holds a 50.10% membership percentage in Emmaus Holdings and thus effectively owns a 25.10% interest in the Emmaus Surgical Center, LLC.

Operating revenues for the combined group of ventures accounted for under the equity method of accounting were \$239,859 and \$220,843 for the years ended December 31, 2018 and 2017, respectively.

Virtua provides employee leasing, rental, and management services to several of its joint ventures. The total revenue, included in other revenue, from these services was \$15,764 and \$13,428 for the years ended December 31, 2018 and 2017, respectively. The total amounts receivable, included in other current assets, related to these services are \$2,289 and \$2,216 at December 31, 2018 and 2017, respectively.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED**

December 31, 2018 and 2017

(Dollars in thousands)

NOTE I - PROPERTY, PLANT, AND EQUIPMENT

Property, plant, and equipment at December 31, 2018 and 2017, consisted of the following:

	<u>2018</u>	<u>2017</u>
Land	\$ 94,249	\$ 94,249
Land improvements	69,104	66,546
Buildings and improvements	682,799	661,192
Fixed equipment	250,099	242,131
Furniture and equipment	<u>778,375</u>	<u>645,170</u>
	1,874,626	1,709,288
Less accumulated depreciation	<u>(1,048,003)</u>	<u>(979,463)</u>
	826,623	729,825
Construction in progress	<u>57,309</u>	<u>120,313</u>
	<u>\$ 883,932</u>	<u>\$ 850,138</u>

Depreciation expense related to property, plant, and equipment was \$95,583 and \$89,675 for the years ended December 31, 2018 and 2017, respectively.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED**

December 31, 2018 and 2017

(Dollars in thousands)

## NOTE J - LONG-TERM DEBT

Long-term debt at December 31, 2018 and 2017, consisted of the following:

	<u>2018</u>	<u>2017</u>
New Jersey Health Care Facilities Financing Authority (“NJHCFFA”):		
\$11,000 Virtua Health Issue, Series 2003 A-7 Variable Rate Revenue Bonds Composite Program - less issuance cost of \$2 at December 31, 2017 <sup>(a)</sup>	\$ -	\$ 898
\$60,000 Virtua Health Issue, Series 2004 Variable Rate Revenue Bonds - less issuance cost of \$248 and \$274 at December 31, 2018 and 2017, respectively <sup>(b)</sup>	48,477	49,271
\$379,645 Virtua Health Issue, Series 2009A Fixed Rate Revenue Bonds - less net original issue discount and issuance cost of \$5,668 and \$6,110 at December 31, 2018 and 2017, respectively <sup>(c)</sup>	224,447	224,005
\$185,000 Virtua Health Issue, Series 2009B-E Variable Rate Revenue Bonds - less issuance cost of \$1,403 and \$1,465 at December 31, 2018 and 2017, respectively <sup>(d)</sup>	183,597	183,535
\$47,085 Virtua Health Issue, Series 2011 Fixed Rate Revenue and Refunding Bonds - less issuance cost of \$2 at December 31, 2017 <sup>(e)</sup>	-	1,848
\$140,020 Virtua Health Issue, Series 2013 Fixed Rate Revenue and Refunding Bonds - plus net original issue premium and issuance cost of \$5,648 and \$6,528 at December 31, 2018 and 2017, respectively <sup>(f)</sup>	<u>137,378</u>	<u>146,083</u>
	593,899	605,640
Less current maturities of long-term debt	<u>(11,780)</u>	<u>(11,395)</u>
	<u>\$ 582,119</u>	<u>\$ 594,245</u>

- <sup>(a)</sup> The NJHCFFA Variable Rate Revenue Bonds, Virtua Health Issue, Series 2003 A-7 (the “Series 2003 Bonds”) were issued for funding and reimbursing costs of various capital improvements and equipment purchases by Virtua Health, Inc., Virtua-Memorial, and Virtua-West Jersey. The final principal payment was made on July 1, 2018. Interest was payable monthly at a variable rate not to exceed 12%. The interest rate was 1.74% at December 31, 2017.

(Continued)

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED**

December 31, 2018 and 2017

(Dollars in thousands)

NOTE J - LONG-TERM DEBT - Continued

- (b) The NJHCFFA Variable Rate Revenue Bonds, Virtua Health Issue, Series 2004 (the “Series 2004 Bonds”) were issued for the purpose of refinancing the 2001 Capital Asset Program loan and funding and reimbursing costs of various capital improvements and equipment purchases by Virtua-Memorial and Virtua-West Jersey. Annual principal payments range from \$1,785 to \$6,385, maturing on July 1 of each year through 2033. Interest is payable monthly at a variable rate not to exceed 10%. The interest rate was 1.64% and 1.74% at December 31, 2018 and 2017, respectively. The Series 2004 Bonds are variable rate demand bonds secured by an irrevocable letter of credit with a bank, which expires on May 31, 2021. No amounts were outstanding on the letter of credit at December 31, 2018 and 2017.
- (c) The NJHCFFA Fixed Rate Revenue Bonds, Virtua Health Issue, Series 2009A (the “Series 2009A Bonds”) bear interest between 5.50% and 5.75%, payable on January 1 and July 1. Annual principal payments on the Series 2009A Bonds range from \$5,455 to \$33,430, mature beginning on July 1, 2020 annually through 2038. A portion of the Series 2009A Bonds are insured by Assured Guaranty Corp. (“Assured”) for \$161,650 with the remaining bonds uninsured for \$68,465 at December 31, 2018. Bond proceeds were used for constructing and equipping the Voorhees replacement hospital, funding capitalized interest, funding a Debt Service Reserve Fund, and paying certain finance costs.
- (d) NJHCFFA Variable Rate Revenue Bonds, Virtua Health Issue, Series 2009B-E (the “Series 2009B-E Bonds”) were issued in connection with the Series 2009A Bonds for the purpose of constructing and equipping the Voorhees replacement hospital, funding capitalized interest, and paying certain finance costs. Annual principal payments range from \$34,820 to \$39,245, mature beginning on July 1, 2039 annually through 2043. Interest is payable monthly at a variable rate not to exceed 12%. The interest rates were 1.28%, 1.25%, 1.65%, and 1.60% at December 31, 2018 and 1.65%, 1.80%, 1.80%, and 1.53% at December 31, 2017, respectively. The Series 2009B-E Bonds are variable rate demand bonds secured by irrevocable letters of credit with two banks; with one bank for Series B-C providing two letters of credit for a total of \$100,000, which expire on January 2, 2020; and another bank for Series D-E providing two letters of credit for a total of \$85,000, which expire on January 2, 2021. No amounts were outstanding on the letters of credit at December 31, 2018 and 2017.
- (e) The NJHCFFA Fixed Rate Revenue and Refunding Bonds, Virtua Health Issue, Series 2011 (the “Series 2011 Bonds”) bore interest at 1.96%, payable on January 1 and July 1. The final principal payment on the Series 2011 Bonds was made on July 1, 2018. The Series 2011 Bonds were issued to refinance a portion of Series 1998 Bonds.
- (f) The NJHCFFA Fixed Rate and Revenue Refunding Bonds, Virtua Health Issue, Series 2013 (the “Series 2013 Bonds”) were issued to refund the outstanding Series 1998 Bonds and certain Series 2009A Bonds and pay for costs of issuance of the Series 2013 Bonds. The Series 2013 Bonds bear interest between 3.00% and 5.00%, payable on January 1 and July 1. Annual principal payments range from \$4,975 to \$15,515, maturing on July 1 of each year through 2029.

(Continued)

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED**

December 31, 2018 and 2017

(Dollars in thousands)

## NOTE J - LONG-TERM DEBT - Continued

Original issue discounts/premiums and debt issuance costs for indebtedness are being amortized over the term of the related debt using the effective interest method.

Under the terms of its bond trust agreements, Virtua has the option to convert the variable rate demand bonds to a fixed rate term mode. For all series of variable rate demand bonds backed by bank letters of credit and subjected to remarketing agreements, in the event that any or all of the bonds are tendered by the bondholder and are unable to be remarketed, the letters of credit are drawn upon by the bond trustee to purchase the unremarketed bonds. Draws for this purpose under the letters of credit are repaid with interest over a period of one to three years under existing term-out provisions, noting certain bonds have a one-year interest-only period prior to the repayment period. All series of variable rate demand bonds are subjected to mandatory tender for purchase prior to the expiration of the letter of credit if a substitute facility has not been made effective. The Series 2009 B-C Bonds have a three-year loan provision for converting a letter of credit draw for the purchase of bonds in connection with the letter of credit expiration.

The Series 2004, 2009A, 2009B-E, and 2013 Bonds are all secured equally and ratably on a parity basis by notes issued under the master trust indenture (the "Master Trust Indenture"), with Virtua Health, Inc., Virtua-West Jersey, and Virtua-Memorial as obligated issuers (the "Virtua Obligated Group"). The notes are secured by a pledge of gross receipts of the Virtua Obligated Group and a mortgage on the Voorhees replacement hospital. The Virtua Obligated Group is obligated to pay the principal or redemption price and interest on the bonds under loan agreements with the NJHCFEA. The Master Trust Indenture and other bond agreements require the Virtua Obligated Group to comply with certain financial covenants. At December 31, 2018 and 2017, the Virtua Obligated Group has complied with all financial covenants related to the bonds.

Future Principal Payments

Principal payments on long-term debt for the next five years and thereafter are as follows:

Year ending December 31,	
2019	\$ 11,780
2020	12,290
2021	12,855
2022	13,355
2023	13,935
Thereafter	<u>531,355</u>
	<u>\$ 595,570</u>

(Continued)

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED**

December 31, 2018 and 2017

(Dollars in thousands)

NOTE J - LONG-TERM DEBT - Continued

Lines and Letters of Credit

Virtua has a revolving credit line in place with a bank for \$30,000, with the interest rate based on the London Inter Bank Offered Rate (“LIBOR”), plus 75 basis points (the one-month LIBOR was 2.52% and 1.56% at December 31, 2018 and 2017, respectively), or the bank’s prime rate, minus 50 basis points (the prime rate was 5.50% and 4.50% at December 31, 2018 and 2017, respectively), which expires on December 31, 2019. There were no amounts outstanding under the line of credit at December 31, 2018 and 2017. The line of credit has a provision for letters of credit. There was \$4,033 in letters of credit commitments at December 31, 2018, which was not drawn upon, with expiration dates in 2019 in connection with Virtua’s insurance captive and a capital project.

Virtua has bank agreements for two additional lines of credit of \$25,000 for each line with expiration dates in December 2019 and January 2020. The interest rate for one line is based on LIBOR, plus 65 basis points, or the prime rate, minus 150 basis points, with the rate on the other line at LIBOR, plus 75 basis points, or the prime rate. There were no amounts outstanding on the lines of credit at December 31, 2018 and 2017.

Fair Value

Virtua uses current quoted market prices in estimating the fair value of its revenue bonds. The fair value of long-term debt at December 31, 2018 and 2017 is \$613,174 and \$637,477, respectively. Fair value of long-term debt was determined using the market approach, which is considered a Level 2 measurement.

NOTE K - RETIREMENT BENEFIT PLANS

Defined Contribution Plans

Virtua sponsors the Virtua 401(k) savings plan covering all nonbargaining unit employees and a group of bargaining unit employees. Employer contributions to the Virtua 401(k) savings plan are based on a formula as defined by the plan document.

Virtua also has a supplemental executive retirement plan (“SERP”) that covers a group of management designated by the Board of Trustees. The contributions to the plan are determined annually. The accrued benefit amount of this SERP as of December 31, 2018 and 2017, was \$5,368 and \$13,144, respectively, and is recorded in accrued retirement benefits in the consolidated balance sheets.

The amount of expense related to these two plans was \$16,304 and \$16,039 for the years ended December 31, 2018 and 2017, respectively, and is included in employees’ fringe benefits in the consolidated statements of operations and changes in net assets.

(Continued)

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED**

December 31, 2018 and 2017

(Dollars in thousands)

## NOTE K - RETIREMENT BENEFIT PLANS - Continued

Defined Benefit Plan

Virtua has a noncontributory defined benefit pension plan (the "Virtua Pension Equity Plan"), which used a pension equity plan formula for all nonbargaining unit employees and a portion of the bargaining unit employees through December 31, 2003. Effective January 1, 2004, benefits for nonbargaining employees who had not attained 50 years of age and 10 years of service as of December 31, 2003, were frozen. Nonbargaining unit employees who had attained 50 years of age and 10 years of service continue to accrue vesting and eligibility service. Also effective January 1, 2004, certain active bargaining unit employees who had attained both an age and years of service criteria by December 31, 2003, were provided the choice of accruing benefits in the Virtua 401(k) savings plan or accruing benefits under a legacy formula in the Virtua Pension Equity Plan. These changes were reflected as of January 1, 2004. The Virtua Pension Equity Plan uses a measurement date of December 31.

The information at December 31, 2018 and 2017, and for the years then ended, about the Virtua Pension Equity Plan is as follows:

	<u>2018</u>	<u>2017</u>
Weighted-average assumptions used to determine benefit obligations - end of year:		
Discount rate	3.74%	3.74%
Rate of compensation increase	3.00%	3.00%
Accumulated benefit obligation - end of year	\$ <u>241,556</u>	\$ <u>268,336</u>
Changes in benefit obligations:		
Benefit obligations - beginning of year	\$ 268,432	\$ 250,271
Service cost	1,132	1,116
Interest cost	9,690	10,305
Actuarial loss	(17,065)	25,303
Benefits paid	(21,353)	(18,563)
Special termination benefits	<u>735</u>	<u>-</u>
Benefit obligations - end of year	241,571	268,432
Changes in plan assets:		
Fair value of plan assets - beginning of year	250,722	229,901
Actual return on plan assets	(10,092)	27,383
Employer contribution	-	12,001
Benefits paid	<u>(21,353)</u>	<u>(18,563)</u>
Fair value of plan assets - end of year	<u>219,277</u>	<u>250,722</u>
Funded status of the plan - end of year	\$ <u>(22,294)</u>	\$ <u>(17,710)</u>

(Continued)

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED**

December 31, 2018 and 2017

(Dollars in thousands)

## NOTE K - RETIREMENT BENEFIT PLANS - Continued

	<u>2018</u>	<u>2017</u>
Amounts recognized in the consolidated balance sheets - noncurrent accrued retirement benefits	\$ <u>(22,294)</u>	\$ <u>(17,710)</u>
Amounts recognized in net assets without restrictions:		
Actuarial loss	\$ 122,217	\$ 118,097
Prior service cost	<u>258</u>	<u>267</u>
Total amounts recognized in net assets without restrictions	\$ <u>122,475</u>	\$ <u>118,364</u>
Components of net periodic benefit cost recognized in employee fringe benefits:		
Service cost	\$ <u>1,132</u>	\$ <u>1,116</u>
Components recognized in nonoperating gains and losses		
Interest cost	9,690	10,305
Expected return on plan assets	(14,946)	(14,121)
Amortization of actuarial loss	3,852	3,495
Amortization of prior service credit	11	11
Special termination benefits	<u>735</u>	<u>-</u>
	(658)	(310)
Total net periodic benefit cost	474	806
Other changes in accrued retirement benefits recognized in net assets without restrictions:		
Current-year actuarial loss	7,974	12,041
Recognized actuarial loss	(3,852)	(3,495)
Recognition of prior service cost	<u>(11)</u>	<u>(11)</u>
Total recognized in net assets without restrictions	<u>4,111</u>	<u>8,535</u>
Total recognized in net periodic benefit cost and change in net assets without restrictions	\$ <u>4,585</u>	\$ <u>9,341</u>
Weighted-average assumptions used to determine net periodic benefit cost:		
Discount rate	3.74%	4.22%
Expected long-term rate of return on plan assets	6.20%	6.40%
Rate of compensation increase	3.00%	3.00%

(Continued)

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED**

December 31, 2018 and 2017

(Dollars in thousands)

## NOTE K - RETIREMENT BENEFIT PLANS - Continued

To develop the expected long-term rate of return on assets assumption, Virtua considered the historical returns and the future expectations for returns for each asset class, as well as the target allocation of the pension portfolio. This resulted in the selection of the 6.20% and 6.40% expected return on plan assets for 2018 and 2017, respectively.

The Virtua Pension Equity Plan amortizes prior service cost as a result of plan amendments on a straight-line basis over the expected average future lifetime of active participants expected to benefit under the plan. Plan amendments for the prior West Jersey Health System Retirement Plan were amortized on a decreasing-amount basis, based on the expected future service of active participants as of the date first recognized in each future year.

The estimated net actuarial loss and prior service benefit that is expected to be amortized from net assets without restrictions into net periodic pension cost for the year ending December 31, 2019 is \$4,282 and \$11, respectively.

Plan Assets

The pension plan's actual weighted-average asset allocations and target asset allocations, by asset category as of December 31, 2018 and 2017, are as follows:

<u>Asset Category</u>	Target asset allocation range	2018	2017
Fixed income	30% - 80%	69%	69%
Equity securities	20% - 65%	27	26
Alternative investments/real estate	0% - 10%	<u>4</u>	<u>5</u>
		<u>100%</u>	<u>100%</u>

The investment policy and strategy for the pension plan assets has established guidelines for an asset mix that provides diversification to absorb risk while not sacrificing investment returns.

The fair value of the common/collective trust funds has been determined using the NAV of the funds as provided by the respective fund managers. There were no withdrawal restrictions or unfunded commitments on such funds.

(Continued)

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED**

December 31, 2018 and 2017

(Dollars in thousands)

## NOTE K - RETIREMENT BENEFIT PLANS - Continued

The plan assets in the defined benefit pension plan measured at fair value, using NAV, at December 31, 2018 and 2017, are as follows:

	<u>2018</u>	<u>2017</u>
Common/collective trust funds:		
Fixed income <sup>(a)</sup>	\$ 150,271	\$ 172,183
Domestic equity <sup>(b)</sup>	35,290	38,319
International equity <sup>(c)</sup>	24,065	26,881
U.S. real estate <sup>(d)</sup>	<u>9,651</u>	<u>13,339</u>
	<u>\$ 219,277</u>	<u>\$ 250,722</u>

- (a) Fixed income - Seeks favorable returns comparable to the broad fixed-income market by investing in bonds representing diverse sectors and maturities.
- (b) Domestic equity - Seeks to provide a long-term capital growth, by investing primarily in common stocks of U.S. companies with various capitalizations, while managing volatility and maintaining diversification.
- (c) International equity - Seeks long-term returns comparable to the broad international stock market by investing in companies from developed and emerging countries around the world.
- (d) U.S. real estate - Employs a multiadvisor, multifund approach to private core and enhanced core real estate investments with a focus on high current income. Manages risk through property type and regional diversification and generally limits portfolio leverage to 30%.

Cash Flows

*Contributions* - Virtua intends to make contributions to the plan assets, as necessary, that will ensure compliance with all provisions of the Pension Protection Act of 2006, as amended ("PPA").

Estimated future benefit payments:	
2019	\$ 17,636
2020	17,645
2021	18,179
2022	18,404
2023	18,109
2024-2028	82,823

(Continued)

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED**

December 31, 2018 and 2017

(Dollars in thousands)

NOTE K - RETIREMENT BENEFIT PLANS - Continued

Multi-employer Plan

Certain Virtua employees represented by a bargaining unit participate in a multi-employer pension plan based on a union-negotiated agreement. For these employees, Virtua contributes to the Central Pension Fund of the International Union of Operating Engineers and Participating Employers (the "Multi-employer Plan"). Participation in the Multi-employer Plan commences on the first of the month after the employee's successful completion of 90 days of employment. Contributions to the Multi-employer Plan are based on union employee worked hours and a negotiated contribution rate in accordance with the union's contractual arrangement.

Under the Employee Retirement Income Security Act of 1974, as amended by the Multi-employer Pension Plan Amendments Act of 1980, the risks of participating in multi-employer plans are different from single-employer plans in the following respects:

- Assets contributed to the multi-employer plan by one employer may be used to provide benefits to employees of other participating employers.
- If a participating employer stops contributing to the plan, the unfunded obligations of the plan may be borne by the remaining participating employers.
- If the employer chooses to stop participating in some of its multi-employer plans, the employer may be required to pay those plans an amount based on the underfunded status of the plan, referred to as a withdrawal liability.

Until such events above occur, Virtua's share, if any, of the unfunded vested liabilities cannot be determined. As of December 31, 2018, Virtua has no plans to withdraw from the Multi-employer Plan.

Virtua's participation in the Multi-employer Plan for the years ended December 31, 2018 and 2017, is outlined below:

- The Multi-employer Plan's Employer Identification Number is 36-6052390, and the three-digit plan number is 001.
- The PPA zone status is based on information that Virtua received from the Multi-employer Plan's sponsor and is certified by the Multi-employer Plan's actuary. The Multi-employer Plan is in the green zone, which indicates that it is at least 80% funded. The most recent PPA zone status available in 2018 and 2017 is for the Multi-employer Plan years ended January 31, 2018 and 2017, respectively.
- A financial improvement plan or a rehabilitation plan is neither pending nor has one been implemented for the Multi-employer Plan.

(Continued)

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED**

December 31, 2018 and 2017

(Dollars in thousands)

NOTE K - RETIREMENT BENEFIT PLANS - Continued

- Virtua was not required to pay a surcharge to the Multi-employer Plan.
- On March 15, 2018, the bargaining unit members voted to ratify a new three-year collective bargaining agreement to which the Multi-employer Plan is subjected. The contract expires on February 28, 2021.
- Virtua contributed \$4,272 and \$4,038 to the Multi-employer Plan for the years ended December 31, 2018 and 2017, respectively. Virtua did not contribute more than 5% of the total contributions to the Multi-employer Plan and was not listed in the Form 5500 for the Multi-employer Plan years ended January 31, 2018 and 2017.

At the date the consolidated financial statements were issued, the Form 5500 was not available for the Multi-employer Plan year ended January 31, 2018.

NOTE L - CONTINGENCIES AND COMMITMENTS

Operating Leases

Virtua maintains various operating lease agreements for space and equipment. Rent expense for the years ended December 31, 2018 and 2017 totaled \$57,748 and \$58,996, respectively. The future minimum rental commitments for all noncancelable operating leases as of December 31, 2018, are as follows:

Years ending December 31,	
2019	\$ 31,096
2020	25,700
2021	24,741
2022	16,505
2023	9,549
Thereafter	<u>32,530</u>
	<u>\$ 140,121</u>

Self-Insured Malpractice and General Liability and Litigation

Virtua's captive insurance company, VAI, commenced business principally to reinsure the primary layer of exposure underwritten by a third-party insurer for claims-made-basis hospital professional liability, physicians professional liability, and occurrence-basis general liability. For the years ended December 31, 2018 and 2017, malpractice professional liability coverage is limited to \$1,000 per claim and \$3,000 aggregate per facility, and general liability coverage is limited to \$1,000 per claim. In addition to the primary layer by VAI, Virtua maintains excess coverage from third-party insurers for amounts above the limits insured by VAI.

(Continued)

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED**

December 31, 2018 and 2017

(Dollars in thousands)

## NOTE L - CONTINGENCIES AND COMMITMENTS - Continued

The reserves for reported claims and claims incurred but not reported (“IBNR”) are reported gross of expected insurance recoveries. The reserves for reported claims and claims IBNR are reported within accounts payable and accrued expenses and self-insurance liabilities in the consolidated balance sheets. In addition, the expected insurance recoveries are reported in other current assets and other assets in the consolidated balance sheets.

The loss reserves are management’s best estimate based on actuarial estimates of the ultimate net cost of settling losses on incurred claims. The estimates are reviewed and adjusted, as necessary, as experience develops or new information becomes known. Management believes that the loss reserves are adequate; however, the ultimate settlement of losses may vary significantly from the amounts recorded in the accompanying consolidated financial statements.

Claims reserve activity for the years ended December 31, 2018 and 2017 is as follows:

	<u>2018</u>	<u>2017</u>
Claims reserves and IBNR - beginning of the year	\$ 34,168	\$ 35,955
Less: Insurance recoveries on unpaid claims	<u>(8,181)</u>	<u>(8,005)</u>
Claims reserves and IBNR, net - beginning of the year	25,987	27,950
Incurred related to:		
Current year	8,260	7,400
Prior year	<u>3,093</u>	<u>(1,187)</u>
Total incurred	11,353	6,213
Change in IBNR	1,495	364
Paid related to:		
Current year	(669)	(317)
Prior year	<u>(5,111)</u>	<u>(8,223)</u>
Total incurred	<u>(5,780)</u>	<u>(8,540)</u>
Claims reserves and IBNR, net - end of the year	33,055	25,987
Add: Insurance recoveries on unpaid claims	<u>15,314</u>	<u>8,181</u>
Claims reserves and IBNR - end of the year	<u>\$ 48,369</u>	<u>\$ 34,168</u>

Virtua is not a party to, nor are any of its properties the subject of, any material pending legal proceedings other than ordinary, routine litigation incidental to the business.

(Continued)

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED**

December 31, 2018 and 2017

(Dollars in thousands)

NOTE L - CONTINGENCIES AND COMMITMENTS - Continued

Self-Funded Healthcare Plan for Employees

Virtua has a self-funded healthcare employee benefit plan that is administered by a third-party administrator. Virtua obtains an excess insurance policy for claims to a member in excess of \$1,000. The reserves for claims that are not paid at December 31, 2018 and 2017 totaled \$6,051 and \$6,995, respectively, and are reported within accounts payable and accrued expenses in the consolidated balance sheets.

NOTE M - NET ASSETS WITH DONOR RESTRICTIONS

Net assets with donor restrictions at December 31, 2018 and 2017, are restricted for the following programs:

	<u>2018</u>	<u>2017</u>
Temporarily - Subject to expenditure for specific purpose:		
Property, plant, and equipment and other	\$ 16,058	\$ 20,549
Education and nursing scholarships	<u>1,712</u>	<u>1,307</u>
	17,770	21,856
Permanently - Investment in perpetuity whose income is expendable to support:		
Scholarships and other	<u>7,459</u>	<u>8,530</u>
	<u>\$ 25,229</u>	<u>\$ 30,386</u>

NOTE N - CONCENTRATIONS OF CREDIT RISK

Virtua grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payer agreements. The mix of accounts receivable from patients and third-party payers prior to allowances (in 2017 only) at December 31, 2018 and 2017, is as follows:

	<u>2018</u>	<u>2017</u>
Managed care	31%	31%
Medicare and Medicaid	37	29
Self-pay	14	26
Other third-party payers	<u>18</u>	<u>14</u>
	<u>100%</u>	<u>100%</u>

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED**

December 31, 2018 and 2017

(Dollars in thousands)

## NOTE O - FUNCTIONAL EXPENSES

Virtua's primary mission is to provide health care services to its patients. The majority of all operating expenses incurred by Virtua are related to the provision of health care services. Virtua provides general health care services to residents within its geographic location. Expenses related to providing these services for the years ended December 31, 2018 and 2017, are as follows:

<u>2018</u>	<u>Healthcare Services</u>	<u>General and Administrative</u>	<u>Total</u>
Salaries and wages	\$ 497,739	\$ 101,422	\$ 599,161
Professional fees	18,317	1,513	19,830
Employers' fringe benefits	107,057	27,964	135,021
Other operating expenses	396,357	51,798	448,155
Interest	21,287	4	21,291
Depreciation	<u>76,526</u>	<u>19,057</u>	<u>95,583</u>
	<u>\$ 1,117,283</u>	<u>\$ 201,758</u>	<u>\$ 1,319,041</u>
<u>2017</u>			
Salaries and wages	\$ 476,337	\$ 95,455	\$ 571,792
Professional fees	18,206	875	19,081
Employers' fringe benefits	108,116	25,069	133,185
Other operating expenses	406,375	28,322	434,697
Interest	19,593	3	19,596
Depreciation	<u>72,228</u>	<u>17,447</u>	<u>89,675</u>
	<u>\$ 1,100,855</u>	<u>\$ 167,171</u>	<u>\$ 1,268,026</u>

## NOTE P - SUBSEQUENT EVENTS

Virtua has evaluated its December 31, 2018 consolidated financial statements for subsequent events through May 6, 2019, the date the consolidated financial statements were issued. Virtua is not aware of any subsequent events, which require recognition or disclosure in the consolidated financial statements, except as follows:

In April 2019, the Series 2009A Bonds were refinanced with NJHCFFA Refunding Bonds, Virtua Health Issue, Series 2019. The related Series 2009A debt service reserve funds held by the trustee were released along with the refinancing. Series 2019 is a \$205,435 tax-exempt, private placement 3.20% fixed-rate bond issue with a bank and has principal payments ranging from \$5,630 to \$27,880 with maturities beginning on July 1, 2020 annually through 2038.

SUPPLEMENTARY INFORMATION

Virtua Health, Inc.

**COMBINING BALANCE SHEET INFORMATION - VIRTUA OBLIGATED GROUP**

December 31, 2018

ASSETS	Virtua Obligated Group	Reclassifying/ Eliminating Entries	Total	Virtua Health, Inc.	Virtua/Memorial Hospital of Burlington County	Virtua- West Jersey Health System	Virtua Holding Companies
<b>CURRENT ASSETS:</b>							
Cash and cash equivalents	\$ 29,812	\$ -	\$ 29,812	\$ 389	\$ 210	\$ 26,781	\$ 2,432
Assets limited as to use	14,567	(14,072)	28,639	14,567	571	13,501	-
Patient accounts receivable	126,418	-	126,418	-	34,622	89,710	2,086
Due from affiliates, net	26,339	(20,910)	47,249	27,094	4,236	15,919	-
Other current assets	46,221	-	46,221	23,565	4,582	17,104	970
Total current assets	<u>243,357</u>	<u>(34,982)</u>	<u>278,339</u>	<u>65,615</u>	<u>44,221</u>	<u>163,015</u>	<u>5,488</u>
<b>ASSETS LIMITED AS TO USE:</b>							
By Board of Trustees' designation	961,540	-	961,540	12,031	115,479	834,030	-
Other designated funds	255,048	-	255,048	-	-	255,048	-
Under debt agreements	26,617	(26,616)	53,233	26,617	2	26,614	-
Trust funds	5,116	-	5,116	4,938	178	-	-
Donor-restricted funds	1,169	-	1,169	-	1,169	-	-
	<u>1,249,490</u>	<u>(26,616)</u>	<u>1,276,106</u>	<u>43,586</u>	<u>116,828</u>	<u>1,115,692</u>	<u>-</u>
<b>PROPERTY, PLANT, AND EQUIPMENT, NET</b>	814,009	-	814,009	-	147,806	664,980	1,223
<b>OTHER LONG-TERM ASSETS:</b>							
Due from affiliates, net	47,931	(668,793)	716,724	348,166	368,558	-	-
Investment in unconsolidated joint ventures	161,669	(40,944)	202,613	3,044	40,502	101,073	57,994
Other assets	18,698	-	18,698	12,361	1,421	4,910	6
Goodwill and other intangibles	22,216	-	22,216	-	-	7,409	14,807
Beneficial interest in perpetual trust	7,459	-	7,459	-	7,459	-	-
	<u>257,973</u>	<u>(709,737)</u>	<u>967,710</u>	<u>363,571</u>	<u>417,940</u>	<u>113,392</u>	<u>72,807</u>
<b>TOTAL</b>	<u>\$ 2,564,829</u>	<u>\$ (771,335)</u>	<u>\$ 3,336,164</u>	<u>\$ 472,772</u>	<u>\$ 726,795</u>	<u>\$ 2,057,079</u>	<u>\$ 79,518</u>

## COMBINING BALANCE SHEET INFORMATION - VIRTUA OBLIGATED GROUP - CONTINUED

December 31, 2018

LIABILITIES AND NET ASSETS	Virtua Obligated Group	Reclassifying/ Eliminating Entries	Total	Virtua Health, Inc.	Virtua/Memorial Hospital of Burlington County	Virtua- West Jersey Health System	Virtua Holding Companies
<b>CURRENT LIABILITIES:</b>							
Current maturities of long-term debt	\$ 11,780	\$ (11,137)	\$ 22,917	\$ 11,780	\$ 765	\$ 10,372	\$ -
Accounts payable and accrued expenses	113,054	-	113,054	43,468	13,566	55,340	680
Accrued compensation and related liabilities	52,487	-	52,487	24,938	8,768	18,455	326
Accrued interest payable	9,841	(9,669)	19,510	9,841	199	9,470	-
Estimated settlements due to third-party payers	1,550	-	1,550	-	1,174	376	-
Total current liabilities	188,712	(20,806)	209,518	90,027	24,472	94,013	1,006
<b>LONG-TERM LIABILITIES:</b>							
Estimated settlements due to third-party payers	4,073	-	4,073	-	2,102	1,971	-
Self-insurance liabilities	36,006	-	36,006	36,006	-	-	-
Accrued retirement benefits	27,622	-	27,622	26,641	-	981	-
Due to affiliates, net	-	(134,774)	134,774	-	-	134,774	-
Long-term debt, net of current maturities	582,119	(574,811)	1,156,930	582,119	9,062	565,749	-
Other liabilities	17,522	-	17,522	6,600	4,594	6,199	129
Total liabilities	856,054	(730,391)	1,586,445	741,393	40,230	803,687	1,135
<b>MEMBERS' EQUITY (DEFICIT)</b>	-	(47,921)	47,921	-	-	-	47,921
<b>RETAINED EARNINGS</b>	-	(22,666)	22,666	-	-	-	22,666
<b>NET ASSETS (DEFICIENCY)</b>							
Without donor restrictions:							
Virtua Obligated Group	1,644,740	(3,044)	1,647,784	(277,134)	673,659	1,251,259	-
Noncontrolling interests	40,483	32,687	7,796	-	-	-	7,796
	1,685,223	29,643	1,655,580	(277,134)	673,659	1,251,259	7,796
With donor restrictions:	23,552	-	23,552	8,513	12,906	2,133	-
Total net assets (deficiency)	1,708,775	29,643	1,679,132	(268,621)	686,565	1,253,392	7,796
<b>TOTAL</b>	<u>\$ 2,564,829</u>	<u>\$ (771,335)</u>	<u>\$ 3,336,164</u>	<u>\$ 472,772</u>	<u>\$ 726,795</u>	<u>\$ 2,057,079</u>	<u>\$ 79,518</u>

Virtua Health, Inc.

**COMBINING STATEMENT OF OPERATIONS AND CHANGES IN NET ASSETS INFORMATION -  
VIRTUA OBLIGATED GROUP**

For the year ended December 31, 2018

	Virtua Obligated Group	Eliminating Entries	Total	Virtua Health, Inc.	Virtua/Memorial Hospital of Burlington County	Virtua- West Jersey Health System	Virtua Holding Companies
<b>NET ASSETS WITHOUT DONOR RESTRICTIONS:</b>							
Revenue:							
Net patient service revenue	\$ 1,052,448	\$ -	\$ 1,052,448	\$ -	\$ 315,203	\$ 721,235	\$ 16,010
Other revenue	66,683	(317,189)	383,872	345,026	12,393	25,857	596
Equity in income of unconsolidated joint ventures	46,418	(12,061)	58,479	-	11,925	28,118	18,436
Total revenue	<u>1,165,549</u>	<u>(329,250)</u>	<u>1,494,799</u>	<u>345,026</u>	<u>339,521</u>	<u>775,210</u>	<u>35,042</u>
Expenses:							
Salaries and wages	441,699	-	441,699	115,620	105,812	217,475	2,792
Professional fees	37,591	-	37,591	596	15,296	21,634	65
Employees' fringe benefits	124,200	(52,888)	177,088	96,043	26,144	54,324	577
Other operating expenses	363,893	(242,652)	606,545	110,811	161,351	328,395	5,988
Interest	21,291	(21,649)	42,940	21,956	409	20,556	19
Depreciation	86,882	-	86,882	-	15,141	71,284	457
Total expenses	<u>1,075,556</u>	<u>(317,189)</u>	<u>1,392,745</u>	<u>345,026</u>	<u>324,153</u>	<u>713,668</u>	<u>9,898</u>
INCOME (LOSS) FROM OPERATIONS	<u>89,993</u>	<u>(12,061)</u>	<u>102,054</u>	<u>-</u>	<u>15,368</u>	<u>61,542</u>	<u>25,144</u>
NONOPERATING GAINS AND LOSSES:							
Investment return, net	(62,677)	4,886	(67,563)	(5,594)	(7,062)	(54,907)	-
Other accrued retirement costs	658	-	658	658	-	-	-
Total nonoperating (losses) gains, net	<u>(62,019)</u>	<u>4,886</u>	<u>(66,905)</u>	<u>(4,936)</u>	<u>(7,062)</u>	<u>(54,907)</u>	<u>-</u>
EXCESS OF (DEFICIENCY IN) REVENUE AND NONOPERATING GAINS (LOSSES), NET OVER EXPENSES	27,974	(7,175)	35,149	(4,936)	8,306	6,635	25,144
EXCESS OF REVENUE AND NONOPERATING GAINS, NET OVER EXPENSES ATTRIBUTED TO NONCONTROLLING INTERESTS	<u>(13,083)</u>	<u>(10,605)</u>	<u>(2,478)</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>(2,478)</u>
INCREASE (DECREASE) IN NET ASSETS WITHOUT DONOR RESTRICTIONS ATTRIBUTED TO VIRTUA OBLIGATED GROUP	14,891	(17,780)	32,671	(4,936)	8,306	6,635	22,666

Virtua Health, Inc.

**COMBINING STATEMENT OF OPERATIONS AND CHANGES IN NET ASSETS INFORMATION -  
VIRTUA OBLIGATED GROUP - CONTINUED**

For the year ended December 31, 2018

	Virtua Obligated Group	Eliminating Entries	Total	Virtua Health, Inc.	Virtua/Memorial Hospital of Burlington County	Virtua- West Jersey Health System	Virtua Holding Companies
INCREASE (DECREASE) IN NET ASSETS WITHOUT DONOR RESTRICTIONS ATTRIBUTED TO VIRTUA OBLIGATED GROUP	\$ 14,891	\$ (17,780)	\$ 32,671	\$ (4,936)	\$ 8,306	\$ 6,635	\$ 22,666
OTHER CHANGES IN NET ASSETS WITHOUT DONOR RESTRICTIONS - Virtua Obligated Group							
Net assets released for property, plant, and equipment	7,163	-	7,163	-	4,993	2,170	-
Other changes in accrued retirement benefits	(4,111)	-	(4,111)	(4,111)	-	-	-
Transfers with affiliates, net	(60,507)	-	(60,507)	(26,446)	8,295	(42,356)	-
Paid-in capital	-	(5,327)	5,327	-	-	-	5,327
Income distributions	-	11,682	(11,682)	-	-	-	(11,682)
(Decrease) increase in net assets without donor restrictions - Virtua Obligated Group	(42,564)	(11,425)	(31,139)	(35,493)	21,594	(33,551)	16,311
NONCONTROLLING INTERESTS:							
Excess of revenues and nonoperating gains, net over expenses attributable to noncontrolling interests	13,083	10,605	2,478	-	-	-	2,478
Distributions	(12,899)	-	(12,899)	-	-	-	(12,899)
Membership interest transfer	8,871	-	8,871	-	-	-	8,871
Increase (decrease) in net assets without donor restrictions - noncontrolling interests	9,055	10,605	(1,550)	-	-	-	(1,550)
CHANGE IN NET ASSETS WITH DONOR RESTRICTIONS:							
Contributions	3,566	-	3,566	1,894	893	779	-
Decrease in beneficial interest in perpetual trust	(1,071)	-	(1,071)	-	(1,071)	-	-
Net assets released from restrictions for operations	(507)	-	(507)	(388)	(72)	(47)	-
Net assets released from restrictions for property, plant, and equipment	(7,163)	-	(7,163)	-	(4,993)	(2,170)	-
Transfers with affiliates, net	5	-	5	(896)	115	786	-
(Decrease) increase in net assets with donor restrictions	(5,170)	-	(5,170)	610	(5,128)	(652)	-
(DECREASE) INCREASE IN NET ASSETS	(38,679)	(820)	(37,859)	(34,883)	16,466	(34,203)	14,761
NET ASSETS (DEFICIENCY) - beginning of year	1,747,454	(40,124)	1,787,578	(233,738)	670,099	1,287,595	63,622
NET ASSETS (DEFICIENCY) - end of year	\$ 1,708,775	\$ (40,944)	\$ 1,749,719	\$ (268,621)	\$ 686,565	\$ 1,253,392	\$ 78,383

**DEBT SERVICE COVERAGE RATIO CALCULATION - VIRTUA OBLIGATED GROUP**

December 31, 2018

(Dollars in thousands)

1 Funds available for debt service:		
Excess of revenue and gains over expenses and losses	\$	14,891
Add (deduct):		
Interest expense		21,291
Joint venture interest		(9)
Depreciation and amortization expenses		86,882
Joint venture depreciation and amortization expenses		(224)
Provision for other non-cash expenses		38,489
Joint venture provision for other non-cash expenses		(142)
Unrealized loss		<u>64,796</u>
Total	\$	<u><u>225,974</u></u>
2 Maximum annual debt service requirement:	\$	<u><u>39,489</u></u>
3 Debt service coverage ratio:		
<u>Funds available for debt service</u>	\$	<u>225,974</u>
Maximum annual debt service requirement	\$	<u>39,489</u>
Debt service coverage ratio		<u><u>5.72</u></u>

- \* “Funds Available for Debt Service” shall mean, in any Fiscal Year, for any one or more Members of the Obligated Group or, as the context requires, the entire Obligated Group, the sum of: (i) the excess of revenues over expenses, as determined in accordance with generally accepted accounting principles; (ii) interest expense with respect to interest requirements on all Long-Term Indebtedness then outstanding; and (iii) all depreciation expense, amortization of financing charges and other noncash expenses deducted in determining the excess of revenues over expenses for such Fiscal Year, all as determined in accordance with accounting principles generally accepted in the United States of America as it existed as of the date of Virtua’s MTI dated January 1, 2011. In the event that the Fiscal Year of any Member of the Obligated Group ends on a date other than the last day of any Fiscal Year under consideration, the Funds Available for Debt Service for such Fiscal Year will include the amounts for such Member of the Obligated Group for its most recent Fiscal Year.

**CUSHION RATIO CALCULATION - VIRTUA OBLIGATED GROUP**

December 31, 2018

(Dollars in thousands)

1	Cash and cash equivalents and assets limited as to use by Board of Trustees' designation as of December 31, 2018:	
	Cash and cash equivalents	\$ 29,812
	Less: Joint venture's cash and cash equivalents	(1,192)
	Assets limited as to use by Board of Trustees' designation	<u>961,540</u>
	Total	<u>\$ 990,160</u>
2	Maximum annual debt service requirement:	<u>\$ 39,489</u>
3	Cushion ratio:	
	<u>Cash and cash equivalents and assets limited as to use by Board of Trustees' designation</u>	<u>\$ 990,160</u>
	Maximum annual debt service requirement	\$ 39,489
	Cushion ratio	<u>25.07</u>

**DAY'S CASH ON HAND CALCULATION - VIRTUA OBLIGATED GROUP**

December 31, 2018

(Dollars in thousands)

Cash and cash equivalents and assets limited as to use by Board of Trustees' designation as of December 31, 2018:

Cash and cash equivalents	\$ 29,812
Less: Joint venture's cash and cash equivalents	(1,192)
Assets limited as to use by Board of Trustees' designation	<u>961,540</u>

Adjusted cash and cash equivalents	<u><u>\$ 990,160</u></u>
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2018 operating expenses:	\$ 1,075,556
Less: Joint venture operating expenses	(4,849)
Less: Depreciation and amortization	(86,882)
Add: Joint venture depreciation and amortization	<u>224</u>

Cash operating expenses	984,049
Divided by 365 days	<u>/365</u>

Daily cash operating expenses	<u><u>\$ 2,696</u></u>
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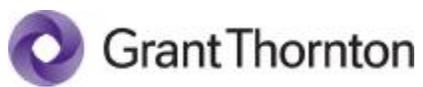
Day's cash on hand	<u><u>367.27</u></u>
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**DEBT TO CAPITALIZATION RATIO CALCULATION - VIRTUA OBLIGATED GROUP**

December 31, 2018

(Dollars in thousands)

1 Long-term indebtedness at December 31, 2018:	
Long-term debt	<u>\$ 593,899</u>
2 Capitalization amount:	
Long-term debt	\$ 593,899
Net assets without donor restrictions - Virtua Obligated Group	<u>1,644,740</u>
Total	<u>\$ 2,238,639</u>
3 Debt to capitalization ratio:	
<u>Long-term indebtedness</u>	<u>\$ 593,899</u>
Capitalization amount	\$ 2,238,639
Debt to capitalization ratio	<u>0.27</u>



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