The Valley Hospital

Consolidated Financial Statements
and Supplementary Information

December 31, 2019 and 2018

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Independent Auditors' Report

To the Board of Trustees of
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 sheets as of December 31, 2019 and 2018, 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, for which The Valley Hospital is the sole member, which statements reflect total assets of $128.7 million and $53.0 million as of December 31, 2019 and 2018, respectively, and total revenues of $170.3 million and $152.7 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, 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 audits to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

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

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

Opinion

In our opinion, 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, 2019 and 2018, 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.

Emphasis of Matter

As discussed in Note 1 to the financial statements in 2019, the Organization adopted new accounting guidance related to the Financial Accounting Standards Board Accounting Standards Update (ASU) No. 2014-09, *Revenue from Contracts with Customers (Topic 606) and* FASB ASU 2016-18 *Statement of Cash Flows, Restricted Cash (Topic 230),* ASU No. 2016-02, *Leases (Topic 842).* Our opinion is not modified with respect to these matters.

Change in Reporting Entity

As discussed in Note 1 to the consolidated financial statements, a change in the corporate structure of VHS Insurance Company, Ltd., an entity that was a wholly owned subsidiary of the Valley Hospital, Inc. prior to the change, and is now a wholly owned subsidiary of the parent entity the Valley Health System, Inc., resulted in a change of the reporting entity of the Organization. The change has been applied retrospectively, by excluding all of the accounts of VHS Insurance Company, Ltd. in the consolidated financial statements as of and for the year ended December 31, 2019 and 2018. Our opinion is not modified with respect to this matter.

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, 2019 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
April 17, 2020

The Valley Hospital

Consolidated Balance Sheets
December 31, 2019 and 2018
(In Thousands)

Assets	2019	2018 (As Adjusted)
Current Assets		
Cash and cash equivalents	$ 19,497	$ 7,511
Accounts receivable	90,379	80,389
Prepaid expenses	5,606	5,086
Supplies and other current assets	11,474	9,085
Total current assets	126,956	102,071
Assets Whose Use is Limited		
Board designated	758,577	541,411
Trustee-held funds	394,070	-
Donor restricted investments	6,580	6,506
	1,159,227	547,917
Property and Equipment, Net	431,690	396,627
Finance Lease Right-of-Use Asset	56,313	57,615
Operating Lease Right-of Use Asset	73,116	-
Other Assets	74,025	74,489
Prepaid Pension Asset	10,838	22,083
Assets Held by Related Organization	51,874	64,816
Total assets	$ 1,984,039	$ 1,265,618

Liabilities and Net Assets	2019	2018 (As Adjusted)
Current Liabilities		
Accounts payable	$ 42,663	$ 39,738
Accrued salaries and related benefits	58,105	50,768
Current portion of long term debt	11,880	-
Current portion of finance lease obligation	188	94
Current portion of operating lease liability	8,561	-
Other accrued expenses	49,727	20,722
Accrued bond interest payable	867	-
Total current liabilities	171,991	111,322
Operating Lease Liability	65,622	-
Long Term Debt, Noncurrent Portion	387,742	-
Finance Lease, Noncurrent Portion	59,457	59,645
Estimated Professional Liability	32,300	32,448
Amounts Due to Third-Party Payors and Other Liabilities	68,579	79,753
Total liabilities	785,691	283,168
Net Assets		
Without donor restrictions	1,186,916	969,900
With donor restrictions	11,432	12,550
Total net assets	1,198,348	982,450
Total liabilities and net assets	$ 1,984,039	$ 1,265,618

See notes to consolidated financial statements

The Valley Hospital

Consolidated Statements of Operations and Changes in Net Assets
Years Ended December 31, 2019 and 2018
(In Thousands)

	2019	2018 (As Adjusted)
Changes in Net Assets Without Donor Restrictions		
Net patient service revenues	$ 950,074	$ 856,968
Provision for bad debts	-	(27,694)
Net patient service revenues less provision for bad debts	950,074	829,274
Other revenues	23,131	15,144
Total operating revenue	973,205	844,418
Expenses		
Salaries and wages	418,595	397,214
Employee benefits	79,438	76,063
Medical fees	801	2,445
Other expenses	329,291	294,525
Interest expense	3,371	2,880
Depreciation	50,088	43,198
Total operating expenses	881,584	816,325
Operating income before other items and special projects	91,621	28,093
Other Items and Special Projects	(2,076)	18,589
Operating income	$ 89,545	$ 46,682

See notes to consolidated financial statements

The Valley Hospital

Consolidated Statements of Operations and Changes in Net Assets
Years Ended December 31, 2019 and 2018
(In Thousands)

	2019	2018 (As Adjusted)
Other Income / (Loss)		
Income from operations	$ 89,545	$ 46,682
Non-operating gains	14,016	28,853
Change in unrealized gains (losses) on investments	39,986	(31,815)
Pension costs	(4,436)	(162)
Revenues in excess of expenses	139,111	43,558
Other Changes in Net Assets Without Donor Restrictions		
Change in prepaid pension asset/accrued pension liability to be recognized in future periods	(6,809)	(11,967)
Net changes in assets held by related organization and net assets transfers to / from affiliated entities	70,223	22,515
Total other changes in net assets without donor restrictions	63,414	10,548
Cumulative Effect of Change in Accounting Principle	14,491	-
Increase in net assets without donor restrictions	217,016	54,106
Changes in Net Assets With Donor Restrictions		
Decrease in assets with donor restrictions	(1,118)	(1,161)
Increase in net assets	215,898	52,945
Net Assets, Beginning, As Adjusted	982,450	929,505
Net Assets, Ending	$ 1,198,348	$ 982,450

See notes to consolidated financial statements

The Valley Hospital

Consolidated Statements of Cash Flows
Years Ended December 31, 2019 and 2018
(In Thousands)

	2019	2018
Cash Flows From Operating Activities		
Increase in net assets	$ 215,898	$ 52,945
Adjustments to reconcile increase in net assets to net cash provided by operating activities:		
Depreciation and amortization	54,627	47,470
Interest expense right-of-use leases	1,067	-
Change in assets held by related organization	12,942	(20,939)
Change in prepaid pension asset / accrued pension liability to be recognized in future periods	6,809	11,967
Net realized losses (gains) on investments	553	(18,160)
Change in unrealized (gains) losses on investments	(39,986)	31,815
Transfers to/from affiliated entities	(83,165)	(1,576)
Changes in assets and liabilities:		
Accounts receivable	(9,990)	(2,365)
Prepaid expenses, supplies and other current assets	(2,909)	(332)
Other assets	1,079	(30,198)
Accounts payable and other current liabilities	39,519	(3,717)
Pension asset/liability	4,436	163
Estimated professional liability	(148)	(1,507)
Amounts due to third-party payors and other liabilities	(11,174)	5,656
Net cash provided by operating activities	189,558	71,222
Cash Flows From Investing Activities		
Purchase of property and equipment	(88,640)	(73,277)
Net purchases of assets whose use is limited	(177,807)	(7,618)
Net cash used in investing activities	(266,447)	(80,895)
Cash Flows From Financing Activities		
Issuance of long term debt	400,728	-
Cost of issuance	(854)	-
Transfers to/from affiliated entities.	83,165	1,576
Principal payments on capital lease obligation	(94)	(13)
Net cash provided by (used in) financing activities	482,945	1,563
Increase (decrease) in cash and cash equivalents and restricted cash	406,056	(8,110)
Cash and Cash Equivalents and Restricted Cash, Beginning	7,511	15,621
Cash and Cash Equivalents and Restricted Cash, Ending	$ 413,567	$ 7,511
Supplemental Schedule of Noncash Investing and Financing Activities		
Capitalized interest on bonds	$ 615	$ -
Capital lease agreements	$ -	$ 59,752
Supplemental Schedule of Noncash Operating Activity		
Interest expense on right-of-use leases	$ 1,067	$ -
Reconciliation of Cash and Restricted Cash to Balance Sheets		
Cash and cash equivalents, operations	$ 19,497	$ 7,511
Trustee-held funds	394,070	-
	$ 413,567	$ 7,511

See notes to consolidated 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) and Valley Physician Services, Inc. (VPS), (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. 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 2019 and 2018 consolidated results of operations. VPS, VMS, VPSPC, VMSPC and VPSNY all operate under the name "Valley Medical Group" (VMG).

Principles of Consolidation and Change in Reporting Entity

As of December 31, 2019 and 2018 and for the years then ended, the consolidated financial statements include the accounts of the Hospital and VMG, and the other companies created for real estate acquisitions. All significant intercompany accounts and transactions have been eliminated.

In prior year, the Hospital was the sole member of VHS Insurance Company, Ltd. (VHSIC) which is a captive insurance company that provides professional and commercial general liability insurance on a mature claims made basis to the Organization. In 2019, the corporate structure of VHSIC was amended to name the System as the sole member in replacement of the Hospital. VHSIC provides insurance services to all entities under the System and therefore this change was made in order to better align business relationships between affiliated entities of the System. The change has been applied retrospectively to all prior periods presented in accordance with generally accepted accounting principles. The consolidated financial statements as of and for the year ending December 31, 2018 were impacted as follows as a result of this change:

	As Originally Presented for 2018	Effect of Change in Reporting Entity	As Adjusted for Change in Reporting Entity for 2018
		(in thousands)	
Consolidated Balance Sheet:			
Insurance company held funds	$ 73,830	$ (73,830)	$ -
Other assets	42,041	32,448	74,489
Net assets without donor restriction	1,011,282	(41,382)	969,900
Consolidated Statements of Operations and Changes in Net Assets:			
Net assets, beginning	970,887	(41,382)	929,505
Net assets, ending	1,023,832	(41,382)	982,450
Consolidated Statements of Cash Flows:			
Other assets	2,250	(32,448)	(30,198)
Net purchases of assets whose use is limited	(40,066)	32,448	(7,618)
Net cash used in investing activities	(113,343)	32,448	(80,895)

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 sheets 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, 2019.

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 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 nonoperating gains and losses in the consolidated statements of operations and changes in net assets.

Assets Whose Use is Limited

Assets whose use is limited primarily include assets held by trustee under indenture agreements; designated assets set aside by the Board of Trustees for future capital improvements, over which the Board retains control and may at its discretion subsequently use for other purposes; and donor restricted assets.

Accounts Receivable

Accounts receivable are recorded at net realizable value at the transaction price based on standard charges for services provided, reduced by contractual adjustments provided to third-party payors, discounts provided to uninsured or underinsured patients in accordance with the Organization's policies, and/or implicit price concessions provided to uninsured or underinsured patients, and do not bear interest. Subsequent changes to the estimate of the transaction price are generally recorded as adjustments to patient revenue in the period of the change.

Supplies

Supplies are carried at the lower of cost (first-in, first-out method) or net realizable value. Supplies totaling approximately $8.1 million and $6.7 million are included in supplies and other current assets in the consolidated balance sheets at December 31, 2019 and 2018, 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 2019 or 2018.

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 support with donor restrictions if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, net assets with donor restrictions are reclassified as net assets without donor restrictions and reported in the consolidated statements of operations 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 contributions without donor restrictions 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, 2019 and 2018, amounts on deposit with trustees were equal to liabilities under the plans and aggregated $20.8 million and $18.6 million, respectively. 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 sheets.

The investments held by the trustees are classified as trading securities. For the years ended December 31, 2019 and 2018, the Hospital recorded investment income (loss) related to deferred compensation assets of $4.1 million and $(1.6) 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, 2019 and 2018, there is an insurance asset of $21.3 million and $20.7 million, respectively, which is included in other assets. Related benefit liabilities and expense of $6.5 million in 2019 and $5.8 million in 2018 are included in amounts due to third-party payors and other liabilities in the consolidated balance sheets and employee benefits expenses in the consolidated statements of operations and changes in net assets.

Deferred Financing Costs

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

Classification of Net Assets

The Organization separately accounts for and reports net assets with donor restrictions and net assets without donor restrictions. Net assets with donor restrictions are those whose use is restricted by the donor for a specified period of time or purpose or 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 sheets. 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 for the benefit for the Hospital 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 $1.25 million irrevocable standby letter of credit with a bank for self-insured workers' compensation coverage. The letter of credit expires on March 31, 2021 and is automatically extended.

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. Anticipated insurance recoveries or claims receivable from VHSIC associated with reported claims are reported separately in the Organization's consolidated balance sheets at net realizable value in other assets.

Revenue Recognition

Net patient service revenues are recognized at the amount that reflects the consideration to which the Organization expects to be entitled in exchange for providing patient care. These amounts are due from patients, third-party payors (including commercial and governmental programs), and others and includes variable consideration for retroactive revenue adjustments due to settlement of audits, reviews and investigations. Generally, the Organization bills the patients and third-party payors several days after the services are performed and/or the patient is discharged from the facility. Revenue is recognized as performance obligations are satisfied.

Performance obligations are determined based on the nature of the services provided by the Organization. Revenue for performance obligations satisfied over time is recognized based on actual services incurred in relation to total expected (or actual) payments. The Organization believes that this method provides a faithful depiction of the transfer of services over the term of the performance obligation based on the inputs needed to satisfy the obligation. Generally, performance obligations satisfied over time relate to patients in the Organization receiving inpatient acute care services. The Organization measures the performance obligation from admission into the facility to the point when it is no longer required to provide services to that patient, which is generally at the time of discharge. Revenue for performance obligations satisfied at a point in time are recognized when services are provided and the Organization does not believe it is required to provide additional services to the patient.

Generally, because all the Organization's performance obligations relate to contracts with a duration of less than one year, the Organization has elected to apply the optional exemption provided in Accounting Standard Codification (ASC) 606-10-50-14(a) and, therefore, the Organization is not required to disclose the aggregate amount of the transaction price allocated to performance obligations that are unsatisfied or partially unsatisfied at the end of the reporting period. The unsatisfied or partially unsatisfied performance obligations referred to above are primarily related to inpatient acute care services at the end of the reporting period. The performance obligations for these contracts are generally completed when the patients are discharged, which generally occurs within days or weeks of the end of the reporting period.

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

Other Expenses

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

Reclassifications

Certain reclassifications have been made to the prior period to confirm with current reporting.

Measure of Operations

The consolidated statements of operations and changes in net assets reflects all operating revenues and expenses that are an integral part of the Organization's healthcare services and supporting activities and net assets released from donor restrictions to support operating expenditures. Changes in revenues in excess of expenses that are excluded from operating income, consistent with industry practice, include investment income (including realized and unrealized gains and losses on investments, interest, dividends and investment expense), contributions, nonoperating grant revenue and net periodic pension cost.

Revenues in Excess of Expenses

The consolidated statements of operations and changes in net assets includes the determination of revenues in excess of expenses. Changes in net assets without donor restrictions which are excluded from the determination of revenues in excess of expenses, consistent with industry practice, include 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, 2019 and 2018 and for the years 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.

The Organization accounts for uncertainty in income taxes by prescribing a recognition threshold of more-likely-than-not to be sustained upon examination by the appropriate taxing authority. Measurement of the tax uncertainty occurs if the recognition threshold has been met. There were no tax uncertainties that met the recognition threshold in 2019 or 2018.

Subsequent Events

The Hospital has evaluated the impact of subsequent events through April 17, 2020, representing the date at which the consolidated financial statements were issued.

The Hospital's operations and financial performance will be affected by the recent COVID-19 outbreak which has spread globally and is adversely affecting economic conditions throughout the world. The Organization's evaluation of the effects of these events is ongoing as of the date the accompanying financial statements were issued. The pandemic will impact various parts of 2020 operations and financial performance including, but not limited to, additional costs for emergency preparedness, disease control and containment, potential shortages of personnel, supply chain disruption, closure of certain facilities or service lines, and declines in revenue related to decreases in occupancy or volumes of certain revenue streams. The extent of the impact will depend on future developments, including the duration and spread of the outbreak and related governmental or other regulatory actions.

New Accounting Pronouncements

Revenue From Contracts With Customers

In 2019, the Organization adopted the Financial Accounting Standards Board (the FASB) Accounting Standards Update (ASU) No. 2014-09, *Revenue from Contracts with Customers (Topic 606)* using the modified retrospective approach. ASU No. 2014-09 supersedes the revenue recognition requirements in Topic 605, *Revenue Recognition*, and most industry specific guidance. The core principle under ASU No. 2014-09 is that revenues are recognized to depict the transfer of promised goods or services to customers (patients) in an amount that reflects the consideration at which the entity expects to be entitled in exchange for those goods or services. Additionally, ASU No. 2014-09 requires enhanced disclosures of revenue arrangements.

The Organization applied the modified retrospective approach to all contracts when adopting ASU No. 2014-09. As a result of the adoption, the majority of what was previously classified as the provision for bad debts in the consolidated statements of operations and changes in net assets is now reflected as implicit price concessions, as defined in Topic 606, and therefore included as a reduction of net patient service revenues. For changes in transaction price related to changes in patient circumstances, the Organization will prospectively recognize those amounts as a provision for bad debts within operating expenses on the consolidated statements of operations and changes in net assets. For periods prior to January 1, 2019, the provision for bad debts of approximately $27.7 million has been presented consistent with the previous revenue recognition standards that required separate presentation of these amounts as a component of net patient service revenues. Additionally, as a result of the adoption of ASU No. 2014-09, the allowance for doubtful accounts of approximately $58.2 million as of January 1, 2019 was reclassified as a component of accounts receivable, net. Also due to the adoption of ASU No. 2014-09 $14.5 million was recorded as a cumulative effect of accounting principle as a result of reviewing reserves recorded within due to third-party payors as of December 31, 2019.

Statement of Cash Flows

In 2019, the Organization adopted the FASB ASU 2016-18 *Statement of Cash Flows, Restricted Cash (Topic 230)*. The amendments in this update require that a statement of cash flows explain the change during the period in the total of cash and amounts generally described as restricted cash. Amounts generally described as restricted cash should be included with cash and cash equivalents when reconciling the beginning-of-period and end-of-period total amounts shown on the statement of cash flows. The Organization has adjusted the presentation of these financial statements accordingly. ASU No. 2016- 18 has been applied retrospectively to all periods presented. With the change in reporting entity, there were no restricted investments during 2018 as adjusted, therefore the adoption had no impact on the statements of cash flows for the year ended December 31, 2018.

Leases

In February 2016, the FASB issued ASU No. 2016-02, *Leases (ASC Topic 842).* ASU No. 2016-02 was issued to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. Under the provisions of ASU No. 2016-02, a lessee is required to recognize a right-to-use asset and lease liability, initially measured at the present value of the lease payments, in the consolidated balance sheets. In addition, lessees are required to provide qualitative and quantitative disclosures that enable users to understand more about the nature of the Organization's leasing activities. In 2019, the Organization adopted the provisions of ASU No. 2016-02 on January 1, 2019 using the modified retrospective application method. Upon completing the implementation assessment of ASC Topic 842, the Organization concluded that no adjustment was required to the opening balance of retained net assets without donor restriction at the date of initial application. As a result of adopting ASC Topic 842, the Organization has recognized a right-of-use asset and lease liability of $73.1 million and $74.1 million, respectively, on the balance sheets for the year ended December 31, 2019. A finance lease right-of-use asset of $57.6 million was reclassed from property and equipment, net for the year ended December 31, 2018. Additional disclosures required by ASC Topic 842 are presented within Note 16.

Retirement Benefits

In March 2017, the FASB issued ASU No. 2017-07, *Compensation - Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost.* The new guidance requires that an employer report the service cost of net periodic benefit cost in the same line item(s) as other compensation costs arising from services rendered by employees during the period. Other cost components are required to be presented in the consolidated statements of operations and changes in net assets separately from the service cost component, and outside of the operating indicator. The guidance allows for the service cost component to be eligible for capitalization, when applicable. The Organization retrospectively adopted in 2019. There was no significant effect on the financial statements as a result of the adoption of this guidance.

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. Charges for charity care rendered were approximately $22.6 million and $21.3 million for the years ended December 31, 2019 and 2018, respectively. Total charity care costs were approximately $5.5 million and $5.3 million for the years ended December 31, 2019 and 2018.

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 $0.4 million and $0.3 million for the years ended December 31, 2019 and 2018, respectively, and is included in other revenue.

3. Net Patient Service Revenues

The composition of the Organization's net patient care service revenue by payor for the years ended December 31 is as follows:

	2019	2018
Medicare	$ 252,660	$ 213,684
Horizon	189,194	176,875
United / Oxford	166,210	143,719
Self Pay / Charity	12,161	10,007
Other	329,849	284,989
Total	$ 950,074	$ 829,274

The composition of patient care service revenue based on the Organization's lines of business for years ended December 31 is as follows:

	2019	2018
Medical Center	$ 801,025	$ 695,115
Physicians practice	149,049	134,159
Total	$ 950,074	$ 829,274

The Organization 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 2016 at December 31, 2019. Medicare informed hospitals of their intent to reopen cost report years 2006-2009 and 2011-2013. The Hospital has filed appeals for 2010-2014 with the Provider Reimbursement Review Board.

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 2017 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.

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.

Settlements with third-party payors for retroactive adjustments due to audits, reviews or investigations are considered variable consideration and are included in the determination of the estimated transaction price for providing patient care. These settlements are estimated based on the terms of the payment agreement with the payor, correspondence from the payor and the Hospital's historical settlement activity, including an assessment to ensure that it is probable that a significant reversal in the amount of cumulative revenue recognized will not occur when the uncertainty associated with the retroactive adjustment is subsequently resolved. Estimated settlements are adjusted in future periods as adjustments become known (that is, new information becomes available), or as years are settled or are no longer subject to such audits, reviews and investigations. Revenue received under third-party arrangements is subject to audit and retroactive adjustments. For the year ended December 31, 2019, net patient service revenues on the consolidated statements of operations and changes in net assets includes favorable transaction price adjustments in the amount of $21.9 million related to successful settlements and favorable changes to estimated third-party payor settlement estimates. For the year ended December 31, 2019, the Hospital recorded an increase of approximately $14.5 million to net assets on the consolidated statements of operations related to the adoption of ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606) as a cumulative effect of change in accounting principle. For the year ended December 31, 2018, approximately $32.5 million of successful settlements and favorable changes to estimated third-party payor settlement estimates was recorded as an increase to other items and special projects (see Note 10).

Generally, patients who are covered by third-party payors are responsible for related deductibles and coinsurance, which vary in amount. The Organization also provides services to uninsured patients, and offers those uninsured or underinsured patients a discount, either by policy or law, from standard charges. The Organization estimates the transaction price for patients with deductibles and coinsurance and from those who are uninsured based on historical experience and current market conditions. The initial estimate of the transaction price is determined by reducing the standard charges by any contractual adjustment, discounts, and implicit price concessions. Subsequent changes to the estimate of the transaction price are generally recorded as adjustment to net patient service revenue in the period of the change. For the year ended December 31, 2019 the impact of changes in the estimates of discounts and contractual adjustments for performance obligations satisfied in prior years was insignificant to the consolidated financial statements.

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

4. Assets Whose Use is Limited

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

	2019	2018
Cash and cash equivalents	$ 406,753	$ 11,508
Equity securities	3,283	2,602
Pooled/collective investment funds	83,731	65,815
U.S. government obligations and government secured obligations	376,755	256,461
Corporate bonds	285,018	208,718
Alternative investments	115	237
	1,155,655	545,341
Accrued interest receivable	3,572	2,576
Total	$ 1,159,227	$ 547,917

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, 2019 and 2018, the change in net unrealized gains and losses was approximately $40.0 million and $(31.8) million, respectively.

Investment income consists of the following (in thousands):

	2019	2018
Included in nonoperating gains (Note15)		
Interest and dividend income	$ 14,569	$ 10,693
Realized (losses) gains on sales of securities	(553)	18,160
Total	$ 14,016	$ 28,853

5. Property and Equipment

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

	2019	2018
Land	$ 92,598	$ 94,567
Land improvements	16,643	16,621
Building	518,487	485,502
Equipment and furnishings	513,773	476,040
	1,141,501	1,072,730
Less accumulated depreciation	781,532	725,446
	359,969	347,284
Construction in progress	71,721	49,343
Property and equipment, net	$ 431,690	$ 396,627

Depreciation expense for the years ended December 31, 2019 and 2018 totaled $54.4 million and $47.5 million, respectively. Included in these amounts are $4.3 million in 2019 and 2018, which are included in other items and special projects (see Note 10).

The Organization has begun the process of replacing the acute care facility, with a new acute care hospital and medical center facility to be located in Paramus, New Jersey. At December 31, 2019, the Organization had commitments outstanding of approximately $551.9 million related to current construction projects. The Organization has obtained financing through the issuance of bonds in 2019 (Note 17).

6. Net Assets With Donor Restrictions

Net assets with donor restrictions are available for the following purposes (in thousands):

	2019	2018
Health care services	$ 1,566	$ 1,491
VMG services	4,852	6,044
Health education	585	586
Endowment funds	4,429	4,429
Total	$ 11,432	$ 12,550

Endowment funds 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 donor 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 net assets with donor restrictions 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 classified as net assets with donor restrictions in perpetuity 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 amounts due (to) and from related parties as follows (in thousands):

	2019	2018
Valley Health System, Inc.	$ (6,167)	$ (2,864)
Valley Hospital Foundation, Inc.	1,114	714
Total	$ (5,053)	$ (2,150)

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 and are noninterest bearing.

The Organization had net asset transfers (to) and from related parties as follows (in thousands):

	2019	2018
Transfer from Valley Home Care	$ 30,211	$ -
Transfer from Foundation	29,512	-
Transfer to VHSIC	(3,055)	-
Contributions from Foundation	5,015	1,590
Change in assets held by related organization	8,664	22,080
Transfer from Hospital to VMG	(78,306)	(85,487)
VMG net transfers	79,182	85,832
Acquisition companies net transfers	(1,000)	(1,500)
Total	$ 70,223	$ 22,515

These amounts are recorded as net changes in assets held by related organization and net transfers to/from affiliated entities on the consolidated statements of operations and changes in net assets. For the years ended December 31, 2019 and 2018, the Hospital reported approximately $5.0 million and $1.6 million, respectively, of contributions received from the Foundation which include both equipment reimbursements and other funds without donor restrictions. The Hospital and VMG reported $51.9 million and $64.8 million at December 31, 2019 and 2018, respectively, for its accumulated interest in net assets of the Foundation as assets held by related organization in the accompanying consolidated balance sheets. Changes in the Hospital's interest in the net assets were $8.7 million and $22.1 million for the years ended December 31, 2019 and 2018, respectively. For the year ended December 31, 2019, transfers from Valley Home Care of $30.2 million and from the Foundation of $29.5 million were related to the completion of financing (Series 2019) with the New Jersey Health Care Facilities Financing Authority (see Note 17).

Effective January 1, 2017, certain administrative department cost centers were transferred to The Valley Health System. For the years ended December 31, 2019 and 2018, total costs, consisting of salaries and operating expenses, of $74.7 million and $65.8 million, respectively, were charged to individual entities based upon pre-determined allocation methods. These amounts are included in operating expenses on the consolidating statements of operations and changes in net assets.

8. Pension Plans

Defined Benefit Plan

The Hospital maintains a defined benefit plan covering employees of the Hospital and VMG. 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.

On June 30, 2019, the Board of Trustees resolved its intent to terminate the defined benefit plan and the settlement date is expected to be in 2020. As a result of the decision to terminate the Plan, the benefit obligation for the year ended December 31, 2019 assumes that 70 percent of active and terminated vested participants are to elect a lump sum distribution at the plan termination distributions date, and that annuities will be purchased for the remaining plan participants. The benefit obligation was adjusted for this pending termination.

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):

	2019	2018
Change in benefit obligation:		
Benefit obligation, beginning of year	$ 240,132	$ 261,934
Interest cost	9,548	8,919
Actuarial loss (gain)	48,682	(13,553)
Benefits paid	(2,391)	(2,072)
Settlements	(14,953)	(15,096)
Benefit obligation, end of year	281,018	240,132
Change in plan assets:		
Fair value of plan assets, beginning of year	262,215	296,147
Actual return on plan assets	46,985	(16,764)
Employer contribution	-	-
Benefits paid (annuity)	(2,391)	(2,072)
Benefits paid (lump sum)	(14,953)	(15,096)
Fair value of plan assets, end of year	291,856	262,215
Funded status	$ 10,838	$ 22,083
Amounts recognized in accumulated net assets without donor restrictions consist of:		
Net actuarial gain	$ 80,467	$ 73,402
Prior service cost	877	1,133
Total	$ 81,344	$ 74,535

The estimated net actuarial gain and prior service cost that are expected to be amortized from accumulated net assets without donor restrictions into net pension cost in 2020 is $6,426 and $256, respectively.

At December 31, 2019 and 2018, the funded status of the Plan is reported in the consolidated balance sheets as a noncurrent asset. The accumulated benefit obligation for the Hospital's Plan totaled approximately $281.0 million and $240.1 million at December 31, 2019 and 2018, respectively.

The discount rate used in determining the Plan's projected benefit obligation was 2.5 percent and 4.1 percent at December 31, 2019 and 2018, respectively. The change in the discount rate is based on the assumed rate of the cost of purchasing annuities as discussed above.

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

	2019	2018
Interest cost	$ 9,548	$ 8,919
Expected return on assets	(15,300)	(17,344)
Recognized actuarial loss	5,650	3,717
Amortization of prior service cost	256	256
Total	$ 154	$ (4,452)

In addition, there were pension settlement costs of $4.3 million and $4.6 million for the years ended December 31, 2019 and 2018, which is included in other income (loss) in the consolidated statements of operations and changes in net assets, in accordance with the adoption of ASU No. 2017-07, *Compensation - Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost.* The total pension cost was $4.4 million and $.2 million for the years ended December 31, 2019 and 2018, respectively.

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

	2019	2018
Discount rate	4.10 %	3.50 %
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	2019	2018	Target Allocation
Equity securities	12 %	54 %	0 - 15 %
Fixed income	87	32	85 - 100
Other	1	-	0 - 10
Alternative investments	-	14	0
	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 2019 and did not make a contribution. The Hospital does not have a minimum required contribution in 2020 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):

2020	$ 171,109
2021	3,794
2022	4,120
2023	4,474
2024	4,779
Thereafter	26,778

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 percent to 25 percent of their salary on a pretax basis, not to exceed the Internal Revenue Service limitation of $19,000 and $18,500 in 2019 and 2018, respectively. All employee pretax contributions are 100 percent vested. Prior to January 1, 2010, the Organization contributed 2 percent of the employee's base compensation and it matched up to 2 percent 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 percent to 6 percent based on points. Additionally, the Hospital will match 100 percent of the first 3.5 percent employee contribution on top of the basic contribution.

Effective January 1, 2019, changes have been made to the basic and matching contributions. The basic contribution will now include only years of service and will range between 1.5 percent and 4 percent. Additionally, the Hospital will match 100 percent of the first 1 percent employee contribution and 50 percent of the next 5 percent employee contribution on top of the basic contribution. The Organization contributed $13.5 and $16.8 million to the 401(k) Retirement Savings Plan in 2019 and 2018, 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:

	2019	2018
Blue Cross	20 %	20 %
Medicare and Medicaid	20	22
Commercial	8	7
United/Oxford	15	15
Managed care	21	19
Self-pay	16	17
	100 %	100 %

10. Other Items and Special Projects

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

	2019	2018
Offsite properties	$ (6,970)	$ (7,024)
Changes to prior year allowances and reimbursement estimates	-	32,454
Strategic initiatives and other nonrecurring items	4,894	(6,841)
Total	$ (2,076)	$ 18,589

For the year ended December 31, 2019, legal expenses of approximately $25 million are recorded to strategic initiatives and other nonrecurring items. The amount relates to a reserve for a judgment against the Hospital in a matter where alleging breach of the implied covenant of good faith and fair dealing. The Hospital is in the process of filing an appeal.

During 2019, the VHSIC Board of Directors approved approximately $41 million premium credit to the Hospital and is included in strategic initiatives and other nonrecurring items. The assets are included in the board designated assets whose use is limited. (See Note 13).

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, 2019 are classified in the table below in one of the three categories described above (in thousands):

	2019			
	Level 1	**Level 2**	**Level 3**	**Total**
Cash and cash equivalents	$ 408,635	$ -	$ -	$ 408,635
Equity securities	3,283	-	-	3,283
Fixed income:				
Mortgage backed securities	-	3,109	-	3,109
U.S. Treasuries	373,646	-	-	373,646
Corporate bonds	-	242,068	-	242,068
Loomis Sayles Mutual Fund	42,950	-	-	42,950
Equity mutual funds:				
Deferred Comp Mutual Funds	20,558	-	-	20,558
MSCI ACWI	-	24,517	-	24,517
Equity Index Fund	-	43,022	-	43,022
Russell 200 Index Fund	-	16,192	-	16,192
Total assets in the fair value hierarchy	$ 849,072	$ 328,908	$ -	1,177,980
Assets recorded at net asset value				290,322
Assets at fair value				$ 1,468,302

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, 2018 are classified in the table below in one of the three categories described above (in thousands):

	2018			
	Level 1	**Level 2**	**Level 3**	**Total**
Cash and cash equivalents	$ 12,430	$ -	$ -	$ 12,430
Equity securities	2,602	-	-	2,602
Fixed income:				
Mortgage backed securities	-	4,220	-	4,220
U.S. Treasuries	252,241	-	-	252,241
Corporate bonds	-	170,893	-	170,893
Loomis Sayles Mutual Fund	47,603	-	-	47,603
Equity mutual funds:				
Deferred Comp Mutual Funds	17,960	-	-	17,960
MSCI ACWI	-	20,186	-	20,186
Equity Index Fund	-	32,754	-	32,754
Russell 200 Index Fund	-	12,875	-	12,875
PIMCO Mutual Fund	5,539	-	-	5,539
Wellington Mutual Fund	4,241	-	-	4,241
Total assets in the fair value hierarchy	$ 342,616	$ 240,928	$ -	583,544
Assets recorded at net asset value				242,712
Assets at fair value				$ 826,256

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 used at December 31, 2019 and 2018.

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 sheets and defined benefit plan assets include $290 million and $243 million of common collective trusts (CCTs), hedge funds and other alternative investments funds (the Funds) at December 31, 2019 and 2018, 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, 2019 and 2018.

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, 2019 and 2018.

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, 2019 and 2018.

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, 2019 and 2018.

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, 2019 and 2018.

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, 2019 and 2018.

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 million at December 31, 2019 and 2018 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.

During the year ended December 31, 2019, the board approved a premium credit of up to $45 million, and approximately $41 million of the insurance company-held funds were transferred to the Hospital investments and are included in limited use assets as Board designated in the accompanying consolidated balance sheets. The actuarially determined undiscounted professional and general liabilities aggregated approximately $32.3 million and $32.4 million at December 31, 2019 and 2018, respectively (includes approximately $5.8 million and $7.1 million at December 31, 2019 and 2018, respectively, for estimated incurred but not reported costs), and are reported as estimated professional liability in the Organization's consolidated balance sheets. At December 31, 2019 and 2018, approximately $29.2 million and $32.4 million, respectively, of insurance claims receivable from the captive are included in other assets in the accompanying consolidated balance sheets

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 Revenues

The Organization's other revenues consist of the following (in thousands):

	2019	2018
Patient convenience	$ 654	$ 563
Valley Health Pharmacy	3,535	3,351
Food services	2,187	2,095
Purchase discounts and rebates	3,494	2,615
Investment (loss) income	4,738	(1,011)
Charity care subsidy	369	270
Acquisition companies rent	3,737	3,348
Other	4,417	3,913
Total	$ 23,131	$ 15,144

15. Nonoperating Gains

The Organization's nonoperating gains consist of the following (in thousands):

	2019	2018
Investment income, net	$ 14,016	$ 28,853

16. Right-of-Use Assets and Lease Liabilities

The Organization enters into finance and operating leases for buildings, office space and equipment. As of January 1, 2019 the Organization adopted the provisions of ASC 842. Accordingly, all agreements with terms for more than one year were capitalized, where a right of use asset was identified. In connection with the adoption of ASC 842 on January 1, 2019, certain practical expedients available under ASC 842-10-65-1 were elected that provide certain concessions to ease the burden of transition, such as the treatment of indirect lease costs, and service contracts which may contain embedded leases. In addition, certain expedients not related to the transition were elected, such as the election to capitalize lease and nonlease components of an agreement as a single component for purposes of simplicity, with the exception of those related to equipment and machinery. Generally, amounts capitalized represent the present value of minimum lease payments over the term, and the duration is equivalent to the base agreement, however, management used certain assumptions when determining the value and duration of leases. These assumptions include, but are not limited to, the probability of renewing a lease term, certain future events impacting lease payments, as well as fair value not explicit in an agreement. Most of our leases do not include variable payments but contain scheduled escalations. The leases expire at various dates through 2047.

Operating Right-of-Use Assets and Operating Lease Liabilities

In the calculation of the right of use asset and lease liability, the Organization assumed lease renewals of one to three terms where it was probable that the Organization would continue to utilize the facility. Lease expense is recognized on a straight-line basis over the lease term and is included in other expenses on the consolidated statement of operations. Lease expense for 2019 was $12.0 million. At December 31, 2019 the Organization had a current lease liability of $8.6 million and a noncurrent lease liability of $65.6 million. The future lease payments are discounted using the practical expedient for not-for-profit entities, which is the risk-free interest rate. The interest rate used in calculating the lease liability ranges from 1.74 percent to 6.50 percent depending on the length of the lease term. Additional information with respect to the Organization's operating leases as of December 31, 2019 is presented below.

Weighted average remaining lease term in years	
Hospital	1.37
VMG	14.76

The following table presents information about the amount and timing of cash flows arising from operating leases as of December 31, 2019 (in thousands):

2020		
2021	$	10,472
2022		9,258
2023		8,359
2024		7,352
Thereafter		5,084
		51,001
Total lease payments		91,526
Less interest		(17,343)
Present value of lease liabilities	$	74,183

Finance Lease Right-of-Use Asset and Finance Lease Obligation

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 was 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, was 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.

The lease was recorded as a finance lease with a long-term lease asset and lease liability in the amount of $59.7 million and is amortized over the term of the lease. The following is a schedule by years of future minimum lease payments under the finance lease as of December 31, 2019 (in thousands):

2020	$ 3,332
2021	3,424
2022	3,518
2023	3,615
2024	3,714
Thereafter	97,377
Total minimum lease payments	114,980
Less amount representing interest at 6%	(55,335)
Present value of net minimum lease payments	$ 59,645

17. Long-Term Debt

In December 2019, The Valley Hospital completed a financing (Series 2019) with the New Jersey Health Care Facilities Financing Authority (NJHCFFA) for $356,410,000 of publicly issued tax-exempt bonds. These funds, together with investment earnings and other available funds, will be used to finance the costs of planning, development, acquisition, construction, equipping, expansion, furnishing and renovation of a new 372 bed, approximately 875,000 square foot acute care hospital and medical center facility to be located in Paramus, New Jersey, including a 1,500 space parking garage attached thereto, and all infrastructure improvements, relocations and modifications.

The Series 2019 funds are structured with fixed-rate serial bonds maturing from 2020 to 2039 and fixed-rate term bonds maturing in 2044 and 2049.

Yields on the Series 2019 serial bonds range from 1.12 percent for the 2020 maturity to 2.56 percent for the 2039 maturity. Yields for the fixed-rate term bonds are as follows: for the term bond maturing in 2044, a yield to call of 2.71 percent and for the term bond maturing in 2049, a yield to call of 3.15 percent

The overall interest cost for the bond issue is 2.93 percent.

A summary of long term debt is as follows as of December 31, 2019 (in thousands):

Hospital revenue bonds financed with the NJHCFFA, Series 2019	$ 356,410
Net original issue premium	46,027
Less current portion	(11,880)
Less unamortized underwriter discount	(1,703)
Less accumulated amortization of bond premium	(261)
Less unamortized bond issuance costs	(851)
Long-term debt	$ 387,742

Principal payments for the next five years under the NJHCFFA obligations are as follows (in thousands):

2020	$ 11,880
2021	11,885
2022	11,885
2023	11,880
2024	11,880
Aggregate thereafter	297,000
	$ 356,410

The 2019 Bonds loan agreements require the Hospital to comply with financial covenants.

18. Functional Expenses

The financial statements report certain categories of expenses that are attributed to more than one program or supporting function. Therefore, expenses require allocation on a reasonable basis that is consistently applied. Salaries, benefits, medical fees and other expenses are allocated based upon estimates of time and effort. Depreciation and interest are allocated based upon square footage. Amounts shown are in thousands:

	2019		
	Total	**Program**	**Administrative**
Salaries and wages	$ 418,595	$ 359,029	$ 59,566
Employee benefits	79,438	70,135	9,303
Medical fees	801	801	-
Other expenses	329,291	265,426	63,865
Depreciation	50,088	36,063	14,025
Interest	3,371	3,371	-
Total	$ 881,584	$ 734,825	$ 146,759

	2018		
	Total	**Program**	**Administrative**
Salaries and wages	$ 397,214	$ 347,247	$ 49,967
Employee benefits	76,063	66,196	9,867
Medical fees	2,445	2,445	-
Other expenses	294,525	239,622	54,903
Depreciation	43,198	30,239	12,959
Interest	2,880	2,880	-
Total	$ 816,325	$ 688,629	$ 127,696

19. Liquidity and Availability

The Organization's financial assets available within one year of the balance sheets date for general expenditure such as operating expenses are as follows:

	2019	2018
Financial assets at year-end:		
Cash and cash equivalents	$ 19,497	$ 7,511
Accounts receivable	90,379	80,389
Board designated investments	758,577	541,411
Total financial assets	$ 868,453	$ 629,311

As part of the Organization's liquidity management, it has a policy to structure its financial assets to be available as its general expenditures, liabilities and other obligations come due. In addition, the Organization invests cash in excess of daily requirements in short-term investments.

The Valley Hospital

Consolidating Balance Sheet
December 31, 2019
(In Thousands)

	Valley Hospital	Valley Medical Group	Acquisition Companies	Eliminations	Consolidated
Assets					
Current Assets					
Cash and cash equivalents	$ 10,984	$ 6,654	$ 1,859	$ -	$ 19,497
Accounts receivable	74,960	15,419	-	-	90,379
Prepaid expenses	5,357	249	-	-	5,606
Supplies and other current assets	10,826	648	-	-	11,474
Total current assets	102,127	22,970	1,859	-	126,956
Assets Whose Use is Limited					
Board designated	758,577	-	-	-	758,577
Trustee-held funds	394,070	-	-	-	394,070
Donor restricted investments	6,580	-	-	-	6,580
	1,159,227	-	-	-	1,159,227
Property and Equipment, Net	362,703	27,287	41,700	-	431,690
Finance Lease Right-of Use-Asset	56,313	-	-	-	56,313
Operating Lease Right-of Use-Assets	1,048	72,068	-	-	73,116
Other Assets	71,959	1,569	497	-	74,025
Prepaid Pension Asset	10,838	-	-	-	10,838
Assets Held by Related Organization	47,022	4,852	-	-	51,874
Total assets	$ 1,811,237	$ 128,746	$ 44,056	$ -	$ 1,984,039

The Valley Hospital

Consolidating Balance Sheet
December 31, 2019
(In Thousands)

	Valley Hospital	Valley Medical Group	Acquisition Companies	Eliminations	Consolidated
Liabilities and Net Assets					
Current Liabilities					
Accounts payable	$ 40,069	$ 2,594	$ -	$ -	$ 42,663
Accrued salaries and related benefits	39,327	18,778	-	-	58,105
Current portion of long term debt	11,880	-	-	-	11,880
Current portion of finance lease obligation	188	-	-	-	188
Current portion of operating lease liability	762	7,799	-	-	8,561
Other accrued expenses	38,504	10,684	539	-	49,727
Accrued bond interest payable	867	-	-	-	867
Total current liabilities	131,597	39,855	539	-	171,991
Operating Lease Noncurrent Portion	286	65,336	-	-	65,622
Long Term Debt, Noncurrent Portion	387,742	-	-	-	387,742
Finance Lease, Noncurrent Portion	59,457	-	-	-	59,457
Estimated Professional Liability	32,300	-	-	-	32,300
Amounts Due to Third-Party Payors and Other Liabilities	64,867	3,712	-	-	68,579
Total liabilities	676,249	108,903	539	-	785,691
Net Assets					
Without donor restrictions	1,128,408	14,991	43,517	-	1,186,916
With donor restrictions	6,580	4,852	-	-	11,432
Total net assets	1,134,988	19,843	43,517	-	1,198,348
Total liabilities and net assets	$ 1,811,237	$ 128,746	$ 44,056	$ -	$ 1,984,039

The Valley Hospital

Consolidating Statement of Operations and Changes in Net Assets
Year Ended December 31, 2019
(In Thousands)

	Valley Hospital	Valley Medical Group	Acquisition Companies	Eliminations	Consolidated
Changes in Net Assets Without Donor Restrictions					
Net patient service revenues	$ 801,025	$ 149,049	$ -	$ -	$ 950,074
Other revenues	19,225	21,263	3,737	(21,094)	23,131
Total operating revenue	820,250	170,312	3,737	(21,094)	973,205
Expenses					
Salaries and wages	264,961	153,634	-	-	418,595
Employee benefits	56,981	22,457	-	-	79,438
Medical fees	21,895	-	-	(21,094)	801
Other expenses	254,040	72,987	2,264	-	329,291
Interest expense	3,371	-	-	-	3,371
Depreciation	50,088	-	-	-	50,088
Total operating expenses	651,336	249,078	2,264	(21,094)	881,584
Operating income (loss) before other items and special projects	168,914	(78,766)	1,473	-	91,621
Other Items and Special Projects	(843)	-	(1,233)		(2,076)
Operating income (loss)	168,071	(78,766)	240	-	89,545
Other Income (Loss)					
Non-operating gains and losses	14,016	-	-	-	14,016
Change in unrealized gains and losses on investments	39,986	-	-	-	39,986
Pension costs	(4,436)	-	-	-	(4,436)
Revenues in excess of (less than) expenses	217,637	(78,766)	240	-	139,111
Other Changes in Net Assets Without Donor Restrictions					
Change in accrued pension liability to be recognized in future periods	(6,809)	-	-	-	(6,809)
Net changes in assets held by related organization and net assets transfers to / from affiliated entities	(7,959)	79,182	(1,000)	-	70,223
Total other changes in net assets without donor restrictions	(14,768)	79,182	(1,000)	-	63,414
Cumulative Effect of Change in Accounting Principle	14,491	-	-	-	14,491
Increase (decrease) in net assets without donor restrictions	217,360	416	(760)	-	217,016
Changes in Net Assets With Donor Restrictions					
Net assets released from restriction for operating purposes	74	(1,192)	-	-	(1,118)
Increase in net assets with donor restrictions	74	(1,192)	-	-	(1,118)
Increase (decrease) in net assets	217,434	(776)	(760)	-	215,898
Net Assets, Beginning	917,554	20,619	44,277	-	982,450
Net Assets, Ending	$ 1,134,988	$ 19,843	$ 43,517	$ -	$ 1,198,348