

Trinitas Regional Medical Center

Consolidated Financial Statements

December 31, 2017 and 2016



BAKER TILLY

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Trinitas Regional Medical Center

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December 31, 2017 and 2016

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Independent Auditors' Report

Board of Trustees
Trinitas Regional Medical Center

We have audited the accompanying consolidated financial statements of Trinitas Regional Medical Center, (the "Medical Center") (an affiliate of Trinitas Health) and its subsidiaries, which comprise the consolidated balance sheet as of December 31, 2017 and 2016, and the related consolidated statements of operations, changes in net assets, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Consolidated Financial Statements

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

Auditors' Responsibility

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

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

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Trinitas Regional Medical Center and its subsidiaries as of December 31, 2017 and 2016, and the results of its operations, changes in net assets and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Baker Tilly Virchow Krause, LLP

Iselin, New Jersey
April 18, 2018

Trinitas Regional Medical Center

 Consolidated Balance Sheet
 December 31, 2017 and 2016

	<u>2017</u>	<u>2016</u>		<u>2017</u>	<u>2016</u>
Assets			Liabilities and Net Assets		
Current Assets			Current Liabilities		
Cash and cash equivalents	\$ 132,741,105	\$ 130,023,301	Current portion of long-term debt	\$ 5,065,000	\$ 6,055,000
Assets whose use is limited	4,789,990	8,436,557	Accounts payable and accrued expenses	24,496,220	24,433,614
Patient accounts receivable, less allowance for doubtful collections of \$26,589,000 in 2017 and \$32,631,000 in 2016	27,697,494	26,770,713	Deferred revenue	7,330,546	5,542,064
Other receivables	2,596,572	3,384,131	Accrued bond interest payable	2,241,000	3,026,454
Other current assets	<u>6,105,115</u>	<u>5,641,062</u>	Accrued salaries and wages	5,994,526	5,992,441
			Construction and retainage payable	-	1,874,554
			Estimated settlements with third-party payors	<u>13,071,014</u>	<u>16,501,567</u>
Total current assets	<u>173,930,276</u>	<u>174,255,764</u>	Total current liabilities	58,198,306	63,425,694
Assets Whose Use is Limited and Investments			Estimated Settlements with Third-party Payors	49,618,391	46,892,222
Assets Whose Use is Limited:			Long-Term Debt	95,220,237	118,532,642
Internally designated	101,660,141	95,474,057	Other Long-Term Liabilities	<u>18,378,339</u>	<u>16,223,842</u>
Internally designated - other	8,451,871	6,711,884			
Held by trustees under bond indentures	-	13,068,545	Total liabilities	<u>221,415,273</u>	<u>245,074,400</u>
Donor restricted	3,028,167	3,084,982	Net Assets		
Investments	<u>29,829,519</u>	<u>28,597,341</u>	Unrestricted	184,428,392	165,748,761
			Temporarily restricted	9,514,673	7,006,894
Total assets whose use is limited and investments, net of current	142,969,698	146,936,809	Permanently restricted	<u>3,272,888</u>	<u>3,140,794</u>
Beneficial Interest in Net Assets of Trinitas Health Foundation	9,759,389	7,062,702	Total net assets	197,215,953	175,896,449
Property and Equipment, Net	86,120,548	87,230,946			
Other Assets	<u>5,851,315</u>	<u>5,484,628</u>			
Total assets	<u>\$ 418,631,226</u>	<u>\$ 420,970,849</u>	Total liabilities and net assets	<u>\$ 418,631,226</u>	<u>\$ 420,970,849</u>

See notes to consolidated financial statements

Trinitas Regional Medical Center

Consolidated Statement of Operations

Years Ended December 31, 2017 and 2016

	<u>2017</u>	<u>2016</u>
Revenues		
Net patient service revenue	\$ 246,122,448	\$ 243,847,105
Provision for doubtful collections	<u>(16,907,577)</u>	<u>(15,961,302)</u>
Net patient service revenue less provision for doubtful collections	229,214,871	227,885,803
Other revenue	66,787,624	68,606,506
Net assets released from restrictions used for operations	<u>749,362</u>	<u>1,026,473</u>
Total revenues	<u>296,751,857</u>	<u>297,518,782</u>
Expenses		
Salaries and wages	137,453,014	136,253,521
Employee benefits	27,281,250	27,488,850
Supplies and other	111,810,523	112,041,432
Depreciation	10,492,885	10,830,287
Interest	<u>4,605,167</u>	<u>6,540,570</u>
Total expenses	<u>291,642,839</u>	<u>293,154,660</u>
Operating income	<u>5,109,018</u>	<u>4,364,122</u>
Nonoperating Gains		
Interest, dividends and other	3,423,425	3,580,134
Net realized gains on investments	2,277,397	692,290
Loss on refinancing	<u>(1,238,343)</u>	<u>(655,153)</u>
Total nonoperating gains	<u>4,462,479</u>	<u>3,617,271</u>
Revenues in excess of expenses before medicare/medicaid meaningful use	9,571,497	7,981,393
Medicare/Medicaid Meaningful Use	<u>-</u>	<u>645,094</u>
Revenues in excess of expenses	9,571,497	8,626,487
Change in Net Unrealized Gains on Investments	3,251,228	2,564,554
Net Assets Released from Restrictions Used for Purchase of Property and Equipment	<u>5,856,906</u>	<u>6,271,604</u>
Increase in unrestricted net assets	<u>\$ 18,679,631</u>	<u>\$ 17,462,645</u>

See notes to consolidated financial statements

Trinitas Regional Medical Center

Consolidated Statement of Changes In Net Assets
Years Ended December 31, 2017 and 2016

	<u>2017</u>	<u>2016</u>
Unrestricted Net Assets		
Revenues in excess of expenses	\$ 9,571,497	\$ 8,626,487
Change in net unrealized gains on investments	3,251,228	2,564,554
Net assets released from restrictions used for purchase of property and equipment	<u>5,856,906</u>	<u>6,271,604</u>
Increase in unrestricted net assets	<u>18,679,631</u>	<u>17,462,645</u>
Temporarily Restricted Net Assets		
Contributions	6,520,726	7,060,073
Interest and dividends	10,332	14,465
Net assets released from restrictions	(6,606,268)	(7,298,077)
Change in beneficial interest in net assets of Trinitas Health Foundation	<u>2,582,989</u>	<u>(657,370)</u>
Increase (decrease) in temporarily restricted net assets	<u>2,507,779</u>	<u>(880,909)</u>
Permanently Restricted Net Assets		
Change in beneficial interest in net assets of Trinitas Health Foundation	113,698	73,168
Change in net unrealized gains on investments	<u>18,396</u>	<u>32,462</u>
Increase in permanently restricted net assets	<u>132,094</u>	<u>105,630</u>
Increase in net assets	21,319,504	16,687,366
Net Assets, Beginning	<u>175,896,449</u>	<u>159,209,083</u>
Net Assets, Ending	<u>\$ 197,215,953</u>	<u>\$ 175,896,449</u>

See notes to consolidated financial statements

Trinitas Regional Medical CenterConsolidated Statement of Cash Flows
Years Ended December 31, 2017 and 2016

	<u>2017</u>	<u>2016</u>
Cash Flows from Operating Activities		
Increase in net assets	\$ 21,319,504	\$ 16,687,366
Adjustments to reconcile increase in net assets to net cash provided by operating activities:		
Provision for doubtful collections	16,907,577	15,961,302
Depreciation	10,492,885	10,830,287
Loss on sale of bond refinancing	1,238,343	655,153
Amortization of deferred bond premium	(1,136,402)	(129,467)
Amortization of deferred financing costs	127,514	181,457
Restricted contributions for capital additions	(5,856,906)	(6,271,604)
Change in net unrealized gains on investments	(3,251,228)	(2,564,554)
Net realized gains on investments	(2,277,397)	(692,290)
Change in beneficial interest in net assets of Trinitas Health Foundation	(2,696,687)	584,202
Change in assets and liabilities:		
Patient accounts receivable	(17,834,358)	(18,367,383)
Other receivables	787,559	(757,881)
Other assets and other current assets	(830,740)	(46,531)
Accounts payable and accrued expenses	62,606	1,770,518
Deferred revenue	1,788,482	346,899
Accrued bond interest payable	(1,536,988)	26,938
Accrued salaries and wages	2,085	798,344
Other long-term liabilities	2,154,497	(3,161,239)
Construction and retainage payable	(1,874,554)	186,181
Estimated settlements with third-party payors	(704,384)	4,518,817
Net cash provided by operating activities	<u>16,881,408</u>	<u>20,556,515</u>
Cash Flows from Investing Activities		
Acquisition of property and equipment	(9,382,487)	(11,214,695)
Sales and (purchases) of investments and assets whose use is limited, net	<u>13,142,303</u>	<u>(6,519,000)</u>
Net cash provided by (used in) investing activities	<u>3,759,816</u>	<u>(17,733,695)</u>
Cash Flows from Financing Activities		
Restricted contributions for capital additions	5,856,906	6,271,604
Repayment on extinguishment of debt (Note 8)	(109,675,000)	(12,365,000)
Proceeds from refunding and revenue bonds	93,217,203	16,016,795
Payment of deferred financing costs	(182,529)	(541,515)
Repayments of long-term debt	<u>(7,140,000)</u>	<u>(7,339,133)</u>
Net cash (used in) provided by financing activities	<u>(17,923,420)</u>	<u>2,042,751</u>
Net Increase in Cash and Cash Equivalents	2,717,804	4,865,571
Cash and Cash Equivalents, Beginning	<u>130,023,301</u>	<u>125,157,730</u>
Cash and Cash Equivalents, Ending	<u>\$ 132,741,105</u>	<u>\$ 130,023,301</u>
Supplemental Disclosure of Cash Flow Information,		
Interest paid	<u>\$ 4,378,113</u>	<u>\$ 6,430,884</u>

See notes to consolidated financial statements

Trinitas Regional Medical Center

Notes to Consolidated Financial Statements
December 31, 2017 and 2016

1. Summary of Significant Accounting Policies

Reporting Organizations

The consolidated financial statements include the accounts of Trinitas Regional Medical Center (the "Medical Center"), Marillac Corporation ("Marillac"), a wholly-owned subsidiary of the Medical Center and Trinitas Physicians Practice, LLC.

Elizabeth General Medical Center and St. Elizabeth Hospital in 2000, merged to form Trinitas Hospital, a not-for-profit, tax-exempt, voluntary, acute health care provider located in Elizabeth, New Jersey. Trinitas Hospital officially changed its name to Trinitas Regional Medical Center as of October 2008. The Medical Center provides inpatient, outpatient, and emergency care services for local residents. Admitting physicians are primarily practitioners from the local area.

Marillac, a not-for-profit, tax-exempt corporation pursuant to Section 501(c)(3) of the Internal Revenue Code, owns and operates a medical office building in Elizabeth, New Jersey.

Trinitas Physicians Practice, LLC, a New Jersey professional limited liability company (LLC), is a for-profit taxable entity.

The sole member of the Medical Center is Trinitas Health (the "Parent"), a tax-exempt holding company. Both the Parent and the Medical Center are tax-exempt organizations, pursuant to Section 501(c)(3) of the Internal Revenue Code.

The Medical Center is an affiliated member of the Parent, the controlling entity. Other affiliates of Trinitas Health include: Trinitas Healthcare Corporation, Trinitas Health Services Corporation and subsidiary, and Trinitas Health Foundation and Affiliate (the "Foundation"). Only the Medical Center's financial statements and its subsidiaries including Marillac and Trinitas Physicians Practice, LLC are presented herein. The Parent's affiliates, with the exception of Trinitas Health Services Corporation, are not-for-profit, tax-exempt organizations. Trinitas Health Services Corporation is a for-profit, taxable entity.

Basis of Accounting

The consolidated financial statements have been prepared on the accrual basis of accounting. All significant intercompany accounts and transactions have been eliminated.

Use of Estimates

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

Trinitas Regional Medical Center

Notes to Consolidated Financial Statements
December 31, 2017 and 2016

Cash and Cash Equivalents

Cash and cash equivalents include certain investments in highly liquid debt investments purchased with an original maturity of three months or less, excluding assets whose use is limited and investments.

Patient Accounts Receivable

Patient accounts receivable are reported at net realizable value. Accounts are written off when they are determined to be uncollectible based upon management's assessment of individual accounts. In evaluating the collectability of patient accounts receivable, the Medical Center analyzes its past history and identifies trends for each of its major payor sources of revenue to estimate the appropriate allowance for doubtful collections and provision for doubtful collections. For receivables associated with services provided to patients with third party insurance coverage (partial or complete) and patients with no coverage (partial or none), the Medical Center analyzes contractually due amounts and provides an allowance for doubtful collections and a provision for doubtful collections, if necessary. For receivables associated with patients with no insurance or partial insurance (which includes both patients without insurance and patients with deductible and copayment balances due), the Medical Center records a significant provision for doubtful collections in the period of service on the basis of its past experience, which indicates that many patients are unable to pay the portion of their bill for which they are financially responsible. The difference between the billed rates and the amounts actually collected after all reasonable collection efforts have been exhausted is charged off against the allowance for doubtful collections.

The Medical Center's allowance for doubtful collections for self-pay patients was approximately 92.5% of self-pay accounts receivable at December 31, 2017 and 2016. In addition, the Medical Center's self-pay account write-offs net of recoveries increased to \$18,504,000 in 2017 from \$15,684,000 in 2016. The Medical Center had not changed their financial assistance policy in 2017.

Other Receivables

Other receivables include grant revenue receivables which are reported at net realizable value.

Inventories

Inventories, which are included in other current assets in the accompanying consolidated balance sheet, are stated at the lower of cost or net realizable value. Cost is determined on a first-in, first-out basis.

Trinitas Regional Medical Center

Notes to Consolidated Financial Statements

December 31, 2017 and 2016

Investments and Investment Risk

Investments in equity and debt securities are measured at fair value. Cash and cash equivalents are carried at cost which approximates fair value. Donated investments are recorded at fair value at the date of receipt.

Investment income or loss (including realized gains and losses on investments, interest and dividends) is included in the determination of revenues in excess of expenses. Gains and losses on sales of investment assets are determined using the average-cost method. Donor-restricted investment income is reported as an increase in temporarily or permanently restricted net assets.

The Medical Center's investments are comprised of a variety of financial instruments. The Medical Center utilizes an independent advisor to monitor and evaluate two investment managers. The Medical Center's investments are held by an independent custodian and marked to market daily.

The fair values reported in the consolidated balance sheet are exposed to various risks including changes in the equity markets, the interest rate environment, and general economic conditions. Due to the level of risk associated with certain investment securities and the level of uncertainty related to changes in the fair value of investment securities, it is reasonably possible that the amounts reported in the accompanying consolidated financial statements could change materially in the near term.

Assets Whose Use is Limited

Assets whose use is limited include assets held by trustees under bond indenture agreements, assets set aside under deferred compensation plans, assets of donor-restricted funds and designated assets set aside by the Board of Trustees and management for future use.

Property and Equipment

Property and equipment acquisitions are recorded at cost, except donated assets which are recorded at fair market value at the date of donation. Depreciation expense is calculated on a straight-line basis for all depreciable assets, based upon the following estimated useful lives of the assets:

	<u>Years</u>
Land improvements	10 - 25
Buildings and improvements	10 - 40
Fixed equipment	10 - 15
Major movable equipment	5 - 15

Trinitas Regional Medical Center

Notes to Consolidated Financial Statements

December 31, 2017 and 2016

Gifts of long-lived assets such as land, buildings, or equipment are reported as unrestricted net assets, unless explicit donor stipulations specify how the donated assets must be used. Gifts of long-lived assets with explicit restrictions that specify how the assets are to be used and gifts of cash or other assets that must be used to acquire long-lived assets are reported as restricted support. Absent explicit donor stipulations about how long those long-lived assets must be maintained, expirations of donor restrictions are reported when the donated or acquired long-lived assets are placed in service.

Interest costs incurred on borrowed funds during the period of construction of capital assets are capitalized as a component of the cost of acquiring those assets. No amounts were capitalized during 2017 or 2016.

Other Assets

Other assets include insurance recovery receivable, split-dollar life insurance receivable, and security deposits.

Estimated Malpractice Costs

The provision for estimated medical malpractice claims includes estimates of the ultimate costs for both reported claims and claims incurred but not reported, including costs associated with litigating or settling claims. Anticipated insurance recoveries associated with reported claims are reported separately in the Medical Center's consolidated balance sheet at net realizable value.

Deferred Financing Costs

Deferred financing costs consist principally of debt acquisition costs that are being amortized using the effective interest method over the life of the related debt. These costs are reported in the consolidated balance sheet as a reduction of the related debt. Amortization expense is reported as a component of interest expense in the consolidated statement of operations. In 2017, the Medical Center wrote off a portion of the deferred financing costs which related to the Series 2007A and 2007B Bonds and is included in loss on refinancing in the consolidated statement of operations. The Medical Center recorded new deferred financing costs of \$182,529 related to the Series 2017A Bonds. In 2016, the Medical Center wrote off a portion of the deferred financing costs which related to the Series 2006 Bonds and is included in loss on refinancing in the consolidated statement of operations. The Medical Center recorded new deferred financing costs of \$541,515 related to the Series 2016A Bonds (Note 8).

Other Liabilities

Other long-term liabilities include deferred compensation, postretirement benefits, estimated medical malpractice costs, and deferred revenue.

Trinitas Regional Medical Center

Notes to Consolidated Financial Statements
December 31, 2017 and 2016

Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets are those whose use by the Medical Center has been limited by donors to a specific time period or purpose, and are available for use by the Medical Center, as specified by the donor, for capital acquisitions, research, and education.

Permanently restricted net assets have been restricted by donors to be maintained by the Medical Center in perpetuity. The income, including gains and losses, earned on these funds is primarily unrestricted.

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 and assets released from donor restrictions related to long-lived assets.

Net Patient Service Revenue

The Medical Center reports net patient service revenue at the estimated net realizable amounts from patients, third party payors, and others for services rendered, including an estimate for retroactive adjustments that may occur as a result of 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, review and investigations. Net patient service revenue as reported in the consolidated statements of operations is reduced both by (1) estimated allowances for the excess of charges over anticipated patient or third party payor payments and (2) a provision for doubtful collections. Certain health care services provided by the Medical Center are reimbursed by third party payors on the basis of the lower of cost or charges, with costs subject to certain imposed limitations.

Patient accounts receivable are reported at net realizable value and include charges for accounts due from Medicare, Medicaid, other commercial and managed care insurers, and self-paying patients (Note 1). Patient accounts receivable also includes management's estimate of the impact of certain undercharges to be recouped or overcharges to be paid back for inpatient and outpatient services in subsequent years rates as discussed above. Deducted from patient accounts receivable are estimates of doubtful collections related to patients and allowances for the excess of charges over the payments to be received from third party payors.

The Medical Center has agreements with third-party payors that provide for payments to the Medical Center at amounts different from its established rates. The Medical Center recognizes patient service revenue associated with services provided to patients who have third-party payor coverage on the basis of these established rates for the services rendered. For uninsured patients that do not qualify for charity care, the Medical Center recognizes revenues on the basis of its standard rates, discounted in accordance with the Medical Center's policy. On the basis of historical experience, a significant portion of the Medical Center's uninsured patients will be unable to pay for the services provided. Thus, the Medical Center records a significant provision for doubtful collections related to uninsured patients in the period the services are provided.

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Notes to Consolidated Financial Statements
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Patient service revenues, net of contractual allowances and discounts (but before the provision for doubtful collections), recognized in 2017 and 2016 from these major payor sources, are as follows:

	Patient Service Revenues (Net of Contractual Allowances and Discounts)				Total
	Medicare	Medicaid	Other Third Party Payors	Self-Pay and Other	
December 31, 2017	<u>\$ 74,921,850</u>	<u>\$ 87,852,420</u>	<u>\$ 63,758,070</u>	<u>\$ 19,590,108</u>	<u>\$ 246,122,448</u>
December 31, 2016	<u>\$ 71,258,753</u>	<u>\$ 89,460,734</u>	<u>\$ 64,773,749</u>	<u>\$ 18,353,869</u>	<u>\$ 243,847,105</u>

Accounting for Uncertainty in Income Taxes

The Medical Center accounts for uncertainty in income taxes recognized in the financial statements using a recognition threshold of more-likely-than-not as to whether the uncertainty will be sustained upon examination by the appropriate taxing authority. Measurement of the tax uncertainty occurs if the recognition threshold has been met. Management determined there were no tax uncertainties that met the recognition threshold.

Advertising Costs

Advertising costs, which pertain mainly to marketing and public relations, are expensed as incurred. Advertising expense was \$717,540 in 2017 and \$1,234,948 in 2016.

Subsequent Events

The Medical Center evaluated subsequent events for recognition or disclosure through April 18, 2018, the date the financial statements were issued.

New Accounting Pronouncements

Revenue Recognition

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 2014-09 supersedes the revenue recognition requirements in Topic 605, Revenue Recognition, and most industry-specific guidance. Under the requirements of ASU 2014-09, the core principle is that entities should recognize revenue to depict the transfer of promised goods or services to customers (residents) in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. ASU 2014-09 requires retrospective application and is effective for the fiscal year ending December 31, 2018. Early adoption is not permitted. The Medical Center is currently determining the impact of the adoption of ASU 2014-09 on its consolidated financial statements.

Trinitas Regional Medical Center

Notes to Consolidated Financial Statements
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Financial Assets and Liabilities

In January 2016, the FASB issued ASU No. 2016-01, Recognition and Measurement of Financial Assets and Liabilities (Subtopic 825-10). The new guidance requires equity investments (except equity method investments or those that result in consolidation) to be measured at fair value with changes in fair value recognized in the performance indicator. ASU 2016-01 further eliminates the requirement for public business entities to disclose the methods and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized costs on the balance sheet. Finally, ASU 2016-01 requires other specific investment presentation and disclosures in the financial statements for certain financial instruments. ASU 2016-01 requires retrospective application and is effective for the fiscal year ending December 31, 2018. Although certain provisions of ASU 2016-01 can be early adopted, early adoption is generally not permitted. The Medical Center is currently determining the impact of the adoption of ASU 2016-01 on its consolidated financial statements.

Leases

In February 2016, the FASB issued Accounting Standards Update ASU No. 2016-02, Leases (Topic 842). ASU 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 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 Medical Center's leasing activities. ASU 2016-02 requires retrospective application and is effective for the fiscal year ending December 31, 2019, with early adoption permitted. The Medical Center is currently determining the impact of the adoption of ASU 2016-02 on its consolidated financial statements.

Presentation of Financial Statements of Not-for-Profit Entities

In August 2016, the FASB issued ASU No. 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 2014-14 requires retrospective application and is effective for the fiscal year ending December 31, 2018, with early adoption permitted. The Medical Center is currently determining the impact of the adoption of ASU 2016-14 on its consolidated financial statements.

Trinitas Regional Medical Center

Notes to Consolidated Financial Statements
December 31, 2017 and 2016

2. Net Patient Service Revenue

The Medical Center has agreements with third-party payors that provide for payments to the Medical Center at amounts different from its established rates. A significant portion of the Medical Center's net patient service revenue is derived from these third-party payor programs. A summary of the principal payment arrangements with major third-party payors follows:

- Medicare: Inpatient acute care and outpatient services rendered to Medicare program beneficiaries are paid at prospectively determined rates. These rates vary according to patient classification systems that are based on clinical, diagnostic, and other factors. Certain items, such as Medicare bad debts, are paid based on a cost reimbursement methodology. Reimbursements for cost reimbursable items are received at tentative interim rates, with final settlement determined after submission of annual cost reports by the Medical Center and audits thereof by the Medicare fiscal intermediary. The Medical Center's Medicare cost reports have been settled by the Medicare fiscal intermediary through December 31, 2009.
- Medicaid: Inpatient acute care services rendered to Medicaid program beneficiaries are paid at prospectively determined rates per discharge. These rates vary according to a patient classification system that is based on clinical, diagnostic, and other factors. Outpatient services are paid based on a cost reimbursement methodology or published fee schedules, with final settlement determined after submission of annual cost reports. The Hospital's Medicaid cost reports have been settled by the Medicaid fiscal intermediary through December 31, 2015.

Revenue received under third-party arrangements is subject to audit and retroactive adjustments. Net patient service revenue on the consolidated statement of operations includes a positive adjustment of \$1,447,643 and \$0 for the years ended December 31, 2017 and 2016, respectively, related to tentative and final settlements of prior year cost reports and other settlements.

The Medical Center also has entered into payment agreements with certain managed care organizations, commercial, Medicare and Medicaid managed care products with insurance carriers, and preferred provider organizations. The basis for payment to the Medical Center under these agreements includes daily rates, rates per discharge, and discounts from established charges.

3. Subsidy Payments and Charity Care

The Medical Center receives subsidy payments from the State of New Jersey to partially fund charity care and certain other program costs. Subsidy payments included in other revenue for the years ended December 31, 2017 and 2016 are as follows:

	<u>2017</u>	<u>2016</u>
Charity care	\$ 30,744,894	\$ 32,925,120
DSRIP	6,339,569	5,342,374
Mental health	1,811,511	1,781,590
Total	<u>\$ 38,895,974</u>	<u>\$ 40,049,084</u>

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The Delivery System Reform Incentive Payment (DSRIP) includes incentives that are subject to achieving certain measurable and incremental clinical outcomes and results that demonstrate an impact on improving the health care system.

In October 2017, the Medical Center received a DSRIP incentive payment in the amount of \$7,789,257, which included the program's year five incentive payment and an additional appeal incentive payment for year four of the program. In July 2016, the Medical Center received a DSRIP incentive payment in the amount of \$2,602,760 for the program's year four payment.

The allocations of subsidy payments to the Medical Center are subject to change from year to year based on available state budget amounts and allocation methodologies. A proportionate amount is in place through June 30, 2018; however, such amounts are subject to change.

The Medical Center is amortizing the year five and year four DSRIP incentive payments over the program's respective fiscal years, which end on June 30, 2018 and 2017. For the years ended December 31, 2017 and 2016, \$5,456,284 and \$1,041,104 of the incentive payments were recognized in other revenue in the consolidated statement of operations, respectively. The unamortized portions of the incentive of \$3,894,628 and \$1,561,656 were included in deferred revenue in the consolidated balance sheet at December 31, 2017 and 2016, respectively.

The Medical Center, as part of its mission, provides medical care without charge or at reduced charges to residents of its community through the provision of charity care. The Medical Center's definition of charity care is in accordance with state regulations and includes services provided at no charge or partial charge to the uninsured or underinsured.

The Medical Center maintains records to identify and monitor the level of charity care that it provides. The costs associated with the charitable care services provided are estimated by applying the cost-to-charge ratio to the amount of gross uncompensated charges for the patients receiving charity care. Total charity care costs were approximately \$41 million and \$36 million for the years ended December 31, 2017 and 2016, respectively.

4. Related-Party Transactions

The Medical Center has one-year service agreements with its affiliated organizations to provide administrative facilities, supplies, and accounting services for a set annual fee. In addition, the Medical Center leases office space to affiliates. Fees and rent for all agreements approximated \$52,000 in 2017 and 2016, and are recorded as other revenue.

The Foundation was established to solicit contributions from the general public solely for the funding of operations and capital acquisitions by the Medical Center. Funds are distributed to the Medical Center as determined by the Foundation's Board of Trustees. A summary of the Foundation's assets, liabilities, net assets, results of operations, and changes in net assets follows. The Medical Center's interest in the net assets of the Foundation is reported as a noncurrent asset in the consolidated balance sheet.

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	<u>2017</u>	<u>2016</u>
Assets (principally cash and cash equivalents, prepaid expenses and other current assets, investments, assets limited as to use, and pledges receivable)	\$ 9,937,915	\$ 7,305,648
Liabilities	\$ 178,526	\$ 242,946
Net assets	<u>9,759,389</u>	<u>7,062,702</u>
Total liabilities and net assets	<u>\$ 9,937,915</u>	<u>\$ 7,305,648</u>
Revenues and other support	\$ 10,380,220	\$ 7,413,022
Expenses	<u>(1,259,563)</u>	<u>(1,281,293)</u>
Excess of revenues and other support over expenses	9,120,657	6,131,729
Contributions to the Medical Center	(6,423,970)	(6,715,931)
Net assets, beginning	<u>7,062,702</u>	<u>7,646,904</u>
Net assets, ending	<u>\$ 9,759,389</u>	<u>\$ 7,062,702</u>

The Foundation's contributions are reflected as a component of temporarily restricted contributions in the amount of \$6,423,970 and \$6,715,931 in 2017 and 2016, respectively.

At December 31, 2017 and 2016, amounts due to the Medical Center from affiliates were \$831,511 and \$680,924, of which \$95,023 and \$138,834, respectively, were due from Trinitas Healthcare Corporation and are included in other current assets on the consolidated balance sheet.

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5. Assets Limited as to Use and Investments

The composition of assets whose use is limited at December 31, 2017 and 2016, is set forth in the following table:

	<u>2017</u>	<u>2016</u>
Internally designated:		
Cash and cash equivalents	\$ 2,033,823	\$ 3,266,928
U.S. government and agency obligations	9,073,097	10,868,867
Investment-grade corporate bonds	55,752,559	49,406,579
Marketable equity securities:		
Energy	2,660,043	3,108,856
Industrials	3,926,955	2,828,249
Consumer discretionary	3,558,086	4,515,197
Consumer staples	2,474,441	1,369,306
Healthcare	5,080,043	5,522,656
Financials	9,480,025	8,505,552
Information technology	6,052,278	4,629,327
Telecommunication services	1,568,791	1,452,540
Total internally designated assets	<u>\$ 101,660,141</u>	<u>\$ 95,474,057</u>
Internally designated - deferred compensation plans, Mutual funds	<u>\$ 8,451,871</u>	<u>\$ 6,711,884</u>
Assets held by trustees under bond indentures, Cash and cash equivalents	\$ 4,789,990	\$ 21,505,102
Less funds held by trustees available to meet current liabilities	<u>(4,789,990)</u>	<u>(8,436,557)</u>
Noncurrent portion of funds held by trustees under bond indentures	<u>\$ -</u>	<u>\$ 13,068,545</u>
Donor-restricted assets:		
Cash and cash equivalents	\$ 1,539,196	\$ 1,614,407
Mutual funds - intermediate term bond	<u>1,488,971</u>	<u>1,470,575</u>
Total donor restricted assets	<u>\$ 3,028,167</u>	<u>\$ 3,084,982</u>

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The composition of unrestricted investments at December 31, 2017 and 2016 is set forth in the following table:

	<u>2017</u>	<u>2016</u>
Cash and cash equivalents	\$ 988,698	\$ 891,945
U.S. government and agency obligations	3,000,589	3,523,673
Investment-grade corporate bonds	18,879,716	16,907,073
Marketable equity securities:		
Energy	1,193,122	1,438,204
Industrials	632,324	485,349
Consumer discretionary	1,101,119	1,086,177
Consumer staples	1,227,806	336,303
Healthcare	614,468	653,739
Financials	1,022,407	1,554,668
Information technology	892,665	996,483
Telecommunication services	276,605	249,457
Limited partnerships	-	474,270
	<u>\$ 29,829,519</u>	<u>\$ 28,597,341</u>

At December 31, 2017 and 2016, the fair value of certain investments was below historical cost. The unrealized losses on these investments were as follows:

	<u>Unrealized Losses at December 31, 2017</u>			
	<u>Less than One Year</u>	<u>More than One Year</u>	<u>Total</u>	<u>Fair Value</u>
Mutual funds:				
Equity	\$ -	\$ (15,151)	\$ (15,151)	\$ 1,504,121
U.S. government and agency obligations	(528)	(81,302)	(81,830)	5,946,999
Investment-grade corporate obligations	(63,711)	(1,236,626)	(1,300,337)	54,474,423
Marketable equity securities:				
Energy	(14,647)	-	(14,647)	1,244,155
Consumer discretionary and staples	-	(473,390)	(473,390)	2,101,270
Financials	(145,704)	-	(145,704)	675,904
Health care	-	(681,240)	(681,240)	2,458,171
Industrials	(85,541)	-	(85,541)	916,339
Utilities	-	(42,834)	(42,834)	908,454

Trinitas Regional Medical Center

Notes to Consolidated Financial Statements
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	Unrealized Losses at December 31, 2016			
	Less than One Year	More than One Year	Total	Fair Value
Mutual funds:				
Equity	\$ -	\$ (33,545)	\$ (33,545)	\$ 1,470,575
U.S. government and agency obligations	(40,806)	(29,179)	(69,985)	6,361,174
Investment-grade corporate obligations	(815,907)	(1,700,947)	(2,516,854)	58,464,988
Marketable equity securities:				
Energy	(23,034)	-	(23,034)	885,420
Consumer discretionary and staples	-	(572,023)	(572,023)	1,276,128
Health care	(68,524)	(542,734)	(611,258)	2,918,187

Management periodically reviews securities in its portfolio to determine whether any have become other-than-temporarily impaired. Securities are screened to identify those whose market value has declined. The Medical Center considers relevant facts and circumstances surrounding individual securities, such as:

- a. Evidence that would justify immediate impairment, such as bankruptcy, fraud, environmental disaster, etc.
- b. The financial condition and near-term prospects of the issuing entity, including any specific events that may influence the operations of that entity that may impair the earnings potential of the investment or the discontinuance of a segment of the business that may affect future earnings potential.
- c. The ability of the Medical Center to hold securities for a period of time sufficient to allow for recovery in fair value.

The fair value of investments that were below historical cost amounted to \$70,229,836 and \$71,376,472 at December 31, 2017 and 2016, respectively. The unrealized losses relating to these investments amounted to \$2,840,674 and \$3,826,699 at December 31, 2017 and 2016, respectively. The Medical Center has the intent and ability to hold these investments to allow for recovery in fair value.

The fair value of investments that were above historical cost amounted to \$77,529,852 and \$83,996,894 at December 31, 2017 and 2016, respectively. The unrealized gains relating to these investments amounted to \$11,215,930 and \$8,950,727 at December 31, 2017 and 2016, respectively.

6. Fair Value Measurements and Financial Instruments

Fair Value Measurements

Fair value is defined as the price that would be received to sell an asset or the price that would be paid to transfer a liability in an orderly transaction between market participants at the measurement date. The framework for measuring fair value includes a hierarchy used to classify the inputs used in measuring fair value. The hierarchy prioritizes the inputs used in determining valuations into three levels. The level in the fair value hierarchy within which the fair value measurement falls is determined based on the lowest level input that is significant to the fair value measurement. The levels of the fair value hierarchy are as follows:

Level 1 - Fair value is based on unadjusted quoted prices in active markets that are accessible to the Medical Center for identical assets. These generally provide the most reliable evidence and are used to measure fair value whenever available.

Level 2 - Fair value is based on significant inputs, other than Level 1 inputs, that are observable either directly or indirectly for substantially the full term of the asset through corroboration with observable market data. Level 2 inputs include quoted market prices in active markets for similar assets, quoted market prices in markets that are not active for identical or similar assets, and other observable inputs.

Level 3 - Fair value would be based on significant unobservable inputs. Examples of valuation methodologies that would result in Level 3 classification include option pricing models, discounted cash flows, and other similar techniques.

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The Medical Center measures its investments, assets whose use is limited, and derivative financial instruments on a recurring basis at fair value. The financial instruments were measured with the following inputs at December 31:

	2017				
	Quoted Prices in Active Markets (Level 1)	Other Observable Inputs (Level 2)	Unobservable Inputs (Level 3)	Fair Value	Carrying Value
Reported at Fair Value - Assets					
Cash and cash equivalents	\$ 9,351,707	\$ -	\$ -	\$ 9,351,707	\$ 9,351,707
Mutual funds:					
Domestic	8,451,871	-	-	8,451,871	8,451,871
Intermediate term bond	1,488,971	-	-	1,488,971	1,488,971
U.S. government and agency obligations	12,073,686	-	-	12,073,686	12,073,686
Investment-grade corporate bonds	-	74,632,275	-	74,632,275	74,632,275
Marketable equity securities:					
Energy	3,853,165	-	-	3,853,165	3,853,165
Industrials	4,559,279	-	-	4,559,279	4,559,279
Consumer discretionary	4,659,205	-	-	4,659,205	4,659,205
Consumer staples	3,702,247	-	-	3,702,247	3,702,247
Healthcare	5,694,511	-	-	5,694,511	5,694,511
Financials	10,502,432	-	-	10,502,432	10,502,432
Information technology	6,944,943	-	-	6,944,943	6,944,943
Telecommunication services	1,845,396	-	-	1,845,396	1,845,396
Total	\$ 73,127,413	\$ 74,632,275	\$ -	\$ 147,759,688	\$ 147,759,688
Disclosed at Fair Value					
Cash and cash equivalents	\$ 132,741,105	\$ -	\$ -	\$ 132,741,105	\$ 132,741,105
Bonds payable	-	101,201,989	-	101,201,989	100,285,237

Trinitas Regional Medical Center

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	2016				Carrying Value
	Quoted Prices in Active Markets (Level 1)	Other Observable Inputs (Level 2)	Unobservable Inputs (Level 3)	Fair Value	
Reported at Fair Value - Assets					
Cash and cash equivalents	\$ 27,278,382	\$ -	\$ -	\$ 27,278,382	\$ 27,278,382
Mutual funds:					
Domestic	6,711,884	-	-	6,711,884	6,711,884
Intermediate term bond	1,470,575	-	-	1,470,575	1,470,575
U.S. government and agency obligations	14,392,540	-	-	14,392,540	14,392,540
Investment-grade corporate bonds	-	66,313,652	-	66,313,652	66,313,652
Marketable equity securities:					
Energy	4,547,060	-	-	4,547,060	4,547,060
Industrials	3,313,598	-	-	3,313,598	3,313,598
Consumer discretionary	5,601,374	-	-	5,601,374	5,601,374
Consumer staples	1,705,609	-	-	1,705,609	1,705,609
Healthcare	6,176,395	-	-	6,176,395	6,176,395
Financials	10,060,220	-	-	10,060,220	10,060,220
Information technology	5,625,810	-	-	5,625,810	5,625,810
Telecommunication services	1,701,997	-	-	1,701,997	1,701,997
Limited partnerships	-	-	474,270	474,270	474,270
Total	\$ 88,585,444	\$ 66,313,652	\$ 474,270	\$ 155,373,366	\$ 155,373,366
Disclosed at Fair Value					
Cash and cash equivalents	\$ 130,023,301	\$ -	\$ -	\$ 130,023,301	\$ 130,023,301
Bonds payable	-	126,942,107	-	126,942,107	124,587,642

Financial Instruments

The carrying amounts of cash and cash equivalents approximates fair value as of December 31, 2017 and 2016 because of the short maturity of these instruments.

Mutual funds are valued at the published net asset value of the units on the measurement date.

U.S. government and agency obligations are valued by quoted market prices.

Corporate bonds are valued using recently executed transactions, market price quotations (where observable), bond spreads or credit default swap spreads. Marketable equity securities and mutual funds are valued at the closing price reported or the active market on which the individual securities are traded.

Marketable equity securities are valued at the closing price reported on the active market on which the individual securities are traded.

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Investments in limited partnerships do not have readily determinable market values. Fair value estimates are based on statements provided by each fund manager. Such investments are accounted for under the equity method of accounting and any adjustments to the estimated fair value are recorded as changes in the value of the investment. All investments in limited partnerships were sold during 2017.

The fair value of fixed rate long-term debt was estimated using quoted market prices.

7. Property and Equipment and Accumulated Depreciation

Property and equipment and accumulated depreciation at December 31, 2017 and 2016 are as follows:

	<u>2017</u>	<u>2016</u>
Land	\$ 1,589,358	\$ 1,589,358
Land improvements	4,585,528	4,534,962
Buildings and improvements	175,620,149	166,810,503
Fixed and major movable equipment	156,119,650	149,403,792
Construction in progress	888,006	7,343,506
Total	338,802,691	329,682,121
Less accumulated depreciation	<u>(252,682,143)</u>	<u>(242,451,175)</u>
Property and equipment, net	<u>\$ 86,120,548</u>	<u>\$ 87,230,946</u>

In 2014, the Medical Center's Board approved the updating and renovating of the Medical Center's emergency room department and adding additional ICU beds. The project involved architectural, engineering, mechanical studies, relocation of various departments, demolition, purchase of a new CT scan, renovation and new construction. Estimated costs for the project are approximately \$19 million. For the years ended December 31, 2017 and 2016, the Medical Center incurred costs for the project in the amount of \$5,425,443 and \$6,961,756, respectively. The construction project began in the summer of 2015 and was completed, other than for the elevators, in August 2017.

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8. Long-Term Debt

Long-term debt at December 31, 2017 and 2016, consist of the following:

	<u>2017</u>	<u>2016</u>
Serial bonds, Series 2007B, bore interest of 4.75% to 5.25%, payable semiannually, extinguished in 2017	\$ -	\$ 44,625,000
Term bonds, Series 2007A, bore interest of 4.75% to 5.25%, payable semiannually, extinguished in 2017	-	65,050,000
Serial bonds, Series 2016A , which mature July 1, 2017 through July 1, 2030, and bear interest ranging from 4.00% to 5.00%, payable semiannually	13,270,000	13,810,000
Serial bonds, Series 2017A , which mature July 1, 2018 through July 1, 2030, and bear interest of 5.00%, payable semiannually	76,370,000	-
	<u>89,640,000</u>	<u>123,485,000</u>
(Less)/Add:		
Current portion of long-term debt	(5,065,000)	(6,055,000)
Deferred financing costs	(632,657)	(1,793,527)
Unamortized bond premium	11,277,894	2,896,169
	<u>11,277,894</u>	<u>2,896,169</u>
Total	<u>\$ 95,220,237</u>	<u>\$ 118,532,642</u>

The Medical Center, Marillac and Trinitas Physicians Practice, LLC are members of the Obligated Group for the Series 2007A Bonds, 2007B Bonds, Series 2016A Bonds and Series 2017A Bonds.

In October 2016, the New Jersey Health Care Facilities Financing Authority (the "Authority") issued, on behalf of the Medical Center, \$13,810,000 of tax-exempt Refunding and Revenue Bonds, Series 2016A (the "Series 2016A Bonds"), bearing interest rates between 4% (for bond maturing July 2017) and 5% (for all other maturities). The proceeds from the sale of the Series 2016A Bonds were used to refund the Series 2006 Bonds and pay for debt issuance costs. The Medical Center will be required to fund the principal and interest payments on the bonds. The principal amounts are payable annually on July 1, and interest is payable semiannually on January 1 and July 1 through 2030. The Series 2016A Bonds are collateralized by substantially all of the Obligated Group's property and equipment and gross receipts. This 2016 refinancing resulted in a loss on bond refinancing in the amount of \$655,153, which is reflected in the consolidated statement of operations.

In April 2017, the Authority issued, on behalf of the Medical Center, \$82,970,000 in Refunding Bonds, Series 2017A (the "Series 2017A Bonds"), bearing an interest rate of 5% percent. The proceeds from the sale of the Series 2017A Bonds combined with the debt service reserve funds released by the trustee relating to the Series 2007A Bonds and Series 2007B Bonds, were used to refund Series 2007A Bonds and Series 2007B Bonds and pay debt issuance costs. The Medical Center will be required to fund the principal and interest payments on the bonds. The principal amounts are payable annually on July 1, and interest is payable semiannually on January 1 and July 1 through 2030. The Series 2017A Bonds are collateralized by substantially all of the Obligated Group's property and equipment and gross receipts.

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This 2017 refinancing resulted in a loss on bond refinancing in the amount of \$1,238,343, which is reflected in the consolidated statement of operations.

Scheduled principal payments of long-term debt under the terms of their respective repayment schedules at December 31, 2017 are as follows:

	<u>Bonds</u>
2018	\$ 5,065,000
2019	5,315,000
2020	5,580,000
2021	5,865,000
2022	6,150,000
Thereafter	<u>61,665,000</u>
Total	<u>\$ 89,640,000</u>

Interest expense as reported on the consolidated statement of operations is composed of the following for the years ended December 31:

	<u>2017</u>	<u>2016</u>
Interest expense on Series 2016A Bonds, Series 2017A Bonds and other extinguished debt	\$ 5,614,055	\$ 6,488,580
Amortization of deferred financing costs	127,514	181,457
Amortization of bond premium	<u>(1,136,402)</u>	<u>(129,467)</u>
Total	<u>\$ 4,605,167</u>	<u>\$ 6,540,570</u>

9. Derivative Financial Instrument

In September 2016, the interest rate swap agreement was terminated by the Medical Center as the Series 2006 Bonds were fully repaid in 2016 (Note 8). To terminate the agreement, the Medical Center was required to pay \$3,060,173, the effective fair value of the obligation at the termination date. The liability of the interest rate swap agreement was removed from other long-term liabilities in the accompanying consolidated balance sheet on the termination date.

10. Retirement Plans

The Trinitas Savings and Retirement Plan covers all eligible employees as defined by the plan. All employees who are full time employees are eligible to participate upon completing one year of service and attaining age 21. Eligible employees may contribute up to 15% of their salaries, up to the Internal Revenue Service limit. Eligible employees may also contribute catch up contributions up to the Internal Revenue Service limit. The Medical Center will contribute a percentage of eligible salaries on an annual basis, at the option of the Board of Trustees. The Medical Center expensed contributions to this plan for the years ended December 31, 2017 and 2016 of \$2,062,022 and \$2,093,877, respectively.

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In addition, certain key members of senior management participate in deferred compensation plans sponsored by the Medical Center. At December 31, 2017 and 2016, internally designated assets included \$8,451,871 and \$6,711,884, respectively, related to these plans. A liability for the same amount is included in other long-term liabilities.

At December 31, 2017 and 2016, postretirement medical benefits and life insurance agreements for key employees are reflected in the balance sheet as other assets for premium receivables in the amount of \$703,248 and \$677,071 and a liability in other long-term liabilities in the amount of \$963,433 and \$936,980 for both benefits payable, respectively. There were no changes to unrestricted net assets for unfunded post-retirement medical benefits for the years ended December 31, 2017 and 2016, respectively.

11. Operating Leases

The Medical Center leases certain property and equipment under operating leases that have initial or remaining noncancelable terms in excess of one year. Future minimum rental payments under these agreements as of December 31, 2017, are as follows:

2018	\$ 3,985,059
2019	4,111,025
2020	4,176,379
2021	4,247,245
2022	4,296,390
Thereafter	<u>7,416,571</u>
Total	<u>\$ 28,232,669</u>

Total rent expense for the years ended December 31, 2017 and 2016, was approximately \$4,060,568 and \$3,827,118, respectively.

Lease Receivable

On June 23, 2017, the Medical Center renewed a lease and service agreement with a provider of long-term care ("LTAC"). The LTAC built a 25 bed, 13,000 square foot LTAC unit and leases space and purchases certain auxiliary and support services from the Medical Center. The lease renewal commences on January 28, 2018, is for a five year term, with a base rental that increases 2.5% annually, and additional renewal periods available, as defined in the lease agreement.

Future minimum rental to be received under this agreement as of December 31, 2017 not including additional renewal periods, are as follows:

2018	347,910
2019	356,608
2020	365,523
2021	374,661
2022	384,027
Thereafter	<u>360,826</u>
Total	<u>\$ 2,189,555</u>

Trinitas Regional Medical Center

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12. Functional Expenses

The Medical Center provides general health care services to residents within its geographic location. All expenses are related to providing these services. Functional expenses for the years ended December 31, 2017 and 2016 are as follows:

	<u>2017</u>	<u>2016</u>
Health care services	\$ 248,405,903	\$ 249,262,652
General and administrative	<u>43,236,936</u>	<u>43,892,008</u>
Total expenses	<u>\$ 291,642,839</u>	<u>\$ 293,154,660</u>

13. Concentration of Credit Risk

The Medical Center grants credit without collateral to its patients, most of whom are local residents and are insured under third-party arrangements, primarily with Medicaid, Medicare, and various commercial insurance companies. At December 31, 2017 and 2016, accounts receivable related to Medicare amounted to 14% and 12% and accounts receivable related to Medicaid amounted to 33% for both years, respectively, of patient accounts receivable.

The Medical Center maintains its cash and cash equivalents with several financial institutions. Cash and cash equivalents on deposit with any one financial institution are insured up to \$250,000. The Medical Center's cash accounts exceed the insured limits.

14. Meaningful Use

Under certain provisions of the American Recovery and Reinvestment Act of 2009, federal incentive payments are available to hospitals, physicians and certain other professionals ("providers") when they adopt certified electronic health record ("EHR") technology or become "meaningful users" of EHRs in ways that demonstrate improved quality, safety and effectiveness of care. Medicare and Medicaid providers can receive their initial incentive payment by adopting implementing or upgrading certified EHR technology, but must demonstrate meaningful use of EHRs in subsequent years in order to qualify for additional payments. Hospitals may be eligible for both Medicare and Medicaid EHR incentive payments. The Medical Center accounts for EHR payments using the contingency method, whereby revenue is recognized when all contingencies are satisfied. For the year ended December 31, 2017, the Medical Center did not recognize any EHR incentive payments as revenue in excess of expenses in the consolidated statement of operations. For the year ended December 31, 2016, the Medical Center recognized EHR incentive payments as revenue in excess of expenses in the amounts of \$645,094 in the consolidated statement of operations. At December 31, 2017 and 2016, the Medical Center reflected EHR incentive payments in the amount of \$3.4 million from the Medicare and Medicaid programs as estimated settlements with third party payors on the balance sheets, respectively, which will be recognized as non-operating revenue when the Medical Center has satisfied the statutory and regulatory requirements.

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15. Commitment and Contingencies

Litigation and Regulatory Matters

Certain contractual matters may ultimately result in dispute and claim for additional payments. Management and their counsel believe that there are substantial defenses to such claims, should they be asserted, and that the ultimate result of such actions, if any, will not have an adverse material effect to the financial statements. Accordingly, no amounts have been recorded in connection with these matters.

The healthcare industry is subject to numerous laws and regulations of federal, state, and local governments. Compliance with these laws and regulations is subject to future government review and interpretation as well as regulatory actions unknown or unasserted at this time. Government activity continues to increase with respect to investigations and allegations concerning possible violations by healthcare providers of fraud and abuse statutes and regulations, which could result in the imposition of significant fines and penalties as well as significant repayments for patient services previously billed. Starting in 2015, the Medical Center is subject to the Centers for Medicare and Medicaid Services (CMS) calculation for the Medicaid Disproportionate Share Hospital (DSH) payments and the uncompensated care Medicaid DSH audit; the financial impact is uncertain. Management is not aware of any material incidents of noncompliance; however, the possible future financial effects of this matter on the Medical Center, if any, are not presently determinable. In addition, the Medical Center is party to litigation incidental to the normal course of its business. Management believes that the Medical Center's insurance is adequate to cover all payments, if any, that may arise from these lawsuits.

Medical Malpractice

The Medical Center is insured for medical malpractice claims under a claims-made policy with a commercial insurer. The policy currently provides a primary layer of coverage of \$1,000,000 per occurrence and \$3,000,000 annual aggregate; an umbrella layer of \$20,000,000 per occurrence and \$20,000,000 annual aggregate. The Medical Center records an estimated liability for medical malpractice costs, discounted at a rate of 5% at December 31, 2017 and 2016, related to reported claims and incurred claims that have not been reported. The Medical Center's estimated medical malpractice claims liability was approximately \$1,700,000 at December 31, 2017 and 2016, and is included in other long-term liabilities in the accompanying consolidated balance sheet. Insurance recovery assets and related liabilities are presented on a gross basis in the amount of \$5,144,000 in 2017 and \$4,734,000 in 2016, respectively.

The Medical Center believes it has adequate insurance coverages for all asserted claims and it has no knowledge of unasserted claims which would exceed its insurance coverages.

Trinitas Regional Medical Center

Notes to Consolidated Financial Statements
December 31, 2017 and 2016

Real Estate Taxes

As a not-for-profit corporation in New Jersey, the Medical Center 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. The City of Elizabeth has advised the Medical Center of its intentions to remove all of the Medical Center's properties from the current tax exempt status and will place the properties on the real estate property tax rolls. In 2016, the Medical Center signed an agreement with the City of Elizabeth, whereby, the Medical Center will pay a community service contribution in the amount of \$250,000 per year for each of the next four years, effective January 2016, or a higher amount if statewide legislation is passed.

Healthcare Industry Laws and Regulations

The healthcare industry is subject to numerous laws and regulations of federal, state and local governments. Compliance with these laws and regulations is subject to future government review and interpretation as well as regulatory actions unknown or unasserted at this time.

Government activity continues to increase with respect to investigations and allegations concerning possible violations by healthcare providers of fraud and abuse statutes and regulations, which could result in the imposition of significant fines and penalties as well as significant repayments for patient services previously billed. Management is not aware of any material incidents of noncompliance that have not been provided for in the accompanying financial statements; however, the possible future financial effects of this matter on the Medical Center, if any, are not presently determinable.

16. Cogeneration Energy Project

The Medical Center has submitted an application and has received preliminary approval from the Energy Resilience Bank ("ERB"), for a plant electrical and steam generation project. The project would provide additional energy production which will be powered by natural gas during prolonged electrical outages. The project has an estimated cost of \$10.1 million. The financing of the project would consist of a combination of grants for \$6.6 million and a loan from the Department of Housing and Urban Development ("HUD") for approximately \$3.5 million. A portion of the grants, approximately \$520,000 will have to be repaid over ten years, interest free. Final construction and engineering costs are being finalized for approval by ERB and HUD, which is expected for mid-2018.

17. Community Mental Health Center

As of December 31, 2017, the Medical Center had signed a non-binding letter of intent to acquire a community mental health center (the "Center") with the intention of further expanding its behavioral health services. The Center operates an outpatient mental health clinic, outpatient addiction treatment center, adult partial care services program and employee assistance program. The Center will be operated as an outpatient department of the Medical Center. The Medical Center will assume the Center's mortgage on the facility, with an outstanding mortgage of approximately \$91,000. The Medical Center subsequently signed an asset purchase agreement to execute the aforementioned transaction with an effective date of April 12, 2018.