The Valley Hospital

Financial Statements and
Supplementary Information

December 31, 2017 and 2016

BAKER TILLY

Candor. Insight. Results.

The Valley Hospital

Table of Contents
December 31, 2017 and 2016

Independent Auditors' Report

Board of Trustees
The Valley Hospital

Report on the Consolidated Financial Statements

We have audited the accompanying consolidated financial statements of The Valley Hospital and affiliated companies (collectively, the "Organization"), which comprise the consolidated balance sheet as of December 31, 2017 and 2016, 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 Consolidated Financial Statements

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

Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We did not audit the financial statements of Valley Medical Group and VHS Insurance Company, Ltd., for which the Valley Hospital is the sole member, which statements reflect combined total assets of $134.6 million and $119.1 million as of December 31, 2017 and 2016, respectively, and combined total revenues of $137.3 million and $123.8 million for the years then ended. Those statements were audited by other auditors whose reports have been furnished to us and, our opinion, insofar as it relates to the amounts included for Valley Medical Group and VHS Insurance Company, Ltd., is based solely on the reports of the other auditors. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

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

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

Opinion

In our opinion, based on our audits and the reports of the other auditors, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Organization as of December 31, 2017 and 2016, and the results of its operations, changes in net assets and cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Report on 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 included in the consolidating balance sheet as of December 31, 2017 and consolidating statement of operations and changes in net assets for the year then ended is presented for purposes of additional analysis and is not a required part of the consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The information has been subjected to the auditing procedures applied in the audits of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the consolidated financial statements as a whole.

Baker Tilly Virchow Krause, LLP

Iselin, New Jersey
June 5, 2018

The Valley Hospital

Consolidated Balance Sheet
December 31, 2017 and 2016
(In Thousands)

	2017	2016
Assets		
Current Assets		
Cash and cash equivalents	$ 15,621	$ 11,845
Accounts receivable, less allowance for doubtful accounts of $61,381 in 2017 and $63,248 in 2016	78,024	82,465
Prepaid expenses	5,255	10,835
Supplies and other current assets	8,584	7,972
Total current assets	107,484	113,117
Assets Whose Use is Limited		
Board designated	509,405	493,401
Insurance company-held funds	79,405	70,559
Donor restricted investments	6,526	6,417
	595,336	570,377
Property and Equipment, Net	368,683	332,717
Other Assets	44,291	55,272
Prepaid Pension Asset	34,213	2,988
Assets Held by Related Organization	43,877	43,920
Total assets	$ 1,193,884	$ 1,118,391

	2017	2016
Liabilities and Net Assets		
Current Liabilities		
Accounts payable	$ 25,819	$ 28,203
Accrued salaries and related benefits	65,465	69,991
Other accrued expenses	23,661	19,553
Total current liabilities	114,945	117,747
Estimated Professional Liability	33,955	30,224
Amounts Due to Third-Party Payors and Other Liabilities	74,097	83,198
Total liabilities	222,997	231,169
Net Assets		
Unrestricted	957,176	872,849
Temporarily restricted	9,282	9,944
Permanently restricted	4,429	4,429
Total net assets	970,887	887,222
Total liabilities and net assets	$ 1,193,884	$ 1,118,391

See notes to financial statements

The Valley Hospital

Consolidated Statement of Operations and Changes in Net Assets
Years Ended December 31, 2017 and 2016
(In Thousands)

	2017	2016
Unrestricted Revenues		
Patient service revenues	$ 805,083	$ 770,878
Provision for bad debts	(28,974)	(25,644)
Net patient service revenue less provision for bad debts	776,109	745,234
Other revenues	16,324	15,930
Total unrestricted revenues	792,433	761,164
Expenses		
Salaries and wages	382,761	369,806
Employee benefits	81,385	77,119
Medical fees	3,310	4,362
Other expenses	281,095	256,324
Depreciation	40,357	40,621
Total expenses	788,908	748,232
Operating income before other items and special projects	3,525	12,932
Other Items and Special Projects	(873)	(1,178)
Operating income	$ 2,652	$ 11,754

See notes to financial statements

The Valley Hospital

Consolidated Statement of Operations and Changes in Net Assets
Years Ended December 31, 2017 and 2016
(In Thousands)

	2017	2016
Income from operations	$ 2,652	$ 11,754
Non-operating gains	16,705	16,127
Change in unrealized gains (losses) on investments	20,991	4,951
Revenues in excess of expenses	40,348	32,832
Other Changes in Unrestricted Net Assets		
Change in prepaid pension asset/ accrued pension liability to be recognized in future periods	36,449	6,305
Net changes in assets held by related organization and net asset transfers to / from affiliated entities	7,530	10,972
Increase in unrestricted net assets	84,327	50,109
Increase (decrease) in temporarily restricted net assets	(662)	(18)
Increase in net assets	83,665	50,091
Net Assets, Beginning of Year	887,222	837,131
Net Assets, End of Year	$ 970,887	$ 887,222

See notes to financial statements

The Valley Hospital

Consolidated Statement of Cash Flows
Years Ended December 31, 2017 and 2016
(In Thousands)

	2017	2016
Cash Flows from Operating Activities		
Increase in net assets	$ 83,665	$ 50,091
Adjustments to reconcile increase in net assets to net cash provided by operating activities:		
Depreciation and amortization	52,900	44,540
Provision for bad debts	28,974	25,644
Change in assets held by related organization	43	(3,880)
Change in prepaid pension asset/accrued pension liability to be recognized in future periods	(36,449)	(6,305)
Net realized (gains) losses on investments	(8,050)	(9,400)
Change in unrealized gains on investments	(20,991)	(4,951)
Changes in assets and liabilities:		
Accounts receivable	(24,533)	(21,395)
Prepaid expenses, supplies and other current assets	4,968	1,064
Other assets	10,981	(4,066)
Accounts payable and other current liabilities	(2,802)	10,839
Pension asset/liability	5,224	(5,141)
Estimated professional liability	3,731	34
Amounts due to third-party payors and other liabilities	(9,101)	3,775
Net cash provided by operating activities	88,560	80,849
Cash Flows from Investing Activities		
Purchase of property and equipment	(88,866)	(47,787)
Net proceeds from sales (purchases) of limited use assets	4,082	(26,049)
Net cash used in investing activities	(84,784)	(73,836)
Increase in cash and cash equivalents	3,776	7,013
Cash and Cash Equivalents, Beginning	11,845	4,832
Cash and Cash Equivalents, Ending	$ 15,621	$ 11,845

See notes to financial statements

1. Organization and Summary of Significant Accounting Policies

Organization

The Valley Hospital, Inc. (the "Hospital") is a 431-bed, not-for-profit acute care hospital located in Ridgewood, New Jersey and is a subordinate corporation of Valley Health System, Inc. (the "System"). The Hospital is the sole member of Valley Medical Services, Inc. ("VMS"), Valley Physician Services, Inc. ("VPS"), VHS Insurance Company, Ltd. ("VHSIC") and other companies, (collectively, the "Organization"). VMS provides the Hospital with physicians, certain medical services and varied consulting services. VPS was formed to provide medical care and to carry out the purposes of the System. VHSIC is a captive insurance company and was incorporated as an exempted company under the laws of the Cayman Islands and operates under the terms of an Unrestricted Class "B" Cayman Island insurers license. The license allows VHSIC to conduct insurance business, other than Cayman domestic business, from within the Cayman Islands. VHSIC provides professional and commercial general liability insurance on a mature claims made basis to the Organization. Other companies primarily consist of LLCs created for real estate acquisitions.

On January 1, 2017, Valley Physician Services, Inc. ("VPS") and Valley Medical Services, Inc. ("VMS") assigned their New Jersey physician contracts to Valley Physician Services, PC (“VPSPC") and Valley Medical Services, PC ("VMSPC"). VPSPC and VMSPC are captive professional corporations of VPS, whose sole member is The Valley Hospital. Effective with the assignment of these contracts, VPS became a management services corporation providing services to the professional corporations. VPSNY, PC (“VPSNY”) is a captive of VPS. Its operations are reflected in the 2017 consolidated results of operations. VPS, VMS, VPSPC, VMSPC, and VPSNY all operate under the name "Valley Medical Group" (“VMG”).

Principles of Consolidation

As of December 31, 2017 and the year then ended, the consolidated financial statements include the accounts of the Hospital, VMG, VHSIC and the other companies created for real estate acquisitions. As of December 31, 2016 and the year then ended, the consolidated financial statements include the accounts of the Hospital, VMS, VPS, VHSIC and the other companies created for real estate acquisitions. All significant intercompany accounts and transactions have been eliminated.

Use of Estimates

The preparation of the consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. There is at least a reasonable possibility that certain estimates will change by material amounts in the near term. Actual results could differ from those estimates.

Cash Equivalents

The Organization considers all highly liquid financial instruments purchased with a maturity of three months or less to be cash equivalents, except for amounts reported within limited use assets.

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

Investments

All investments are classified as trading securities. Investments included in limited use assets in the accompanying consolidated balance sheet consist of cash, equity securities, pooled/collective investment funds, U.S. government obligations and government secured obligations, corporate bonds, and alternative investments. All investments, except alternative investments and collective investment funds, are reported at fair value. Alternative investments and collective investment funds are stated at net asset value provided by the applicable fund manager using the equity method of accounting, except for alternative investments and collective investments included in the defined benefit pension plan's assets, which are recorded at fair value.

For the defined benefit pension plan, the fair value of the alternative investments and collective investment funds is determined for each investment based upon net asset values as a practical expedient for fair value. Financial information used to evaluate the alternative investments is provided by the investment manager or general partner and includes fair value valuations (quoted market prices and values determined through other means) of underlying securities and other financial instruments held by the investee, and estimates that require varying degrees of judgment.

Alternative investments (nontraditional, not readily marketable securities) consist of event-driven funds, multi-strategy hedge funds, emerging market debt funds, and global hedge funds. Alternative investment interests generally are structured such that the noncontributory, defined benefit pension plan (the "Plan") holds a limited partnership interest or an interest in an investment management company. The Plan's ownership structure does not provide for control over the related investees and the Plan's financial risk is limited to the carrying amount reported for each investee, in addition to any unfunded capital commitment. The Plan has no future funding commitments for alternative investments at December 31, 2017.

Individual investment holdings within the alternative investments include nonmarketable and market-traded debt and equity securities and interests in other alternative investments. The Plan may be exposed indirectly to securities lending, short sales of securities and trading in futures and forward contracts, options and other derivative products. Alternative investments often have liquidity restrictions under which the Plan's capital may be divested only at specified times. Liquidity restrictions may apply to all or portions of a particular invested amount.

There is uncertainty in determining fair values of alternative investments arising from factors such as lack of active markets (primary and secondary), lack of transparency into underlying holdings, time lags associated with reporting by the investee companies and the subjective evaluation of liquidity restrictions. As a result, the estimated fair values reported might differ from the values that would have been used had a ready market for the alternative investment interests existed and there is at least a reasonable possibility that estimates will change.

Investment income or loss (including realized gains and losses on investments, interest and dividends) and changes in unrealized gains and losses on investments are included in revenues in excess of expenses and losses unless the income or loss is restricted by donor or law.

Investment income on deferred compensation investments is reported as other revenue and investment income on other limited use assets is reported as non-operating gains and losses in the consolidated statements of operations and changes in net assets.

Limited Use Assets

Limited use assets include funds designated for malpractice funding, funds whose use is restricted by donors and designated assets set aside by the Board of Trustees, primarily for future capital improvements, over which the Board of Trustees retains control and may at its discretion use for other purposes.

Accounts Receivable

Accounts receivable results from the health care services provided by the Organization. Accounts receivable for which the Organization receives payment under cost reimbursement, prospective payment formula or negotiated rates, which cover the majority of services, are stated at the net amounts receivable from third-party payors.

Accounts receivable are reduced by an allowance for doubtful accounts. The amount of the allowance for doubtful accounts is based upon management's assessment of historical and expected net collections, business and economic conditions, trends in health care coverage and other collection indicators. Additions to the allowance for doubtful accounts result from the provisions for bad debt. Accounts written off as uncollectible are deducted from the allowance for doubtful accounts.

Supplies

Supplies are carried at the lower of cost (first-in, first-out method) or net realizable value. Supplies totaling approximately $6.3 million and $5.8 million are included in supplies and other current assets in the consolidated balance sheet at December 31, 2017 and 2016, respectively.

Property and Equipment

Property and equipment are recorded at cost. Annual provisions for depreciation of property and equipment are computed using the straight-line method. Additions are depreciated beginning with the month that the asset is placed in service.

Property and equipment are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. If such 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 fair value less costs to sell There were no such impairment losses recorded in 2017 or 2016.

Donor-Restricted Gifts

Unconditional promises to give cash and other assets to the Hospital are reported at fair value at the date the promise is received. Conditional promises to give and indications of intentions to give are reported at fair value at the date the gift is received. The gifts are reported as either temporarily or permanently restricted support if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified as unrestricted net assets and reported in the consolidated statements of operations and changes in net assets as net assets released from restriction. Donor-restricted contributions whose restrictions are met within the same year as received are reported as unrestricted contributions in the accompanying consolidated financial statements.

Deferred Compensation

Certain Hospital employees participate in deferred compensation plans. In connection with these plans, the Hospital deposits amounts with trustees on behalf of the participating employees. The assets are restricted for payments under the plans, but may revert to the Hospital in the event of a bankruptcy filing. At December 31, 2017 and 2016, amounts on deposit with trustees were equal to liabilities under the plans and aggregated \$20.6 million and \$29.5 million, respectively, with the decrease due to required participant distributions. Investments consist of mutual funds and are reported at fair value based upon quoted market price. Amounts on deposit are recorded in other assets and liability amounts are included in amounts due to third-party payors and other liabilities in the accompanying consolidated balance sheet.

The investments held by the trustees are classified as trading securities. For the years ended December 31, 2017 and 2016, the Hospital recorded investment income related to deferred compensation assets of \$3.2 million and \$1.8 million, respectively, as other revenue. Changes to the deferred compensation liability are recorded in employee benefits expense.

The Organization has a deferred compensation plan for certain executives which invests in life insurance policies for these executives. At December 31, 2017 and 2016, there is an insurance asset of \$20.1 million and \$19.5 million, respectively, which is included in other assets. Related benefit liabilities and expense of \$5.0 million in 2017 and \$4.4 million in 2016 are included in amounts due to third-party payors and other liabilities in the consolidated balance sheet and employee benefits expenses in the consolidated statement of operations and changes in net assets.

Classification of Net Assets

The Organization separately accounts for and reports donor restricted and unrestricted net assets. Temporarily restricted net assets are those whose use is temporarily restricted by the donor. Permanently restricted net assets have been restricted by donors to be maintained by the Hospital in perpetuity. The Hospital recognizes its accumulated interest in the net assets of the Valley Hospital Foundation, Inc. ("Foundation") as assets held by a related organization in the accompanying consolidated balance sheet. Changes in the Hospital's interest in the net assets of the Foundation are reported in the accompanying consolidated statements of operations and changes in net assets. The net assets held by the Foundation on behalf of the Hospital are temporarily restricted for health care services and capital expenditures.

Self-Insured Health Benefits

The Hospital maintains limited self-insured medical, dental and workers' compensation coverage for its employees. Claims under the plan are accrued as the incidents that give rise to them occur and an estimate of unpaid claims is included in other accrued expenses. The System, Hospital, and VMG are co-borrowers on a $1.0 million irrevocable standby letter of credit with a bank for self-insured workers' compensation coverage. The letter of credit expires on March 31, 2019.

Medical Malpractice Insurance

The Organization participates in the VHSIC malpractice program. The provision for estimated medical malpractice claims includes estimates of the ultimate costs for both reported claims and claims incurred but not reported. The Organization records the actuarially determined liabilities for incurred but not reported professional and general liabilities. Amounts deposited are based on actuarially determined funding requirements and are included in limited use assets. Anticipated insurance recoveries associated with reported claims are reported separately in the Organization's consolidated balance sheet at net realizable value.

Net Patient Service Revenue

Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered, including estimated retroactive adjustments due to ongoing and future audits, reviews and investigations. Retroactive adjustments are considered in the recognition of revenue on an estimated basis in the period the related services are rendered, and such amounts are adjusted in future periods as adjustments become known or as years are no longer subject to such audits, reviews and investigations (see Note 3).

Functional Expenses

All expenses of the Organization are related to the provision of health care services and health education.

Other Expenses

The major categories included in other expenses are drugs, surgical supplies, cardiac cath supplies, other medical supplies, professional fees, contracted services, repairs and maintenance.

Revenues in Excess of Expenses

The consolidated statement of operations and changes in net assets includes the determination of revenues in excess of expenses. Changes in unrestricted net assets which are excluded from the determination of revenues in excess of expenses, consistent with industry practice, include unrealized gains and losses on investments other than trading securities, pension liability adjustment, permanent transfers of assets to and from subsidiaries for other than goods and services, and contributions of long-lived assets (including assets acquired using contributions which by donor restriction were to be used for the purposes of acquiring such assets).

Income Taxes

As of December 31, 2017 and for the year then ended, the Hospital and VMG 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. As of December 31, 2016 and for the year then ended, the Hospital, VPS, and VMS 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. VHSIC obtained an Unrestricted Class B Insurer's license under the provisions of the Cayman Islands Insurance Law. The Organization has received an undertaking from the Cayman Islands Government exempting it from local income, profits and capital gains taxes until April 2023.

Reclassification

Certain reclassifications have been made to conform to current year presentation.

Subsequent Events

The Hospital has evaluated the impact of subsequent events through June 5, 2018, representing the date at which the consolidated financial statements were available to be issued.

New Accounting Pronouncements

Revenue from Contracts with Customers

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2014-09, *Revenue from Contracts with Customers (Topic 606)*. ASU No. 2014-09 supersedes the revenue recognition requirements in Topic 605, *Revenue Recognition*, and most industry-specific guidance. Under the requirements of ASU No. 2014-09, the core principle is that entities should recognize revenue to depict the transfer of promised goods or services to customers (patients) in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The Organization will be required to retrospectively adopt the guidance in ASU No. 2014-09 for years beginning after December 15, 2018. The Organization has not yet determined the impact of adoption of ASU No. 2014-09 on its consolidated financial statements.

Leases

In February 2016, the FASB issued ASU No. 2016-02, *Leases (Topic 842).* ASU No. 2016-02 was issued to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. Under the provisions of ASU No. 2016-02, a lessee is required to recognize a right-to-use asset and lease liability, initially measured at the present value of the lease payments, in the balance sheet. In addition, lessees are required to provide qualitative and quantitative disclosures that enable users to understand more about the nature of the Organization's leasing activities. The Organization will be required to retrospectively adopt the guidance in ASU No. 2016-02 for years beginning after December 15, 2019. The Organization has not yet determined the impact of adoption of ASU No. 2016-02 on its consolidated financial statements.

Financial Statements

In August 2016, the FASB issued ASU 2016-14, *Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities.* The new guidance is intended to improve and simplify the current net asset classification requirements and information presented in financial statements and notes that is useful in assessing a not-for-profit's liquidity, financial performance and cash flows. ASU 2016-14 is effective for fiscal years beginning after December 15, 2017, with early adoption permitted. ASU 2016-14 is to be applied retroactively with transition provisions. The Organization is assessing the impact this standard will have on its consolidated financial statements.

2. Charity Care

The Hospital provides care to patients who meet certain criteria defined by the New Jersey Department of Health ("DOH") without charge or at amounts less than its established rates. Because the Organization does not pursue collection of amounts determined to qualify as charity care, they are not reported as revenue. The cost of providing these services and supplies to patients who meet the charity care eligibility requirements was estimated using a ratio of cost to charges and approximated \$5.2 million and \$4.9 million, respectively, for the years ended December 31, 2017 and 2016.

The Hospital also provides free care to other patients who do not meet the DOH eligibility requirements or are not compliant in pursuing eligibility status. Such amounts are included in the consolidated statements of operations and changes in net assets as part of the provision for bad debts, net of any recoveries realized through collection efforts.

Additionally, the Organization sponsors other charitable programs, which provide substantial benefit to the broader community. Such programs include services to the needy and elderly population that require special support, various clinical outreach programs, as well as health promotion and education for the general community welfare. Health care and other services are also provided to those covered by Medicaid and Medicare for which the Hospital is not reimbursed at its full cost.

The Hospital receives revenue through the State of New Jersey Charity Care Subsidy Fund. The amount received totaled \$0.1 million for the years ended December 31, 2017 and 2016 and is included in other revenue.

3. Hospital Reimbursement Systems

The Hospital has agreements with third-party payors that provide for payment for services rendered at amounts different from its established rates. A summary of the payment arrangements with major third-party payors follows:

Medicare: The Hospital is paid for most Medicare inpatient and outpatient services under the national prospective payment system and other methodologies of the Medicare program for certain other services. Federal regulations provide for certain adjustments to current and prior years' payment rates, based on industry-wide and hospital-specific data. Medicare cost reports of the Hospital have been audited and settled for years through 2014 at December 31, 2017. Medicare informed hospitals of their intent to reopen cost report years 2006-2009, and 2011-2013.

Medicaid: Inpatient acute care services rendered to Medicaid program beneficiaries are paid at prospectively determined rates per discharge. Outpatient services rendered to Medicaid program beneficiaries are reimbursed under cost-based and fee schedule methodologies. The Hospital is reimbursed for outpatient services at a tentative rate with final settlement determined after submission of annual cost reports and audits thereof by the Medicaid fiscal intermediary. The Medicaid cost reports of the Hospital for years through 2015 have been audited and settled.

Other third-party payors: The Hospital also has entered into payment agreements with certain commercial insurance carriers and health maintenance organizations. The basis for payment to the Hospital under these agreements includes prospectively determined rates per discharge or days of hospitalization and discounts from established charges.

The Hospital currently has no cost report appeals pending. There are various proposals at the federal and state levels that could, among other things, significantly reduce payment rates or modify payment methods. The ultimate outcome of these proposals and other market changes, including the potential effects of health care reform that has been enacted by the federal government, cannot presently be determined. Future changes in the Medicare and Medicaid programs and any reduction of funding could have an adverse impact on the Hospital.

Laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term. The Hospital believes that it is in compliance with all applicable laws and regulations and is not aware of any pending or threatened investigations involving allegations of potential wrongdoing that could have a material adverse effect on its financial statements. Noncompliance with such laws and regulations could result in fines, penalties and exclusion from such programs.

Patient service revenue associated with services provided to patients who have third-party payor coverage is determined on the basis of contractual rates. For uninsured patients that do not qualify for charity care, the Hospital recognizes revenue on the basis of its standard rates for services provided (or on the basis of discounted rates, if negotiated or provided by policy). On the basis of historical experience, a significant portion of the Hospital's uninsured patients will be unable or unwilling to pay for the services provided. Thus, the Hospital records a provision for bad debts related to uninsured patients in the period the services are provided.

The components of the Hospital's net patient service revenue (before provision for bad debts) are as follows (in thousands):

	2017	2016
Gross charges	$ 2,174,360	$ 2,032,653
Contractual and other allowances	(1,492,638)	(1,373,033)
Net patient service revenue	$ 681,722	$ 659,620

Accounts receivable are reduced by an allowance for doubtful accounts. In evaluating the collectability of accounts receivable, the Hospital analyzes its past history and identifies trends for each of its major payor sources of revenue to estimate the appropriate allowance for doubtful accounts and provision for bad debts. For receivables associated with services provided to patients who have third-party coverage, the Hospital analyzes contractually due amounts and provides an allowance for doubtful accounts, and a provision for bad debts, for potential uncollectible amounts due from the third party payor, as well as expected uncollectible deductibles and copayments on accounts for which the third party payor has not yet paid.

For receivables associated with self-pay patients (which includes both patients without insurance and patients with deductible and copayment balances due for which third-party coverage exists for a portion of the bill), the Hospital records a provision for bad debts in the period of service. The provision is estimated on the basis of past experience, which indicates that many patients are unable or unwilling to pay the portion of their bill for which they are financially responsible. The difference between the standard rates (or the discounted rates if negotiated) and the amounts actually collected, after all reasonable collection efforts have been exhausted, is used to adjust the allowance for doubtful accounts.

During 2017 and 2016, approximately $24.1 million and $20.5 million, respectively, was written off as bad debt with $15.2 million and $13.8 million, respectively, related to patients' balances after insurance.

During the years ended December 31, 2017 and 2016, approximately $22.1 million and $18.9 million, respectively, of successful settlements and favorable changes to estimated third-party payor settlement estimates were recorded as an increase to other items and special projects. (See Note 10).

The percentages of net patient service revenue received from various third-party payors and patients were as follows for the years ended December 31, 2017 and 2016:

	2017	2016
Medicare and Medicaid	27 %	29 %
Managed care	69	67
Commercial and other	4	4
	100 %	100 %

In addition, net patient service revenue includes amounts related to Valley Medical Group of $123.4 million and $111.3 million for the years ended December 31, 2017 and 2016, respectively.

4. Assets Whose Use is Limited

The components of assets whose use is limited are set forth in the following table (in thousands):

	2017	2016
Cash and cash equivalents	$ 29,090	$ 12,438
Equity securities	26,068	21,779
Pooled/collective investment funds	113,343	112,822
U.S. government obligations and government secured obligations	223,426	223,405
Corporate bonds	190,047	187,793
Alternative investments	11,215	10,059
	593,189	568,296
Accrued interest receivable	2,147	2,081
Total	$ 595,336	$ 570,377

Unrealized gains and losses represent the change in the difference between cost and fair value of the limited use assets. For the years ended December 31, 2017 and 2016, the change in net unrealized gains and losses was approximately $21.0 million and $5.0 million, respectively.

Investment income consists of the following (in thousands):

	2017	2016
Included in non-operating gains and losses (Note 15):		
Interest and dividend income	$ 8,655	$ 6,675
Realized (losses) gains on sales of securities	8,050	9,400
Total	$ 16,705	$ 16,075

5. Property and Equipment

A summary of property and equipment as follows (in thousands):

	2017	2016
Land	$ 92,303	$ 64,098
Land improvements	16,268	16,009
Building	459,441	437,812
Equipment and furnishings	437,916	414,999
	1,005,928	932,918
Less accumulated depreciation	672,097	613,941
	333,831	318,977
Construction in progress	34,852	13,740
Property and equipment, net	$ 368,683	$ 332,717

Depreciation expense for the years ended December 31, 2017 and 2016 totaled $52.9 million and $44.5 million, respectively. Included in these amounts are $12.5 million and $3.9 million in 2017 and 2016, respectively, which are included in other items and special projects (see Note 10).

Due to changes made in connection with the new hospital project, it was determined that $8.3 million of previously capitalized costs had no future benefit and were written off in 2017. This amount is included in depreciation expense.

6. Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets are available for the following purposes (in thousands):

	2017	2016
Health care services	$ 1,472	$ 1,437
VMG services	7,185	7,956
Health education	625	551
Total	$ 9,282	$ 9,944

Permanently restricted net assets represent endowments that have been restricted by donors to be maintained in perpetuity and are held by the Hospital. The Hospital follows the requirements of the Uniform Prudent Management of Institutional Funds Act ("UPMIFA") as they relate to its permanently restricted contributions and net assets, effective upon the State of New Jersey's enactment of the legislation in March 2009.

The Hospital 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 fund absent explicit donor stipulations to the contrary. As a result of this interpretation, the Hospital classifies as permanently restricted net assets the original value of the gifts donated to the permanent endowment and the original value of subsequent gifts to the permanent endowment. Accumulations to the permanent endowment are used in accordance with the direction of the applicable donor gift. The remaining portion of the donor-restricted endowment fund that is not classified in permanently restricted net assets is classified as temporarily restricted net assets until the amounts are appropriated for expenditure in accordance with a manner consistent with the standard of prudence proscribed by UPMIFA. In accordance with UPMIFA, the Hospital considers the following factors in making a determination to appropriate or accumulate donor restricted endowment funds: (1) the duration and preservation of the fund; (2) the purposes of the Hospital and the donor-restricted endowment fund; (3) general economic conditions; (4) the possible effect of inflation and deflation; (5) the expected total return from income and the appreciation of investments; (6) other resources of the Hospital; and (7) the investment and spending policies of the Hospital.

The Hospital has adopted investment and spending policies for endowment assets that attempt to provide a predictable stream of funding to the endowment funds while seeking to maintain the purchasing power of the funds. To satisfy long-term return objectives, the Hospital relies on a total return strategy in which investment returns are achieved through both capital appreciation (realized and unrealized) and current yield (interest and dividends). The Hospital employs a long-term equity oriented strategy of investing in both traditional and alternative asset classes.

7. Related Party Transactions

The Organization has receivables due (to) and from related parties as follows (in thousands):

	2017	2016
Valley Health System, Inc.	$ (3,496)	$ 766
Valley Hospital Foundation, Inc.	852	317
Total	$ (2,644)	$ 1,083

These amounts are reported within supplies and other current assets and other accrued expenses and primarily represent services provided and expenses paid on behalf of affiliates.

For the years ended December 31, 2017 and 2016, the Hospital reported approximately $4.2 million and $9.0 million, respectively, of contributions received from the Foundation in the accompanying consolidated statements of operations and changes in net assets. These contributions included both equipment reimbursements and other unrestricted funds and are included in net changes in assets held by related organization and net asset transfers to/from affiliated entities.

The Hospital and VMG reported $43.9 million at December 31, 2017 and 2016 for its accumulated interest in net assets of the Foundation as assets held by related organization in the accompanying consolidated balance sheet. Changes in the Hospital's interest in the net assets of $0.7 million and $(0.1) million for the years ended December 31, 2017 and 2016, respectively, are reported within changes in related party transactions in the accompanying consolidated statements of operations and changes in net assets.

Effective January 1, 2017, certain administrative department cost centers were transferred to The Valley Health System. Total costs, consisting of salaries and operating expenses, of $64.5 million were charged to individual entities based upon pre-determined allocation methods.

8. Pension Plans

Defined Benefit Plan

The Hospital maintains a defined benefit plan covering employees of the Hospital and VMG as of December 31, 2017. For the year ended December 31, 2016 and prior, the Hospital maintained a defined benefit plan covering employees of the Hospital, VMS and VPS. The benefits are based on years of service and final average earnings. The Hospital's funding policy is based on contribution levels recommended by consulting actuaries considering Employee Retirement Income Security Act of 1974 ("ERISA") regulations.

The Plan was amended effective April 1, 2004 to provide that no employee who first completes an hour of service after such date shall be eligible to participate in the Plan. The Plan was further amended on December 31, 2010 to provide that no participant shall accrue any additional benefits after December 31, 2010 and that a participant's accrued benefit determined as of December 31, 2010 shall not increase thereafter.

The following table provides a reconciliation of the changes in the projected benefit obligation and fair value of the plan assets and a statement of the funded status of the Plan (in thousands):

	2017	2016
Change in benefit obligation:		
Benefit obligation, beginning of year	$ 266,603	$ 257,277
Interest cost	10,112	10,585
Actuarial (gain) loss	(2,004)	8,276
Benefits paid	(1,632)	(9,535)
Settlements	(11,145)	-
Benefit obligation, end of year	261,934	266,603
Change in plan assets:		
Fair value of plan assets, beginning of year	269,591	248,819
Actual return on plan assets	39,333	20,307
Employer contribution	-	10,000
Benefits paid (annuity)	(1,632)	(9,535)
Benefits paid (lump sum)	(11,145)	-
Fair value of plan assets, end of year	296,147	269,591
Funded status	$ 34,213	$ 2,988

	2017	2016
Amounts recognized in accumulated unrestricted net assets consist of:		
Net actuarial (loss) gain	$ 61,179	$ 97,372
Prior service cost	1,388	1,644
	$ 62,567	$ 99,016

The estimated net actuarial loss and prior service cost that are expected to be amortized from accumulated unrestricted net assets into net pension cost in 2018 is $3,718 and $256, respectively.

Effective January 1, 2013, an amendment was adopted to offer lump sums to terminated vested participants whose present values were less than $50,000 as of July 1, 2013. Effective September 1, 2013, an amendment was adopted to offer lump sums to all terminated vested participants as of December 1, 2013.

Effective May 1, 2014, an amendment was adopted to add a lump sum option. In addition, the amendment permits terminated vested participants to elect to receive benefits beginning any month, beginning May 2014, even if such date is prior to the participants' early retirement date.

At December 31, 2017 and 2016, the funded status of the Plan is reported in the consolidated balance sheet as a noncurrent asset. The accumulated benefit obligation for the Hospital's Plan totaled approximately $261.9 million and $266.6 million at December 31, 2017 and 2016, respectively.

The discount rate used in determining the Plan's projected benefit obligation was 3.5% and 3.9% at December 31, 2017 and 2016, respectively.

Net periodic pension costs are comprised of the following (in thousands):

	2017	2016
Interest cost	$ 10,112	$ 10,585
Expected return on assets	(15,739)	(14,614)
Recognized actuarial loss	7,992	8,632
Amortization of prior service cost	256	256
Net periodic pension cost	$ 2,621	$ 4,859

In addition, there were pension settlement costs of $2.6 million for the year ended December 31, 2017, which is included in pension expense in the consolidated statement of operations and changes in net assets. The total pension cost was $5.2 million and $4.9 million for the years ended December 31, 2017 and 2016, respectively.

Weighted-average assumptions used in determining the net periodic pension cost were as follows:

	2017	2016
Discount rate	3.90 %	4.20 %
Expected long-term rate of return on market-related plan assets	6.00 %	6.00 %

The Hospital's Plan weighted-average asset allocations by asset category were as follows:

	Plan Assets at December 31		
Asset Category	2017	2016	Target Allocation
Equity securities	65 %	55 %	50 - 70 %
Fixed income	30	33	30 - 50
Alternative investments	5	12	-
Total	100 %	100 %	

Plan assets are invested in a trust. The investment committee of the Board of Trustees establishes the target asset mix and monitors asset performance. The Hospital's determination of the expected long-term rate of return on assets is based on a building block approach. First, the underlying inflation rate is determined, then the expected real rate of return of stocks and bonds is determined based on their allocation percentages within the trust.

The assets of the Plan are managed in accordance with ERISA. Plan assets are measured at fair value and consist of cash and cash equivalents, collective investment funds, and alternative investments. Cash and cash equivalents and collective funds are reported at fair value in accordance with the policies discussed in Note 1. Collective investment funds underlying securities primarily consist of equity and fixed income securities. Refer to Note 11 for fair value measurement information related to the Plan asset categories noted above.

Any contribution above the minimum requirement is discretionary. The Hospital did not have a minimum required contribution in 2017 and did not make a contribution. The Hospital does not have a minimum required contribution in 2018 and does not expect to contribute to the Plan.

Expected benefit payments (includes future accruals) for the next ten years are as follows (in thousands):

2018	$ 14,363
2019	14,775
2020	16,398
2021	17,781
2022	16,921
Thereafter	76,827

401(k) Retirement Savings Plan

In April 2004, the Hospital introduced a 401(k) Retirement Savings Plan. The Hospital no longer offers the defined benefit plan to employees hired after April 1, 2004. Participants of the defined benefit plan had the option to continue with the defined benefit plan, or begin to earn benefits in the new 401(k) plan effective April 1, 2004 with full credit for benefits earned through the defined benefit plan as of March 31, 2004.

All employees of the Organization who have attained the age of 21, completed one year of service and have at least 1,000 hours of service are eligible to participate. Employees may contribute 1% to 25% of their salary on a pretax basis, not to exceed the Internal Revenue Service limitation of $18,000 in 2017 and 2016. All employee pretax contributions are 100% vested. Prior to January 1, 2010, the Organization contributed 2% of the employee's base compensation and it matched up to 2% of the employee's contribution.

Effective January 1, 2010, the Hospital introduced a new formula under the 401(k) plan to determine the basic contribution percentage that will be provided to each employee in the Organization. Using a points scale system, every employee will be credited with one point for each full year of credited service (a calendar year with 1,000 hours of service), as well as one point for each full year of employee's age. Basic contributions range from 1% to 6% based on points. Additionally, the Hospital will match 100% of the first 3.5% employee contribution on top of the basic contribution. The Organization contributed $16.2 million and $16.5 million to the 401(k) Retirement Savings Plan in 2017 and 2016, respectively.

9. Concentrations of Credit Risk

The Hospital grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payor agreements. The concentrations of gross accounts receivable from patients and third-party payors were as follows:

	2017	2016
Blue Cross	19 %	20 %
Medicare and Medicaid	23	24
Commercial	8	6
Managed care	34	34
Self-pay	16	16
	100 %	100 %

10. Other Items and Special Projects

The components of other items and special projects are as follows (in thousands):

	2017	2016
Offsite properties	$ (14,979)	$ (6,195)
Changes to prior year allowances and reimbursement estimates	22,131	18,903
Strategic initiatives and other nonrecurring items	(8,025)	(13,886)
Total	$ (873)	$ (1,178)

11. Fair Value Measurements

For assets and liabilities required to be measured at fair value, the Organization measures fair value based on the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value measurements are applied based on the unit of account from the Organization's perspective. The unit of account determines what is being measured by reference to the level at which the asset or liability is aggregated (or disaggregated) for purposes of applying other accounting pronouncements.

The Organization follows a valuation hierarchy that prioritizes observable and unobservable inputs used to measure fair value into three broad levels, which are described below:

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

Level 2 - Observable inputs that are based on inputs not quoted in active markets, but corroborated by market data.

Level 3 - Unobservable inputs are used when little or no market data is available. The fair value hierarchy gives the lowest priority to Level 3 inputs.

A financial instrument's categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement. In determining fair value, the Organization uses valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs to the extent possible and considers nonperformance risk in its assessment of fair value.

Financial instruments (included in cash and cash equivalents, limited use assets (excluding amounts accounted for using the equity method of accounting), deferred compensation assets, and defined benefit plan assets), carried at fair value as of December 31, 2017 are classified in the table below in one of the three categories described above (in thousands):

	2017			
	Level 1	**Level 2**	**Level 3**	**Total**
Cash and cash equivalents	$ 30,267	$ -	$ -	$ 30,267
Equity securities	26,068	-	-	26,068
Fixed Income:				
Mortgage backed securities	-	6,276	-	6,276
U.S. Treasuries	217,150	-	-	217,150
Corporate bonds	-	151,028	-	151,028
Loomis Sayles Mutual Fund	49,106	-	-	49,106
Equity mutual funds:				
Deferred Comp Mutual Funds	19,965	-	-	19,965
MSCI ACWI	-	32,613	-	32,613
Equity Index Fund	-	53,498	-	53,498
Russell 2000 Index Fund	-	21,330	-	21,330
PIMCO Mutual Fund	11,802	-	-	11,802
Wellington Mutual Fund	4,793	-	-	4,793
Total assets in the fair value hierarchy	$ 359,151	$ 264,745	$ -	623,896
Assets recorded at net asset value				286,028
Assets at fair value				$ 909,924

Financial instruments (included in cash and cash equivalents, limited use assets (excluding amounts accounted for using the equity method of accounting), deferred compensation assets, and defined benefit plan assets), carried at fair value as of December 31, 2016 are classified in the table below in one of the three categories described above (in thousands):

	2016			
	Level 1	**Level 2**	**Level 3**	**Total**
Cash and cash equivalents	$ 13,658	$ -	$ -	$ 13,658
Equity securities	21,779	-	-	21,779
Fixed income:				
Mortgage backed securities	-	20,382	-	20,382
U.S. Treasuries	203,023	-	-	203,023
Corporate bonds	-	151,797	-	151,797
Loomis Sayles Mutual Fund	45,301	-	-	45,301
Equity mutual funds:				
Deferred Comp Mutual Funds	28,776	-	-	28,776
MSCI ACWI	-	29,442	-	29,442
Equity Index Fund	-	51,861	-	51,861
Russell 2000 Index Fund	-	21,789	-	21,789
PIMCO Mutual Fund	10,534	-	-	10,534
Wellington Mutual Fund	8,922	-	-	8,922
Total assets in the fair value hierarchy	$ 331,993	$ 275,271	$ -	607,264
Assets recorded at net asset value				256,998
Assets at fair value				$ 864,262

Financial Instruments

The following is a description of the valuation methodologies used for assets measured at fair value. There have been no changes in methodologies sued at December 31, 2017 and 2016.

Cash and cash equivalents: the carrying amounts approximate fair value because of the short-term nature of the instruments.

Equity Securities: Valued at closing price reported on the active market on which the individual securities are traded.

Fixed income and equity mutual funds, U.S. government obligations, bonds, and commercial mortgage-backed securities: Valued based on quoted market prices, estimated quoted market prices of similar securities, and model-based valuation techniques for which all significant assumptions are observable in the market or can be corroborated by observable market data for substantially the full term of the assets.

Investments in the accompanying consolidated balance sheet include $286 million and $256 million of common collective trusts ("CCTs"), hedge funds, and other alternative investments funds (the "Funds") at December 31, 2017 and 2016, respectively. The Funds are measured using the net asset value per share as a practical expedient. The Funds are generally structured such that the Organization holds a limited partnership interest or an interest in an investment management company. The Organization's ownership structure does not provide for control over the related investees, and the Organization's financial risk is limited to the carrying amount reported for each investee, in addition to any unfunded capital commitment. The Organization may be exposed indirectly to securities lending, short sales of securities, and trading in futures and forward contracts, options and other derivative products. The Organization has no plans to sell the Funds or a portion of the amounts currently owned. Financial information used by the Organization to evaluate the Funds are provided by the investment manager or general partner, and includes fair value valuations of underlying securities and other financial instruments held by the investee, and estimates that require varying degrees of judgment. The financial statements of the Funds are audited annually by independent auditors, although the timing of reporting the results of the audits does not coincide with the Organization's annual consolidated financial statement reporting. There is uncertainty in the accounting for the Funds arising from factors such as a lack of active markets, lack of transparency in underlying holdings, and time lags associated with reporting by the investee companies. As a result, there is at least a reasonable possibility that estimates of fair value will change in the near term. The following represents each of the fund's objectives and redemption restrictions:

Blackrock Equity Index Non-Lendable Fund: The fund's objective is to seek results that correspond to the price and yield performance of the S&P 500 Index. The Organization is required to provide notice for redemption of this fund by the 15th day of the month prior to redemption. There were no unfunded commitments related to this fund at December 31, 2017 and 2016.

Blackrock MSCI ACWI EX-US Non-Lendable Fund: The fund's objective is to seek investment results that correspond generally to the price and yield performance of the MSCI ACWI ex-U.S. Net Dividend Return Index. The Organization is required to provide notice for redemption of this fund by the 15th day of the month prior to redemption. There were no unfunded commitments related to this fund at December 31, 2017 and 2016.

Blackrock Russell 2000 Index Non-Lendable Fund: The fund's objective is to seek investment results that correspond generally to the price and yield performance of the Russell 2000 Index. The Organization is required to provide notice for redemption of this fund by the 15th day of the month prior to redemption. There were no unfunded commitments related to this fund at December 31, 2017 and 2016.

State Street Bank and Trust Company SSgA U.S. Aggregate Bond Index Non-Lending Fund: The investment objective of the Fund is to approximate as closely as practicable, before expenses, the performance of the Barclays U.S. Aggregate Bond Index over the long term. The Fund attempts to achieve its investment objective by investing in other collective investment funds (each an underlying fund), managed by the Trustee, which have characteristics consistent with the Fund's overall investment objective. In order to redeem the investment in this Fund, the Organization has to provide 30 days written notice. There were no unfunded commitments related to this fund at December 31, 2017 and 2016.

Greenlight Masters Offshore Fund: The hedge fund is a fund-of-funds that allocates capital primarily to long/short value equity managers. The underlying funds generally share a bottom-up, fundamental approach with an emphasis on valuation-driven analysis. Risk is typically managed on an investment-by-investment basis, monitoring the risk-reward characteristics of each fund on an on-going basis and sizing each accordingly in the portfolio. The Organization can redeem their investment in this fund on December 31 with ninety days written notice. There were no unfunded commitments related to this fund at December 31, 2017 and 2016.

Natixis Funds ASG Global Alternative Fund: The fund's objective is to pursue an absolute strategy that seeks to provide capital appreciation consistent with the risk-return characteristics of a diversified portfolio of hedge funds. The secondary goal of the Fund is to achieve these returns with less volatility than major equity indices. In order to redeem the investment in this Fund, the Organization has to provide 30 days written notice. There were no unfunded commitments related to this fund at December 31, 2017 and 2016.

12. Contingencies

Various investigations, lawsuits and claims arising in the normal course of operations are pending or on appeal against the Organization. While the ultimate effect of such actions cannot be determined at this time, it is the opinion of management that the liabilities which may arise from such actions would not materially affect the consolidated financial position or results of operations of the Organization.

As a not-for-profit corporation in New Jersey, the Hospital is an organization which has historically qualified for an exemption from real property taxes; however, a number of cities and municipalities in New Jersey have challenged and continue to challenge such exemption. It is possible in the future that the Hospital will be responsible to make payments to local authorities for real property taxes, payments in lieu of taxes, or other payments based on a certain assessment. The financial effects of this matter on the Hospital are not presently determinable.

13. Professional Insurance

Through March 20, 2003, the Organization had malpractice insurance coverage on a claims made basis under a retrospectively rated policy based primarily on experience of a group of health care providers. Premiums were accrued based on the ultimate cost of the Hospital's claims experience to date. Losses from unasserted claims and incidents that may have occurred, but have not been identified under the incident reporting system are included in other accrued expenses in the amount of approximately $1.0 million at December 31, 2017 and 2016 based principally on estimates that incorporate the Hospital's past experience as well as other considerations, including the nature of each claim or incident and relevant trend factors.

Effective March 20, 2003, the Organization became insured for its malpractice and general liability claims under a policy from VHSIC. Under this policy, the Organization is insured for professional liability up to $3.0 million for each incident and with $10.0 million annual aggregate, with an interstitial layer of $1m/$1m x $3m/$10m. The Hospital funds VHSIC for the projected cost of future professional liabilities. Suggested funding levels are actuarially determined based on experience to date of VHSIC and a projected investment return on the self-insured trust fund.

In accordance with U.S. generally accepted accounting principles, VHSIC is required to apply deposit accounting based upon VHSIC (insurer) not providing indemnification of the Organization (insured) against loss or liability. At December 31, 2017 and 2016, the balance of the deposit account was approximately $79.2 million and $70.4 million, respectively, and is included in limited use assets as insurance company-held funds in the accompanying consolidated balance sheet. The actuarially determined undiscounted professional and general liabilities aggregated approximately $34.0 million and $30.2 million at December 31, 2017 and 2016, respectively (includes approximately $7.0 million and $6.3 million at December 31, 2017 and 2016, respectively, for estimated incurred but not reported costs), and are reported as estimated professional liability in the Organization's consolidated balance sheet.

The Organization maintains excess liability coverage with several qualified commercial carriers of up to $40 million loss per incident once in excess of primary coverage.

14. Other Revenue

The Organization's other revenue consists of the following (in thousands):

	2017	2016
Patient convenience	$ 563	$ 594
Valley Health Pharmacy	2,685	2,013
Food services	1,930	1,992
Purchase discounts and rebates	1,723	1,849
Investment income	3,783	2,324
Charity care subsidy	92	68
Acquisition companies rent	2,737	4,031
Other	2,811	3,059
Total	$ 16,324	$ 15,930

15. Non-Operating Gains and Losses

The Organization's non-operating gains and losses consist of the following (in thousands):

	2017	2016
Investment income, net	$ 16,705	$ 16,075
Grant revenue and other expenses, net	-	52
Total	$ 16,705	$ 16,127

16. Lease Commitments

On October 12, 2016, the Organization entered into leasing arrangement by which the lessor will construct a fitness and wellness center with medical office space and ancillary service facilities which will be made available for use by the Organization upon substantial completion of construction of the leased premises. The lease commencement date, the date the leased premises is made available for use to the Organization, is February 1, 2018. The lease is payable in monthly installments over a period of twenty-five years from the lease commencement date with a purchase option of $1 at the end of the term. Monthly lease payments range from $263,021 in year one to $504,375 in year twenty-five with a final rent payment of $10,000,000.

17. Subsequent Events

Announcement of New Paramus Facility

To ensure its ability to meet the long-term needs of the community it serves, The Valley Hospital has announced plans to build a new, state-of-the-art hospital in Paramus, New Jersey. On December 27, 2017, The Valley Hospital received approval of its Certificate of Need application from the New Jersey Department of Health. The Hospital is undergoing a planning process that will result in detailed architectural and site plans being sent to appropriate local, county and state authorities for review and approval. Those authorities include the Borough of Paramus and the New Jersey Department of Health. The Hospital anticipates breaking ground late in 2019 and the new hospital could open as early as 2023.

The Valley Hospital

Consolidating Balance Sheet
December 31, 2017
(In Thousands)

	Valley Hospital	Valley Medical Group	Acquisition Companies	VHS Insurance Company, Ltd.	Eliminations	Consolidated
Assets						
Current Assets						
Cash and cash equivalents	$ 4,152	$ 9,531	$ 1,938	$ -	$ -	$ 15,621
Accounts receivable	66,832	11,192	-	-	-	78,024
Prepaid expenses	4,935	320	-	-	-	5,255
Supplies and other current assets	7,638	946	-	-		8,584
Total current assets	83,557	21,989	1,938	-	-	107,484
Limited use assets, net of current portion:						
Board designated	509,405	-	-	-	-	509,405
Insurance company-held funds	-	-	-	79,405	-	79,405
Donor restricted investments	6,526	-	-	-	-	6,526
	515,931	-	-	79,405	-	595,336
Property and Equipment, Net	301,942	22,732	44,009	-	-	368,683
Other Assets	120,152	3,249	295	-	(79,405)	44,291
Prepaid Pension Asset	34,213	-	-	-	-	34,213
Assets Held by Related Organization	36,692	7,185	-	-	-	43,877
Total assets	$ 1,092,487	$ 55,155	$ 46,242	$ 79,405	$ (79,405)	$ 1,193,884

The Valley Hospital

Consolidating Balance Sheet
December 31, 2017
(In Thousands)

	Valley Hospital	Valley Medical Services, Inc.	Acquisition Companies	VHS Insurance Company, Ltd.	Eliminations	Consolidated
Liabilities and Net Assets						
Current Liabilities						
Accounts payable	$ 24,281	$ 1,538	$ -	$ -	$ -	$ 25,819
Accrued salaries and related benefits	48,020	17,445	-	-	-	65,465
Other accrued expenses	8,998	13,994	669	38	(38)	23,661
Deposit liability	-	-	-	79,247	(79,247)	-
Total current liabilities	81,299	32,977	669	79,285	(79,285)	114,945
Estimated Professional Liability	33,955	-	-	-	-	33,955
Amounts Due to Third-Party Payors and Other Liabilities	70,714	3,383	-	-	-	74,097
Total liabilities	185,968	36,360	669	79,285	(79,285)	222,997
Net Assets						
Unrestricted	899,993	11,610	45,573	120	(120)	957,176
Temporarily restricted	2,097	7,185	-	-	-	9,282
Permanently restricted	4,429	-	-	-	-	4,429
Total net assets	906,519	18,795	45,573	120	(120)	970,887
Total liabilities and net assets	$ 1,092,487	$ 55,155	$ 46,242	$ 79,405	$ (79,405)	$ 1,193,884

The Valley Hospital

Consolidating Statement of Operations and Changes in Net Assets
Year Ended December 31, 2017
(In Thousands)

	Valley Hospital	Valley Medical Group	Acquisition Companies	VHS Insurance Company, Ltd.	Eliminations	Consolidated
Unrestricted Revenues						
Net patient service revenues	$ 681,722	$ 123,361	$ -	$ -	$ -	$ 805,083
Provision for bad debts	(24,072)	(4,902)	-	-	-	(28,974)
Net patient service revenues less provision for bad debts	657,650	118,459	-	-	-	776,109
Other revenue	12,372	18,809	2,737	-	(17,594)	16,324
Total unrestricted revenues	670,022	137,268	2,737	-	(17,594)	792,433
Expenses						
Salaries and wages	244,321	138,440	-	-	-	382,761
Employee benefits	59,716	21,669	-	-	-	81,385
Medical fees	20,904	-	-	-	(17,594)	3,310
Other expenses	223,460	55,450	2,185	-	-	281,095
Depreciation	40,357	-	-	-	-	40,357
Total expenses	588,758	215,559	2,185	-	(17,594)	788,908
Income (loss) from operations before other items and special projects	81,264	(78,291)	552	-	-	3,525
Other items and special projects	203	-	(1,076)	-	-	(873)
Income (loss) from operations	81,467	- (78,291)	(524)	-	-	2,652
Other Income (Loss)						
Non-operating gains and losses	16,705	-	-	-	-	16,705
Change in unrealized gains and losses on investments	20,991	-	-	-	-	20,991
Revenues in excess of (less than) expenses	119,163	(78,291)	(524)	-	-	40,348
Other Changes in Unrestricted Net Assets						
Change in accrued pension liability to be recognized in future periods	36,449	-	-	-	-	36,449
Net changes in assets held by related organization and net asset transfers to / from affiliated entities	(73,322)	80,852	-	-	-	7,530
Increase (decrease) in unrestricted net assets	82,290	2,561	(524)	-	-	84,327
Temporarily Restricted Net Assets						
Net assets released from restriction for operating purposes	109	(771)	-	-	-	(662)
Increase in temporarily restricted net assets	109	(771)	-	-	-	(662)
Increase (decrease) in net assets	82,399	1,790	(524)	-	-	83,665
Net Assets, Beginning of Year	824,120	17,005	46,097	120	(120)	887,222
Net Assets, End of Year	$ 906,519	$ 18,795	$ 45,573	$ 120	$ (120)	$ 970,887