

CONSOLIDATED FINANCIAL STATEMENTS AND
SUPPLEMENTARY INFORMATION

St. Joseph's Health, Inc.
Years Ended December 31, 2019 and 2018
With Report of Independent Auditors

Ernst & Young LLP



St. Joseph's Health, Inc.
Consolidated Financial Statements and
Supplementary Information
Years Ended December 31, 2019 and 2018

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Report of Independent Auditors

The Board of Trustees
St. Joseph's Health, Inc.

We have audited the accompanying consolidated financial statements of St. Joseph's Health, Inc., which comprise the consolidated balance sheets as of December 31, 2019 and 2018, and the related consolidated statements of operations, changes in net assets and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the 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 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 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 financial statements referred to above present fairly, in all material respects, the consolidated financial position of St. Joseph's Health, Inc. at December 31, 2019 and 2018, and the consolidated results of its operations, changes in its net assets and its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

Supplementary Information

Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The accompanying consolidating balance sheet at December 31, 2019, and the consolidating statements of operations and changes in net assets for the year then ended are presented for purposes of additional analysis and are 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. In our opinion, the information is fairly stated, in all material respects, in relation to the consolidated financial statements as a whole.

Ernst + Young LLP

June 19, 2020

St. Joseph's Health, Inc.

Consolidated Balance Sheets

	December 31	
	2019	2018
	<i>(In Thousands)</i>	
Assets		
Current assets:		
Cash and cash equivalents	\$ 60,786	\$ 30,783
Investments	241,309	233,738
Current portion of assets whose use is limited	20,294	18,114
Patient accounts receivable, net	68,772	83,186
Contributions and pledges receivable	1,245	1,036
Prepaid expenses and other current assets	41,633	36,067
Total current assets	<u>434,039</u>	<u>402,924</u>
Assets whose use is limited – less current portion	55,521	47,052
Property and equipment – net	367,624	366,251
Beneficial interest in perpetual trusts	6,196	5,530
Equity investments in joint ventures	28,050	28,396
Other noncurrent assets	7,459	11,631
Total assets	<u>\$ 898,889</u>	<u>\$ 861,784</u>
Liabilities and net assets		
Current liabilities:		
Current portion of long-term debt	\$ 5,366	\$ 5,755
Accounts payable	60,461	52,479
Accrued salaries and expenses	89,565	77,330
Accrued interest payable	7,133	7,210
Deferred revenue	556	1,038
Current portion of estimated third-party payer settlements	3,675	762
Total current liabilities	<u>166,756</u>	<u>144,574</u>
Long-term debt – net of current portion	358,409	365,663
Estimated third-party payer settlements – net of current portion	15,909	9,394
Accrued pension liability	121,812	100,278
Estimated professional liability claims payable – net of current portion	34,650	32,412
Other liabilities	7,171	10,870
Total liabilities	<u>704,707</u>	<u>663,191</u>
Commitments and contingencies		
Net assets:		
Net assets without donor restrictions	173,693	179,654
Net assets with donor restrictions	19,913	18,355
Total St. Joseph's Health, Inc. net assets	<u>193,606</u>	<u>198,009</u>
Non-controlling interests in joint ventures	576	584
Total net assets, including non-controlling interests	<u>194,182</u>	<u>198,593</u>
Total liabilities and net assets	<u>\$ 898,889</u>	<u>\$ 861,784</u>

See accompanying notes.

St. Joseph's Health, Inc.

Consolidated Statements of Operations

	Year Ended December 31	
	2019	2018
	<i>(In Thousands)</i>	
Operating revenues:		
Net patient service revenue	\$ 729,784	\$ 713,470
Other revenue	96,094	93,426
Net assets released from restrictions – operations	1,768	1,716
Total operating revenues	<u>827,646</u>	<u>808,612</u>
Operating expenses:		
Salaries and wages	415,344	385,755
Employee benefits	71,340	74,048
Physician fees	18,486	22,593
Supplies and other	275,585	280,853
Interest	14,215	11,764
Depreciation and amortization	36,175	33,880
Total operating expenses	<u>831,145</u>	<u>808,893</u>
Operating loss	(3,499)	(281)
Non-operating gains and losses:		
Investment return	8,150	6,963
Net change in unrealized gains and losses on equity investments	8,968	–
Net periodic pension (cost) benefit	(749)	2,592
Excess of revenues over expenses, before non-controlling interests in joint ventures	12,870	9,274
Less: net gain attributable to non-controlling interests in joint ventures	525	3,972
Excess of revenues over expenses	<u>12,345</u>	<u>5,302</u>
Other changes in net assets without donor restrictions:		
Change in net unrealized gains and losses on investments	8,287	(10,301)
Pension-related adjustments	(26,785)	(6,443)
Net assets released from restrictions – capital acquisitions	192	402
Transfer of assets from joint ventures	–	344
Dissolution of joint ventures	–	(5,000)
Change in net assets without donor restrictions	<u>\$ (5,961)</u>	<u>\$ (15,696)</u>

See accompanying notes.

St. Joseph's Health, Inc.

Consolidated Statements of Changes in Net Assets

	Year Ended December 31	
	2019	2018
	<i>(In Thousands)</i>	
Net assets without donor restrictions:		
Change in net assets without donor restrictions	\$ (5,961)	\$ (15,696)
Net assets with donor restrictions:		
Contributions, grants, investment income, and other support	2,852	(857)
Net assets released from restrictions – operations	(1,768)	(1,719)
Net assets released from restrictions – capital acquisitions	(192)	(402)
Change in net unrealized gains and losses on investments held in perpetual trusts	666	(609)
Increase (decrease) in net assets with donor restrictions	1,558	(3,587)
Decrease in St. Joseph's Health, Inc. net assets	(4,403)	(19,283)
Non-controlling interests in joint ventures:		
Net gain attributable to non-controlling interests in joint ventures	525	3,972
Distributions to non-controlling interests in joint ventures, net	(533)	(7,269)
Decrease in non-controlling interests	(8)	(3,297)
Change in net assets, including non-controlling interests	(4,411)	(22,580)
Net assets at beginning of year	198,593	221,173
Net assets at end of year	<u>\$ 194,182</u>	<u>\$ 198,593</u>

See accompanying notes.

St. Joseph's Health, Inc.

Consolidated Statements of Cash Flows

	Year Ended December 31	
	2019	2018
	<i>(In Thousands)</i>	
Operating activities		
Change in net assets including non-controlling interests	\$ (4,411)	\$ (22,580)
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation and amortization	36,175	33,880
Change in net unrealized gains and losses on investments and perpetual trusts	(17,921)	10,910
Net realized gains and losses on sales of investments	1,854	1,870
Donor restricted contributions and other support	(2,852)	860
Distributions to non-controlling interests in joint ventures, net	533	7,269
Equity in earnings of joint ventures	(3,191)	(2,778)
Changes in operating assets and liabilities:		
Patient accounts receivable, net	14,414	7,562
Prepaid expenses and other assets	(1,184)	(8,647)
Accounts payable, accrued salaries and expenses and interest payable	20,140	13,893
Estimated third-party payer settlements	9,428	2,126
Accrued pension liability	21,534	(11,149)
Estimated professional liability claims payable and other liabilities	(1,943)	5,559
Net cash provided by operating activities	<u>72,576</u>	<u>38,775</u>
Investing activities		
Acquisition of property and equipment, net	(37,548)	(61,857)
Purchases of investments and assets whose use is limited, net	(1,712)	(1,135)
Net cash used in investing activities	<u>(39,260)</u>	<u>(62,992)</u>
Financing activities		
Repayment of long-term debt	(7,643)	(6,675)
Distributions paid to non-controlling interests in joint ventures, net	(533)	(7,269)
Donor restricted contributions and other support	2,852	(860)
Net cash used in financing activities	<u>(5,324)</u>	<u>(14,804)</u>
Net increase (decrease) in cash and cash equivalents and restricted cash and restricted cash equivalents	27,992	(39,021)
Cash and cash equivalents and restricted cash and restricted cash equivalents, beginning of year	56,656	95,677
Cash and cash equivalents and restricted cash and restricted cash equivalents, end of year	<u>\$ 84,648</u>	<u>\$ 56,656</u>
Reconciliation of cash and cash equivalents and restricted cash and restricted cash equivalents at end of year to the consolidated balance sheets:		
Cash and cash equivalents	\$ 60,786	\$ 30,783
Assets whose use is limited – cash and cash equivalents	23,862	25,873
Total cash and cash equivalents and restricted cash and restricted cash equivalents	<u>\$ 84,648</u>	<u>\$ 56,656</u>
Supplemental disclosure of non-cash investing and financing activities and cash flow information		
Cash paid for interest, net of amounts capitalized	\$ 14,292	\$ 14,405
Assets acquired under capitalized lease obligations	\$ –	\$ 2,310

See accompanying notes.

St. Joseph's Health, Inc.

Notes to Consolidated Financial Statements

December 31, 2019

1. Organization and Summary of Significant Accounting Policies

Organization

The accompanying consolidated financial statements include the accounts of St. Joseph's Health, Inc. (SJH) and its affiliates (collectively, the System). SJH is a not-for-profit holding corporation with Seton Ministries, Inc., effective February 2019, as its sole member. Seton Ministries, Inc. is a subsidiary of Sisters of Charity of Saint Elizabeth formed in February 2019; prior to February 2019, SJH was sponsored by the Sisters of Charity of Saint Elizabeth. Affiliated members of SJH include St. Joseph's University Medical Center, Inc. (SJUMC) and subsidiaries, St. Joseph's Hospital and Medical Center Foundation, Inc. (the Foundation), 200 Hospital Plaza Corporation (200 Hospital Plaza), SJHS Insurance Limited (the Insurance Captive), VHS Management, Inc. and subsidiary (VHS) and St. Joseph's Home Health, LLC (Home Health). In September 2018, St. Joseph's Health Partners, LLC was formed as a single member limited liability corporation to operate a clinically integrated network with SJUMC as its sole owner. In January 2019, St. Joseph's Health Pharmacy, LLC (the Pharmacy) was formed as a single member limited liability corporation to operate a community retail pharmacy with SJUMC as its sole owner. The Pharmacy began operations on May 18, 2020.

Through December 31, 2018, St. Joseph's Wayne Hospital Foundation, Inc. also was an affiliate of SJH. Effective January 1, 2019, the St. Joseph's Wayne Hospital Foundation, Inc. was merged into the Foundation.

In September 2019, SJH entered into a clinical and strategic affiliation with Hackensack Meridian Health (HMH). HMH committed \$60 million for projects related to additional joint ventures for cancer centers in the Paterson, Totowa, and Wayne areas of New Jersey and for other projects yet to be determined. As part of this affiliation, SJH maintains its board and control structure.

SJUMC, formerly known as St. Joseph's Hospital and Medical Center, was founded in 1867 and is located in Paterson, New Jersey. It is an acute-care hospital with 651 licensed beds and 30 newborn bassinets. SJUMC is a state-designated trauma center and provides a full range of health care services. Effective January 1, 2010, St. Joseph's Wayne Medical Center and subsidiary (Wayne Medical Center) was merged with SJUMC and, collectively, the entities are referred to herein as the "Medical Center." Wayne Medical Center, located in Wayne, New Jersey, is an acute-care hospital with 229 licensed beds. Wayne Medical Center provides comprehensive medical and surgical care, and emergency and diagnostic services for its community.

St. Joseph's Health, Inc.

Notes to Consolidated Financial Statements (continued)

1. Organization and Summary of Significant Accounting Policies (continued)

The Medical Center also operates St. Joseph's Healthcare and Rehab Center, a 151 bed skilled nursing facility located in Cedar Grove, New Jersey. In addition, the Medical Center includes the following wholly owned subsidiaries:

- St. Joseph's Healthcare Physicians, Inc.; St. Joseph's Emergency Physicians, Inc.; St. Joseph's Faculty Physicians, Inc.; and St. Joseph's Physician's, Inc. manage the Medical Center's faculty staff billing services.
- Harbor House, Inc. and its subsidiaries, Harborside Apartments, Inc. and Harborview Apartments, Inc., provide housing and services to individuals with mental illnesses.

The Medical Center is also the majority member of St. Joseph's Surgery Management, LLC (Surgery Management). Surgery Management is a limited liability corporation established to manage the surgical services at SJUMC. Additionally, the Medical Center was the majority member of the following entities which were dissolved in 2018: St. Joseph's Regional Cardiology, LLC (Paterson Cardiology); St. Joseph's Wayne Cardiology, LLC (Wayne Cardiology); and Blue Moon Properties, LLC (Blue Moon). Paterson Cardiology and Wayne Cardiology were limited liability corporations that each operated a cardiac catheterization laboratory. Blue Moon was a limited liability corporation that provided radiology-management services. The Medical Center paid \$5.0 million in 2018 to acquire the remaining interests in the dissolved joint ventures.

The Foundation is a public charity whose primary purpose is to raise funds for the Medical Center, its affiliated organizations, and other area charitable organizations.

200 Hospital Plaza is a not-for-profit organization whose purpose is to further the operations of the Medical Center by owning, managing, and operating parking facilities and any other facilities that may be deemed useful or necessary for employees, patients, visitors, doctors, and other persons affiliated with the Medical Center.

The Insurance Captive, a wholly owned captive insurance company domiciled in Bermuda, was established in 2007 to provide the System with general liability and professional medical liability insurance.

St. Joseph's Health, Inc.

Notes to Consolidated Financial Statements (continued)

1. Organization and Summary of Significant Accounting Policies (continued)

VHS is a not-for-profit corporation incorporated in the state of New Jersey and is the holding company of Visiting Health Services of New Jersey, Inc. (the Agency). The Agency operated a not-for-profit home health agency that served Passaic, Bergen, and Morris counties in New Jersey. In May 2017, the System sold certain assets and business operations related to VHS to a newly formed joint venture, VHSNJ at Home, LLC, a joint venture with Hackensack Meridian Home Care Services, Inc. The System holds a 50% ownership interest in the VHSNJ at Home, LLC joint venture.

Significant Accounting Policies

A summary of the System's significant accounting policies follows:

Principles of Consolidation: The consolidated financial statements include the accounts of SJH and its affiliates. SJH accounts for its interests in entities in which it has significant influence but not control using the equity method of accounting.

Investment in Consolidated Subsidiaries: The Medical Center is the majority member of Surgery Management and maintains a 52% and 56% interest at December 31, 2019 and 2018, respectively. The accounts of Surgery Management are consolidated with those of the Medical Center. The change in the non-controlling interests are separately reported. All intercompany transactions and account balances have been eliminated in consolidation.

Basis of Accounting: The consolidated financial statements have been prepared on the accrual basis of accounting in conformity with accounting principles generally accepted in the United States (GAAP) consistent with the Financial Accounting Standards Board (FASB) Accounting Standards Codification 954, *Health Care Entities*, and the American Institute of Certified Public Accountants' Audit and Accounting Guide, *Health Care Entities*, and other pronouncements applicable to health care organizations.

Use of Estimates: The preparation of consolidated financial statements in conformity with GAAP 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 consolidated financial statements. Estimates also affect the amounts of revenue and expenses reported during the period. Actual results could differ from those estimates. Significant estimates include collections on patient accounts receivable, estimated third-party payer settlements, accrued pension liability, estimated professional liability claims payable, and other self-insurance liabilities.

St. Joseph's Health, Inc.

Notes to Consolidated Financial Statements (continued)

1. Organization and Summary of Significant Accounting Policies (continued)

Cash and Cash Equivalents: Cash and cash equivalents include highly liquid investments with an original maturity of three months or less. The carrying amount of cash and cash equivalents reported on the consolidated balance sheets approximates fair value. The System does not hold any money market funds with significant liquidity restrictions that would be required to be excluded from cash equivalents.

Investments and Investment Income: Investments in equity securities with readily determinable fair values and all investments in debt securities are reported at fair value and are classified as other-than-trading securities. Fair value is based on quoted market prices of the investment or similar investments. For 2019, investment return (including realized gains and losses on investments, interest, and dividends) and the net change in unrealized gains and losses on equity investments are included in the excess of revenues over expenses in the accompanying consolidated statements of operations, unless the income or loss is restricted by donor or law. The change in net unrealized gains and losses on fixed income securities in 2019 and fixed income and equity securities in 2018 (prior to the effective date of Accounting Standards Update (ASU) 2016-01) is reported as a separate component of the change in net assets without donor restrictions, except declines in fair value that are determined by management to be other than temporary are reported as realized losses. No such losses were recorded in 2019 or 2018 as unrealized losses on individual investment holdings were not significant. Donated investments are recorded at the fair value on the date of receipt.

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

Assets Whose Use is Limited: Assets whose use is limited include assets held by trustees under bond indenture agreements, investments held by the Insurance Captive, and donor-restricted assets. Amounts available to meet current liabilities of the System have been classified as current assets in the accompanying consolidated balance sheets.

Supplies: Supplies are stated at the lower of cost (first in, first out) or net realizable value. Supplies are used in the provision of patient care and are not held for sale.

St. Joseph's Health, Inc.

Notes to Consolidated Financial Statements (continued)

1. Organization and Summary of Significant Accounting Policies (continued)

Property and Equipment: Property and equipment acquisitions are recorded at cost, except donated assets, which are recorded at fair value at the date of donation. Depreciation expense is provided over the estimated useful life of each class of depreciable asset and is computed using the straight-line method. Equipment under capital lease obligations is amortized on the straight-line method over the shorter period of the lease term or the estimated useful life of the equipment. Such amortization is included in depreciation and amortization in the accompanying consolidated statements of operations.

Estimated useful lives for the property and equipment are as follows:

Land improvements	15–20 years
Buildings and improvements	5–60 years
Fixed and major movable equipment	5–12 years

Gifts of long-lived assets, such as land, buildings, or equipment, are reported as an increase to net assets without donor restrictions, unless explicit donor stipulations specify how the donated assets must be used. Gifts of long-lived assets with explicit restrictions that specify how the assets are to be used and gifts of cash or other assets that must be used to acquire long-lived assets are reported as restricted support. Absent explicit donor stipulations about how long those long-lived assets must be maintained, expirations of donor restrictions are reported when the donated or acquired long-lived assets are placed in service.

Impairment of Long-Lived Assets: Long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. If long-lived assets are deemed to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value. Assets to be disposed of are reported at the lower of the carrying amount or the fair value less costs to sell.

Deferred Financing Costs: Deferred financing costs represent costs incurred to obtain financing for various construction and renovation projects at the Medical Center and 200 Hospital Plaza. These costs are amortized over the remaining term of the applicable indebtedness using the effective interest method.

St. Joseph's Health, Inc.

Notes to Consolidated Financial Statements (continued)

1. Organization and Summary of Significant Accounting Policies (continued)

Beneficial Interest in Perpetual Trusts: Perpetual trusts are arrangements in which a donor establishes and funds a perpetual trust administrated by a third party. The perpetual trusts consist of life estate gifts. Under the terms of the trusts, the Foundation has an irrevocable right to receive the income earned on the trust assets in perpetuity. Income earned is without donor restrictions and included in other revenue in the accompanying consolidated statements of operations. The Foundation does not control the assets held by an outside trust. The Foundation recognizes its respective interests in the trusts within net assets with donor restrictions to be maintained in perpetuity based on the fair value of the trust assets. Changes in the fair value of the trusts are recorded as change in net unrealized gains and losses on investments held in perpetual trusts in the accompanying consolidated statements of changes in net assets.

Equity Investments in Joint Ventures: The System's investments in joint ventures are accounted for using the equity method of accounting except for joint ventures where the System holds a controlling interest.

Deferred Revenue: The System is the recipient of various awards and contracts from governmental agencies. Receipts for which applicable conditions and restrictions are not satisfied are recorded as deferred revenue in the consolidated balance sheets.

Other Assets: Other assets consist primarily of goodwill, investments held by trustee, security deposits and physician loan receivables.

Other Liabilities: Capital project obligations related to grant agreements with the State of New Jersey Department of Human Services, Division of Mental Health and Addiction Services in the amount of \$945,000 at December 31, 2019 and 2018, are included in other noncurrent liabilities in the accompanying consolidated balance sheets.

Contributions and Pledges Receivable: Unconditional promises to give are recorded at net realizable value based on the present value of their estimated future cash flows. Present value of such amounts is computed using a risk-free discount rate at the time of the pledge ranging from 3.5% to 4.5% at December 31, 2019 and 2018. Conditional promises to give are not included as support until the conditions are substantially met.

St. Joseph's Health, Inc.

Notes to Consolidated Financial Statements (continued)

1. Organization and Summary of Significant Accounting Policies (continued)

Self-Insurance: The Medical Center offers medical insurance to its employees through a health maintenance organization and a preferred provider organization (PPO). The PPO provides third-party administrative services for employees, who are enrolled in the program. The Medical Center remains self-insured for the associated health claims. An estimated liability for employee medical benefits incurred but not reported is included within accrued salaries and expenses in the accompanying consolidated balance sheets.

The Medical Center offers workers' compensation through a high deductible structure with commercial insurance above specific amounts. The current portion of the estimated liability for worker's compensation of approximately \$7.1 million and \$6.5 million at December 31, 2019 and 2018, respectively, is included in accrued salaries and expenses, and approximately \$5.6 million at December 31, 2019 and 2018, is included as long-term in other liabilities in the accompanying consolidated balance sheets.

Estimated Professional Liability Claims Payable: The System's professional liability program is described in Note 10. An estimated liability for medical malpractice costs related to reported claims and incurred claims that have not been reported is recorded in the consolidated balance sheets. The Insurance Captive maintains a self-insurance reserve trust as the funding vehicle for the self-insurance program. The System recognizes a receivable for insurance recoveries at the time a liability is recorded and records a valuation allowance for uncollectible receivables when applicable.

Accounting for Pension Plans: The System's retirement plans are described in Note 9. The System recognizes the overfunded or underfunded status of the defined benefit pension plan in the consolidated balance sheets. Changes in the funded status of the plan are reported in the year in which the changes occur as a change in net assets without donor restrictions presented after the excess of revenues over expenses in the accompanying consolidated statements of operations.

St. Joseph's Health, Inc.

Notes to Consolidated Financial Statements (continued)

1. Organization and Summary of Significant Accounting Policies (continued)

Performance Indicator: The consolidated statements of operations include the excess of revenues over expenses as the performance indicator. Changes in net assets without donor restrictions which are excluded from the performance indicator include pension-related adjustments, contributions of long-lived assets, permanent transfers of assets to and from affiliates or controlled joint ventures for other than goods and services, and the net change in unrealized gains and losses on other-than-trading investments (only applicable to fixed income securities in 2019), except for declines in fair value that are determined by management to be other than temporary, which are reported as realized losses.

Transactions deemed by management to be ongoing, major, or central to the provision of health care services are reported as operating revenues and operating expenses and are included in operating loss. Investment return and certain transactions of a peripheral or infrequent nature are excluded from operating loss.

Classification of Net Assets: The System separately accounts for and reports net assets without donor restrictions and net assets with donor restrictions. Net assets without donor restrictions are not externally restricted for identified purposes by donors or grantors. Net assets without donor restrictions include resources that the governing board may use for any designated purpose and resources whose use is limited by agreement between the System and an outside party other than the donor or grantor.

Net assets with donor restrictions are those whose use by the System has been limited by donors to a specific time period or purpose or have been restricted by donors as permanent endowments to be maintained in perpetuity. When the donors' intentions are met or a time restriction expires for net assets limited by donors to a specific time period or purpose, the net assets are reclassified to net assets without donor restriction and reported on the consolidated statements of operations and changes in net assets as net assets released from restrictions.

Donor-restricted contributions whose restrictions are met within the same year as received are reported within other revenue in the accompanying consolidated statements of operations. In the absence of donor specifications that income and gains on donated funds are restricted, such income and gains are reported as investment return in the accompanying consolidated statements of operations.

The System recognizes governmental grants where commensurate value is not exchanged as contributions when conditions and restrictions are satisfied and reports such amounts within other revenue (see Note 12).

St. Joseph's Health, Inc.

Notes to Consolidated Financial Statements (continued)

1. Organization and Summary of Significant Accounting Policies (continued)

Tax Status: SJH and substantially all of its affiliates are not-for-profit corporations as described in Section 501(c)(3) of the Internal Revenue Code (the Code) and are exempt from federal income taxes on related income pursuant to Section 501(a) of the Code. The not-for-profit affiliates of the System are also exempt from state income taxes. Surgery Management and Home Health and other limited liability corporations are treated as partnerships for income tax purposes and do not require a provision for income taxes. The Insurance Captive is exempt from taxes through March 2035.

Certain affiliates of the System are for-profit entities and, as such, are subject to federal, state, and local income taxes. The provision for income taxes associated with these entities and for unrelated business income of tax-exempt entities is not material to the System's consolidated results of operations and is included in supplies and other expenses on the consolidated statements of operations and changes in net assets.

The Taxpayer Certainty and Disaster Tax Relief Act of 2019, signed into law on December 20, 2019 retroactively repealed Section 512(a)(7) of the Code which subjected amounts paid or incurred by an exempt organization to provide certain transportation fringe benefits to its employees to taxation as unrelated business taxable income. Prior year income tax payments, as well as current year payments for income taxes associated with Section 512(a)(7) for which refunds have been requested are recorded as receivables at December 31, 2019. These amounts are not significant to the accompanying consolidated financial statements.

Recently Adopted Accounting Pronouncements: In January 2016, the Financial Accounting Standards Board (FASB) issued ASU 2016-01, *Recognition and Measurement of Financial Assets and Financial Liabilities*. ASU 2016-01 required business-oriented health care not-for-profit entities to measure equity investments that do not result in consolidation and are not accounted for under the equity method at fair value and recognize any changes in fair value in the performance indicator unless the investments qualify for a new practicality exception. The practicality exception is available for equity investments without a readily determinable fair value, for which measurement would be based on cost less impairment and adjusted for observable price changes. The System adopted ASU 2016-01 effective for its December 31, 2019 consolidated financial statements. Subsequent to the adoption of ASU 2016-01 effective January 1, 2019, the System no longer recognizes unrealized holding gains and losses on equity securities classified as other-than-trading outside of the performance indicator. This ASU did not impact the accounting for investments in debt securities.

St. Joseph's Health, Inc.

Notes to Consolidated Financial Statements (continued)

1. Organization and Summary of Significant Accounting Policies (continued)

In August 2016, the FASB issued ASU 2016-15, *Statement of Cash Flows – Classification of Certain Cash Receipts and Cash Payments*, which addresses the following eight specific cash flow issues in order to limit diversity in practice: debt prepayment or debt extinguishment costs; settlement of zero-coupon debt instruments or other debt instruments with coupon interest rates that are insignificant in relation to the effective interest rate of the borrowing; contingent consideration payments made after a business combination; proceeds from the settlement of insurance claims; proceeds from the settlement of corporate-owned life insurance policies, including bank-owned life insurance policies; distributions received from equity method investees; beneficial interests in securitization transactions; and separately identifiable cash flows and application of the predominance principle. The adoption of ASU 2016-15 did not have a material impact on the System's consolidated financial statements.

In November 2016, the FASB issued ASU 2016-18, *Statement of Cash Flows – Restricted Cash*, which requires that the statement of cash flows explain the change during the period in the total of cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents. Therefore, amounts generally described as restricted cash and restricted cash equivalents should be included with cash and cash equivalents when reconciling the beginning-of-period and end-of-period total amounts shown on the statement of cash flows. The System adopted ASU 2016-18 using a retrospective transition method.

In March 2017, the FASB issued ASU 2017-07, *Compensation – Retirement Benefits: Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost*. ASU 2017-07 addresses how employers that sponsor defined benefit pension and/or other postretirement benefit plans present the net periodic benefit cost in the income statement. Employers are required to present the service cost component of net periodic benefit cost in the same income statement line item as other employee compensation costs arising from services rendered during the period. Employers present the other components of the net periodic benefit cost separately from the line item that includes the service cost and outside of any subtotal of operating (loss) income, if one is presented. The standard became effective for the System for annual periods beginning after December 15, 2018 and was adopted in 2019 on a retrospective basis. The adoption of ASU 2017-07 resulted in the System including net periodic pension cost (benefit) (approximately \$0.7 million and (\$2.6) million for 2019 and 2018, respectively) as a separate line item excluded from operating loss but included in the subtotal for excess of revenues over expenses. Net periodic pension cost (benefit) was previously reported within employee benefits expense on the consolidated statements of operations.

St. Joseph's Health, Inc.

Notes to Consolidated Financial Statements (continued)

1. Organization and Summary of Significant Accounting Policies (continued)

In June 2018, the FASB issued ASU 2018-08, *Not-for-Profit Entities (Topic 958); Clarifying the Scope and the Accounting Guidance for Contributions Received and Contributions Made*. ASU 2018-08 clarifies existing guidance in order to address diversity in practice in classifying grants (including governmental grants) and contracts received by not-for-profit entities and requires entities to evaluate whether the resource provider receives commensurate value. In addition, the standard clarifies the guidance on how entities determine when a contribution is conditional, including whether the agreement includes a barrier (or barriers) that must be overcome for the recipient to be entitled to the transferred assets and a right of return of the transferred assets (or a right of release of the promisor's obligation to transfer the assets). The standard was applied on a modified prospective basis to agreements that were not completed as of the effective date and to agreements entered into after the effective date. The System adopted ASU 2018-08 effective January 1, 2019. The adoption of ASU 2018-08 did not have a material impact to the System's consolidated financial statements.

In May 2019, the FASB issued ASU 2019-06, *Intangibles — Goodwill and Other (Topic 350), Business Combinations (Topic 805), and Not-for-Profit Entities (Topic 958), Extending the Private Company Accounting Alternatives on Goodwill and Certain Identifiable Intangible Assets to Not-for-Profit (NFP) Entities*. The standard allows NFPs to apply accounting alternatives that simplify the subsequent accounting for goodwill and the accounting for certain intangible assets they acquire. NFPs that elect the goodwill accounting alternative will amortize goodwill on a straight-line basis over 10 years or over a shorter period if an NFP can demonstrate that another useful life is more appropriate, and perform a one-step impairment test, at either the entity level or the reporting unit level, only when an impairment indicator exists. NFPs that elect the intangible asset accounting alternative may recognize fewer intangible assets in an acquisition, and they would be required to elect the goodwill accounting alternative. The guidance is effective immediately. The System did not elect to adopt the accounting alternatives noted above.

St. Joseph's Health, Inc.

Notes to Consolidated Financial Statements (continued)

1. Organization and Summary of Significant Accounting Policies (continued)

Pending Accounting Pronouncements: In February 2016, the FASB issued ASU 2016-02, *Leases*, which requires lessees to report most leases on their balance sheets, but recognize expenses on their income statements in a manner similar to the current accounting. The guidance also eliminates current real estate-specific provisions. Lessors in operating leases continue to recognize the underlying asset and recognize lease income on either a straight-line basis or another systematic and rational basis. The provisions of ASU 2016-02, as amended by ASU 2020-05, *Revenue from Contracts with Customers (Topic 606) and Leases (Topic 842): Effective Dates for Certain Entities*, are effective for the System for annual periods beginning after December 15, 2019, and interim periods within those years. Subsequent to the adoption, the System's assets and liabilities are expected to increase to reflect the System's right to use certain assets and the corresponding liabilities associated with operating leases, with no significant impact to net assets or the performance indicator.

In June 2016, the FASB issued ASU 2016-13, *Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*. The main objective of ASU 2016-13 and related ASU updates is to provide financial statement users with more decision-useful information about the expected credit losses on financial instruments and other commitments to extend credit held by a reporting entity at each reporting date. The amendments affect loans, debt securities, trade receivables, net investments in leases, off balance sheet credit exposures, reinsurance receivables, and any other financial assets not excluded from the scope that have the contractual right to receive cash. The amendments in this update are effective for the System for fiscal years beginning after December 15, 2023. The System has not completed the process of evaluating the impact of ASU 2016-13 on its consolidated financial statements.

In January 2017, the FASB issued ASU 2017-04, *Intangibles-Goodwill and Other*. ASU 2017-04 will simplify the accounting for goodwill impairment and will remove Step 2 of the current goodwill impairment test, which requires a hypothetical purchase price allocation. Under ASU 2017-04, a goodwill impairment charge will be recognized for the amount by which the carrying value of a reporting unit exceeds its fair value, not to exceed the carrying amount of goodwill. This guidance is effective for the System for annual periods beginning after December 15, 2022, with early adoption permitted for any impairment tests performed after January 1, 2017. The System has not completed the process of evaluating the impact of ASU 2017-04 on its consolidated financial statements.

St. Joseph's Health, Inc.

Notes to Consolidated Financial Statements (continued)

1. Organization and Summary of Significant Accounting Policies (continued)

In August 2018, the FASB issued ASU 2018-15, *Intangibles – Goodwill and Other – Internal-Use Software (Subtopic 350-40): Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement that is a Service Contract*. The standard aligns the requirement for capitalizing implementation costs incurred in a hosting arrangement that is a service contract with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software (and hosting arrangements that include an internal use software license). The accounting for the service element of a hosting arrangement that is a service contract is not affected by this standard. The standard requires the customer in a hosting arrangement that is a service contract to follow the guidance in ASC Subtopic 350-40 to determine which implementation costs to capitalize as an asset related to the service contract and which costs to expense by determining which project stage an implementation activity relates to and the nature of the costs. The standard also requires the customer to expense the capitalized implementation costs of a hosting arrangement that is a service contract over the term of the hosting arrangement. ASU 2018-15 is effective for the System for fiscal years beginning after December 15, 2020, and interim periods within fiscal years beginning after December 15, 2021. Early adoption is permitted, including adoption in any interim period. Either retrospective or prospective adoption is permitted. The System has not completed the process of evaluating the impact of ASU 2018-15 on its consolidated financial statements.

The FASB has amended certain guidance related to various disclosures in ASU 2018-13, *Technical Corrections and Improvements to Financial Instruments-Overall (Subtopic 825-10)-Recognition and Measurement of Financial Assets and Financial Liabilities*, and ASU 2018-14, *Compensation-Retirement Benefits-Defined Benefit Plans-General (Subtopic 715-20)-Disclosure Framework-Changes to the Disclosure Requirements for Defined Benefit Plans*. ASU 2018-13 includes several disclosure changes involving transfers between the fair value levels and other updates related to fair value Level 3 investments. ASU 2018-13 also requires entities that use the practical expedient to measure the fair value of certain investments at their net asset values to disclose (1) the timing of liquidation of an investee's assets and (2) the date when redemption restrictions will lapse, but only if the investee has communicated this information to the entity or announced it publicly.

St. Joseph's Health, Inc.

Notes to Consolidated Financial Statements (continued)

1. Organization and Summary of Significant Accounting Policies (continued)

The guidance in ASU 2018-14 requires all sponsors of defined benefit plans to provide certain new disclosures: the weighted-average interest crediting rate for cash balance plans and other plans with promised interest crediting rates and an explanation of the reasons for significant gains and losses related to changes in the benefit obligation for the period. Among other changes, ASU 2018-14 eliminates the required disclosure for all sponsors of defined benefit plans to disclose the amounts in accumulated other comprehensive income expected to be recognized as components of net periodic benefit cost over the next fiscal year. The updates noted above have effective dates as follows with early adoption permitted: ASU 2018-13: fiscal years beginning after December 15, 2019 and ASU 2018-14: fiscal years ending after December 15, 2021. The System has not completed the process of evaluating the impact of these ASUs on its consolidated financial statements.

Reclassifications: Certain reclassifications have been made to 2018 amounts previously disclosed in order to conform to the current year presentation. These reclassifications had no impact on the previously reported net assets.

2. Uncompensated Care

Uncompensated care includes services provided to indigent persons who cannot afford health care due to inadequate resources and/or who are uninsured or underinsured. Uncompensated care is comprised of the costs of charity care for which state subsidies are not received (see Note 3), implicit price concessions, and the unpaid costs of care provided to beneficiaries of Medicaid and other indigent public programs.

The System provides charity care to patients who meet certain criteria defined by the New Jersey Department of Health (DOH) without charge or at amounts less than established rates. The System receives partial payment for the charity care it provides based upon the approved submission of patient claims once they are qualified for the program (see Note 3).

St. Joseph's Health, Inc.

Notes to Consolidated Financial Statements (continued)

2. Uncompensated Care (continued)

The estimated costs of charity care incurred by the System based on adjudicated claims was approximately \$50.4 million and \$58.8 million for years ended December 31, 2019 and 2018, respectively. The estimated cost of these charity care services was determined using a ratio of cost to gross charges and applying that ratio to the gross charges associated with providing care to charity patients for the period. Gross charges associated with providing care to charity patients include only the related charges for those patients who are financially unable to pay and qualify under the System's charity care policy and that do not otherwise qualify for payment from a governmental program. Because the collection of amounts determined to qualify as charity care is not pursued, it is not reported as revenue.

For uninsured patients who did not qualify for charity care the expected uncollected amounts are classified as an implicit price concession, based on a published financial assistance policy, which reduced net patient service revenue by approximately \$84.2 million and \$88.6 million for years ended December 31, 2019 and 2018, respectively.

3. Net Patient Service Revenue

Net patient service revenue is reported at the amount that reflects the consideration to which the System expects to be entitled in exchange for providing patient care. These amounts are due from patients, third-party payers (including health insurers and government programs), and others and includes variable consideration (reductions to revenue) for retroactive revenue adjustments including adjustments due to settlement of ongoing and future audits, reviews, and investigations.

The System uses a portfolio approach to account for categories of patient contracts as a collective group rather than recognizing revenue on an individual contract basis. The portfolios consist of major payer classes for inpatient and outpatient revenue. Based on historical collection trends and other analyses, the System believes that revenue recognized by utilizing the portfolio approach approximates the revenue that would have been recognized if an individual contract approach were used.

St. Joseph's Health, Inc.

Notes to Consolidated Financial Statements (continued)

3. Net Patient Service Revenue (continued)

The System's initial estimate of the transaction price for services provided to patients subject to revenue recognition is determined by reducing the total standard charges related to the patient services provided by various elements of variable consideration, including contractual adjustments, discounts, implicit price concessions, and other reductions to the System's standard charges. The System determines the transaction price associated with services provided to patients who have third-party payer coverage on the basis of contractual or formula-driven rates for the services rendered (see description of third-party payer payment programs below). The estimates for contractual allowances and discounts are based on contractual agreements, the System's discount policies and historical experience. For uninsured patients who do not qualify for charity care, the System determines the transaction price associated with services on the basis of charges reduced by implicit price concessions based on a published financial assistance policy. Implicit price concessions included in the estimate of the transaction price are based on the System's historical collection experience for applicable patient portfolios. Under the System's charity care policy, a patient who has no insurance and is ineligible for any government assistance program has his or her bill reduced to the amount which would be billed to a commercially insured patient.

Generally, the System bills patients and third-party payers several days after the services are performed and/or the patient is discharged. Net patient service revenue is recognized as performance obligations are satisfied. Performance obligations are determined based on the nature of the services provided by the System. Net patient service revenue for performance obligations satisfied over time is recognized based on actual charges incurred in relation to total charges. The System believes that this method provides a reasonable depiction of the transfer of services over the term of the performance obligation based on the services needed to satisfy the obligation. Generally, performance obligations satisfied over time relate to patients receiving inpatient acute care services or patients receiving services in the System's outpatient and ambulatory care centers. The System measures the performance obligation from admission into the hospital or the commencement of an outpatient service to the point when it is no longer required to provide services to that patient, which is generally at the time of discharge or the completion of the outpatient visit.

St. Joseph's Health, Inc.

Notes to Consolidated Financial Statements (continued)

3. Net Patient Service Revenue (continued)

Substantially all of its performance obligations relate to contracts with a duration of less than one year. Unsatisfied or partially unsatisfied performance obligations primarily relate to inpatient acute care services at the end of the reporting period for patients who remain admitted at that time (in-house patients). The performance obligations for in-house patients are generally completed when the patients are discharged, which for the majority of the System's in-house patients occurs within days or weeks after the end of the reporting period.

Subsequent changes to the estimate of the transaction price (determined on a portfolio basis when applicable) are generally recorded as adjustments to patient service revenue in the period of the change. For the years ended December 31, 2019 and 2018, changes in the System's estimates of implicit price concessions, discounts, contractual adjustments or other reductions to expected payments for performance obligations satisfied in prior periods were not significant. Portfolio collection estimates are updated periodically based on collection trends. Subsequent changes that are determined to be the result of an adverse change in the patient's ability to pay (determined on a portfolio basis when applicable) are recorded as bad debt expense. Bad debt expense for the years ended December 31, 2019 and 2018 was not significant.

The System has determined that the nature, amount, timing and uncertainty of revenue and cash flows are affected by the following factors: payers and lines of business. Tables providing details of these factors are presented below.

Net patient service revenue for the years ended December 31, 2019 and 2018, by major payer sources, based on primary insurance designation, is as follows (in thousands):

	2019	2018
Medicare	\$ 274,900	\$ 272,411
Medicaid	191,774	184,592
Commercial carriers and managed care organizations	257,191	253,370
Self-pay	5,919	3,097
	\$ 729,784	\$ 713,470

Deductibles, copayments and coinsurance under third-party payment programs which are the patient's responsibility are included within the self-pay and commercial carriers category above.

St. Joseph's Health, Inc.

Notes to Consolidated Financial Statements (continued)

3. Net Patient Service Revenue (continued)

Net patient service revenue for the years ended December 31, 2019 and 2018, by line of business is as follows (in thousands):

	<u>2019</u>	<u>2018</u>
Hospital	\$ 697,732	\$ 689,318
Physician services	17,070	10,065
Skilled nursing long-term care	14,982	14,087
	<u>\$ 729,784</u>	<u>\$ 713,470</u>

At December 31, 2019 and 2018, accounts receivable is comprised of the following components (in thousands):

	<u>2019</u>	<u>2018</u>
Patient receivables	\$ 55,992	\$ 71,090
Contract assets	12,780	12,096
	<u>\$ 68,772</u>	<u>\$ 83,186</u>

Contract assets are related to in-house patients who were provided services during the reporting period but were not discharged as of the reporting date and for which the System may not have the right to bill.

Third-Party Payment Programs

The System provides care to patients under Medicare, Medicaid, and other third-party contractual arrangements. Payment arrangements include prospectively determined rates per discharge, reimbursed costs, discounted charges, and per diem payments. The Medicare program pays for most services at predetermined rates. However, certain services and specified expenses are reimbursed on a reasonable-cost basis. The New Jersey Medicaid program pays the Medical Center at predetermined rates for inpatient services. New Jersey Medicaid outpatient services are reimbursed on a reasonable cost basis. The System recognizes patient service revenue associated with services provided to patients who have other third-party payer coverage on the basis of contractual rates for the services rendered. The System has entered into payment agreements with

St. Joseph's Health, Inc.

Notes to Consolidated Financial Statements (continued)

3. Net Patient Service Revenue (continued)

certain commercial insurance carriers, health maintenance organizations, and PPOs. The basis for payment to the System under these agreements includes prospectively determined rates per discharge, discounts from established charges, and prospectively determined daily rates.

For uninsured patients that do not qualify for charity care, the System recognizes revenue on the basis of its standard rates for services provided or, if qualified, based on a discounted rate pursuant to the financial assistance policy.

Settlements with third-party payers for cost report filings and retroactive adjustments due to ongoing and future 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 payer, correspondence from the payer and the System's historical settlement activity (for example, cost report final settlements or repayments related to recovery audits), 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. Such estimates are determined through either a probability-weighted estimate or an estimate of the most likely amount, depending on the circumstances related to a given estimated settlement item. 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.

Medicare and Medicaid regulations require annual retroactive settlements for cost-based reimbursements through cost reports filed by the System. These retroactive settlements are recorded in the consolidated financial statements in the year of the settlement or when amounts can be estimated. A portion of the accrual for estimated settlements with third-party payers has been classified as long-term because such amounts, by their nature or by virtue of regulation or legislation, are not expected to be paid within one year. The estimated settlements recorded at December 31, 2019 and 2018 could differ from actual settlements based on the results of cost report audits. At December 31, 2019, Medicare cost reports for all years through 2016 have been audited and settled. Medicaid cost reports have been audited and settled through 2016. Net patient service revenue was increased by approximately \$0.6 million and \$1.4 million during 2019 and 2018, respectively, as a result of changes in estimates of prior-year settlements.

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 or revisions to health care

St. Joseph's Health, Inc.

Notes to Consolidated Financial Statements (continued)

3. Net Patient Service Revenue (continued)

reform that has been or will be enacted by the federal or state governments, cannot presently be determined. Future changes in the Medicare and Medicaid programs and any reduction of funding could have an adverse impact on the System.

Laws and regulations concerning government programs, including Medicare and Medicaid, are complex and subject to varying interpretation. As a result of investigations by governmental agencies, various health care organizations have received requests for information and notices regarding alleged noncompliance with those laws and regulations, which, in some instances, have resulted in organizations entering into significant settlement agreements. Compliance with such laws and regulations may also be subject to future government review and interpretation as well as significant regulatory action, including fines, penalties, and potential exclusion from the related programs. There can be no assurance that regulatory authorities will not challenge the System's compliance with these laws and regulations, and it is not possible to determine the impact (if any) such claims or penalties would have upon the System. The System is not aware of any allegations of non-compliance that could have a material adverse effect on the accompanying consolidated financial statements and believes that it is in compliance in all material respects with applicable laws and regulations. In addition, certain contracts the System has with commercial payors also provide for retroactive audit and review of claims.

State Subsidy Funds

The New Jersey Health Care Subsidy Fund was established for various purposes, including the distribution of charity care payments to hospitals statewide. The amount of the fund allocation is based on a formula using prior-year claim data for each hospital. Additionally, the State of New Jersey Delivery System Reform Incentive Payment Pool (the Pool) is available to certain hospitals that are able to establish performance improvement activities in one of eight specified clinical improvement areas. Amounts received from the Pool are subject to the satisfaction of certain performance criteria, with adjustments to the Pool allocations processed prospectively. The amounts of state subsidy and Pool funds included in net patient service revenue for the years ended December 31, 2019 and 2018 are as follows (in thousands):

	<u>2019</u>	<u>2018</u>
Charity care payments	\$ 40,139	\$ 38,285
Delivery system reform incentive payments	13,138	12,237
	<u>\$ 53,277</u>	<u>\$ 50,522</u>

St. Joseph's Health, Inc.

Notes to Consolidated Financial Statements (continued)

3. Net Patient Service Revenue (continued)

In April 2020, the System received approximately \$22.6 million in charity care payments from the state for services to be performed in the period from January 1, 2020 to June 30, 2020. Amounts for payments subsequent to June 30, 2020, have yet to be determined by the State of New Jersey.

4. Investments, Assets Whose Use is Limited and Liquidity

Investments and assets whose use is limited, stated at fair value, as of December 31, 2019 and 2018, consist of the following (in thousands):

	<u>2019</u>	<u>2018</u>
Investments	\$ 241,309	\$ 233,738
Assets whose use is limited:		
By bond indenture agreements	15,808	15,254
Assets held for captive insurance program	41,632	34,079
Donor restricted assets	18,375	15,833
Total assets whose use is limited	<u>75,815</u>	<u>65,166</u>
Less current assets whose use is limited	<u>20,294</u>	<u>18,114</u>
Noncurrent assets whose use is limited	<u>55,521</u>	<u>47,052</u>
Total investments and assets whose use is limited	<u>\$ 317,124</u>	<u>\$ 298,904</u>

The composition of investments and assets whose use is limited as of December 31, 2019 and 2018 is as follows (in thousands):

	<u>2019</u>	<u>2018</u>
Cash and cash equivalents	\$ 23,862	\$ 25,873
U.S. government securities and agency obligations	64,530	59,254
Corporate and foreign debt securities	143,411	148,065
Asset-backed and mortgage-backed securities	9,098	7,189
Marketable equity securities	71,173	53,062
Investments held by trustee	1,578	1,578
Municipal bonds	3,460	3,823
Mutual funds – fixed income	12	60
Total	<u>\$ 317,124</u>	<u>\$ 298,904</u>

St. Joseph's Health, Inc.

Notes to Consolidated Financial Statements (continued)

4. Investments, Assets Whose Use is Limited and Liquidity (continued)

Return on investments for the years ended December 31, 2019 and 2018 is as follows (in thousands):

	<u>2019</u>	<u>2018</u>
Return on investments:		
Net assets without donor restrictions:		
Investment return:		
Interest and dividend income	\$ 10,004	\$ 8,833
Net realized gains and losses on sales of investments	(1,854)	(1,870)
Net change in unrealized gains and losses on equity investments	8,968	—
	<u>17,118</u>	6,963
Change in net unrealized gains and losses on investments	8,287	(10,301)
	<u>25,405</u>	(3,338)
Net assets with donor restrictions:		
Investment income	10	18
Net realized gains and losses on sales of investments	(226)	—
	<u>(216)</u>	18
Change in net unrealized gains and losses on investments held in perpetual trusts	666	(609)
	<u>450</u>	(591)
Total return on investments	<u>\$ 25,855</u>	<u>\$ (3,929)</u>

Liquidity and Availability

As of December 31, 2019 and 2018, the System had a working capital surplus of \$267.3 million and \$258.4 million, respectively. The System's days cash on hand as of December 31, 2019 and 2018 were 139 and 125, respectively (based on normal expenditures).

St. Joseph's Health, Inc.

Notes to Consolidated Financial Statements (continued)

4. Investments, Assets Whose Use is Limited and Liquidity (continued)

Financial assets available for general expenditure within one year of December 31, 2019 and 2018 consist of the following:

	<u>2019</u>	<u>2018</u>
Cash and cash equivalents	\$ 60,786	\$ 30,783
Investments	241,309	233,738
Patient accounts receivable, net	68,772	83,186
Physician services receivable, net	12,710	4,673
	<u>\$ 383,577</u>	<u>\$ 352,380</u>

The System has assets for donor-restricted purposes, held under board indenture agreements and for the captive insurance program, which are not readily available for general expenditures.

Additionally, the System maintains a \$1.0 million line of credit, as described in Note 8. As of December 31, 2019 and 2018, there was no balance outstanding on the line of credit. As of December 31, 2019 and 2018, the System was in compliance with all financial debt covenants.

5. Fair Value of Financial Instruments

Fair value is defined as 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. A three-level hierarchy for fair value measurements exists based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. The three levels are defined as follows:

- Level 1 – Inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities in active markets.
- Level 2 – Inputs to the valuation methodology include quoted prices for similar assets or liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.
- Level 3 – Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

St. Joseph's Health, Inc.

Notes to Consolidated Financial Statements (continued)

5. Fair Value of Financial Instruments (continued)

In determining fair value, the System uses valuation techniques that maximize the use of observable inputs and minimizes the use of unobservable inputs to the extent possible and considers nonperformance risks in its assessment of fair value. 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.

The following tables present the financial instruments carried at fair value by caption on the consolidated balance sheets based on the valuation hierarchy defined above:

	December 31, 2019			
	Level 1	Level 2	Level 3	Total
Investments, assets whose use is limited and beneficial interest in perpetual trusts:				
Cash and cash equivalents	\$ 23,862	\$ -	\$ -	\$ 23,862
Marketable equity securities	71,173	-	-	71,173
U.S. government securities and agency obligations	-	64,530	-	64,530
Corporate and foreign debt securities	-	143,411	-	143,411
Asset-backed and mortgage-backed securities	-	9,098	-	9,098
Municipal bonds	-	3,460	-	3,460
Mutual funds – fixed income	-	12	-	12
Investments held by trustee	-	1,578	-	1,578
Beneficial interest in perpetual trusts	-	-	6,196	6,196
Total	<u>\$ 95,035</u>	<u>\$ 222,089</u>	<u>\$ 6,196</u>	<u>\$ 323,320</u>
Assets held in pension plan:				
Cash and cash equivalents	\$ 3,447	\$ -	\$ -	\$ 3,447
Marketable equity securities	238,889	-	-	238,889
U.S. government securities	54,932	-	-	54,932
Corporate bonds	69,968	-	-	69,968
Foreign obligations	-	6,253	-	6,253
Other debt securities	-	21,718	-	21,718
	<u>\$ 367,236</u>	<u>\$ 27,971</u>	<u>\$ -</u>	<u>\$ 395,207</u>
Investments measured at net asset value:				
Fund of funds				1,576
				<u>\$ 396,783</u>

St. Joseph's Health, Inc.

Notes to Consolidated Financial Statements (continued)

5. Fair Value of Financial Instruments (continued)

	December 31, 2018			
	Level 1	Level 2	Level 3	Total
Investments, assets whose use is limited and beneficial interest in perpetual trusts:				
Cash and cash equivalents	\$ 25,873	\$ –	\$ –	\$ 25,873
Marketable equity securities	53,062	–	–	53,062
U.S. government securities and agency obligations	–	59,254	–	59,254
Corporate and foreign debt securities	–	148,065	–	148,065
Asset-backed and mortgage-backed securities	–	7,189	–	7,189
Municipal bonds	–	3,823	–	3,823
Mutual funds – fixed income	–	60	–	60
Investments held by trustee	–	1,578	–	1,578
Beneficial interest in perpetual trusts	–	–	5,530	5,530
Total	\$ 78,935	\$ 219,969	\$ 5,530	\$ 304,434
Assets held in pension plan:				
Cash and cash equivalents	\$ 6,087	\$ –	\$ –	\$ 6,087
Marketable equity securities	185,856	–	–	185,856
U.S. government securities	49,153	–	–	49,153
Corporate bonds	64,002	–	–	64,002
Foreign obligations	–	5,013	–	5,013
Other debt securities	–	21,641	–	21,641
	\$ 305,098	\$ 26,654	\$ –	\$ 331,752
Investments measured at net asset value:				
Fund of funds				1,584
				\$ 333,336

Fair value for Level 1 assets is based upon quoted market prices. Fair value for Level 2 assets is estimated based on quoted prices for similar instruments, pricing metrics, and other valuation considerations (e.g., credit quality and prevailing interest rates). Level 3 investments include the beneficial interest in perpetual trusts and fair value is determined based upon information provided by the trustees. Such information is based on the pro rata interest in the net assets of the trusts.

St. Joseph's Health, Inc.

Notes to Consolidated Financial Statements (continued)

5. Fair Value of Financial Instruments (continued)

Attributes relating to the nature and risk of the fund of funds limited partnership investment held by the pension plan as of December 31, 2019 and 2018 are as follows (in thousands):

	<u>2019</u> Fair Value	<u>2018</u> Fair Value	<u>Unfunded</u> <u>Commitment</u>	<u>Redemption</u> <u>Frequency</u>	<u>Other</u> <u>Redemption</u> <u>Restrictions</u>	<u>Redemption</u> <u>Notice Period</u>
Assets held in pension plan:						
PMF TEI Fund	<u>\$ 1,576</u>	<u>\$ 1,584</u>	None	Illiquid	Discretion of Fund	Discretion of Fund

The PMF TEI Fund operates as a feeder fund. The PMF TEI Fund's investment objective is to manage a portfolio of investment funds, including limited partnerships, limited liability companies, offshore corporations, other foreign investment vehicles, and cash to preserve value while prioritizing liquidity to investors over active management, until such time as a related portfolio has been liquidated.

There were no transfers between levels of the System's or the Plan's investments for the years ended December 31, 2019 and 2018.

The change in fair value measurements for the beneficial interest in perpetual trusts with unobservable inputs at December 31, 2019 and 2018 are presented as follows (in thousands):

	<u>2019</u>	<u>2018</u>
Balance – January 1	\$ 5,530	\$ 6,139
Change in net unrealized gains and losses	666	(609)
Balance – December 31	<u>\$ 6,196</u>	<u>\$ 5,530</u>

St. Joseph's Health, Inc.

Notes to Consolidated Financial Statements (continued)

6. Property and Equipment

Property and equipment as of December 31, 2019 and 2018 consist of the following (in thousands):

	<u>2019</u>	<u>2018</u>
Land	\$ 12,008	\$ 12,008
Land improvements	8,710	8,607
Buildings and improvements	482,684	471,237
Fixed and major movable equipment	350,467	333,346
Total property and equipment	<u>853,869</u>	825,198
Less accumulated depreciation and amortization	<u>(519,829)</u>	(483,654)
	<u>334,040</u>	341,544
Construction in progress	33,584	24,707
Property and equipment – net	<u>\$ 367,624</u>	<u>\$ 366,251</u>

The System recorded capitalized interest of approximately \$1.4 million and \$2.1 million as of December 31, 2019 and 2018, respectively.

Substantially, all property of the Medical Center serves as collateral under debt agreements (see Note 8).

St. Joseph's Health, Inc.

Notes to Consolidated Financial Statements (continued)

7. Equity Investments in Joint Ventures

The System's investments in unconsolidated entities accounted for under the equity method of accounting as of December 31, 2019 and 2018, consist of the following (in thousands):

Name of Joint Venture	Ownership Percentage	2019					
		Total Assets	Total Liabilities	Total Revenue	Net Income	Equity Investment	Share of Earnings
Simeon Dialysis, LLC	35%	\$ 67,819	\$ 2,862	\$ 27,111	\$ 7,606	\$ 22,737	\$ 2,662
Wayne Valley Imaging, LLC	50%	1,223	521	2,379	518	549	259
VHSNJ at Home, LLC	50%	10,544	2,683	16,029	(161)	3,931	(80)
Eufaula Dialysis, LLC	20%	5,731	1,565	9,275	1,751	833	350
		<u>\$ 85,317</u>	<u>\$ 7,631</u>	<u>\$ 54,794</u>	<u>\$ 9,714</u>	<u>\$ 28,050</u>	<u>\$ 3,191</u>

Name of Joint Venture	Ownership Percentage	2018					
		Total Assets	Total Liabilities	Total Revenue	Net Income	Equity Investment	Share of Earnings
Simeon Dialysis, LLC	35%	\$ 66,096	\$ 931	\$ 25,459	\$ 5,165	\$ 22,808	\$ 1,808
Wayne Valley Imaging, LLC	50%	1,092	29	2,166	755	557	378
VHSNJ at Home, LLC	50%	11,182	3,161	13,660	506	4,011	253
Eufaula Dialysis, LLC	20%	5,373	437	8,484	1,695	987	339
		<u>\$ 83,743</u>	<u>\$ 4,558</u>	<u>\$ 49,769</u>	<u>\$ 8,121</u>	<u>\$ 28,363</u>	<u>\$ 2,778</u>

St. Joseph's Health, Inc.

Notes to Consolidated Financial Statements (continued)

8. Long-Term Debt

Long-term debt as of December 31, 2019 and 2018 consists of the following (in thousands):

	<u>2019</u>	<u>2018</u>
New Jersey Healthcare Facilities Financing Authority – \$246,845 St. Joseph's Healthcare System Obligated Group Issue, Series 2016 Revenue Bonds ^(a)	\$ 234,230	\$ 238,040
St. Joseph's Hospital and Medical Center – \$81,200 St. Joseph's Healthcare System Obligated Group, Series 2017 Taxable Bonds ^(b)	81,200	81,200
Passaic Authority – \$29,620 200 Hospital Plaza Corporation Project, Series 2010 County Guaranteed Parking Revenue Bonds ^(c)	690	1,360
Passaic Authority – \$24,650 200 Hospital Plaza Corporation Project, Series 2017 County Guaranteed Parking Revenue Bonds ^(d)	24,505	24,505
Promissory note with Urban Enterprise Zone, bearing interest at 2.25%, maturing in 2021	138	150
Promissory note bearing interest of 6.04%, maturing in 2020 ^(e)	601	1,770
Capital lease ^(f)	1,585	2,310
Total long-term debt	<u>342,949</u>	<u>349,335</u>
Original issue premium	24,660	26,353
Original issue discount	(1,858)	(2,142)
Net deferred financing costs	(1,976)	(2,128)
Current portion of long-term debt	(5,366)	(5,755)
Long-term debt – net of current portion of long-term debt	<u>\$ 358,409</u>	<u>\$ 365,663</u>

In connection with the issuance of the New Jersey Healthcare Facilities Financing Authority St. Joseph's Healthcare System Obligated Group Issue, Series 2016 Revenue Bonds in 2016, the System formed an "Obligated Group," which includes only the Medical Center. The Obligated Group also issued Series 2017 Taxable Bonds in September 2017.

St. Joseph's Health, Inc.

Notes to Consolidated Financial Statements (continued)

8. Long-Term Debt (continued)

- (a) The New Jersey Health Care Facilities Financing Authority (NJHCFFA) Series 2016 Revenue Bonds (the Series 2016 Bonds) bear interest at rates ranging from 3.0% to 5.0%. The Series 2016 Bonds mature annually, commencing July 1, 2017, through July 1, 2048. The proceeds of the Series 2016 Bonds were used by the System to advance refund the outstanding principal balance of NJHCFFA Series 2008 Bonds and the (a) renovation of inpatient nursing care units; (b) renovation and equipment upgrades within ambulatory surgery and neuro-interventional suites; (c) build out of clinic facilities; and (d) upgrade and installation of information technology systems for clinical information systems, pharmaceutical dispensing technology, imaging and other minor equipment.
- (b) The St. Joseph's Hospital and Medical Center Series 2017 Taxable Bonds (the Series 2017 Bonds) were issued in September 2017 and consist of two term bonds of \$40.6 million, which bear interest at 3.926% and 4.584% and are due at July 1, 2022 and July 1, 2027, respectively. The proceeds of the Series 2017 Bonds were used to provide funding for additional contributions to the defined benefit pension plan (see Note 9). The Series 2017 Bonds are secured by a Series 2017 Note which was issued on a parity with other obligations under the Master Indenture for the Series 2016 Bonds.
- (c) The Passaic Authority Series 2010 County Guaranteed Parking Revenue Bonds (the Series 2010 Bonds) bear interest at rates ranging from 2.0% to 5.0%. The Series 2010 Bonds were scheduled to mature between 2014 and 2042; a portion of the Series 2010 Bonds was advance refunded in 2017 (see (d) below). Funds were paid into escrow to repay the debt through the final redemption date in May 2020. The proceeds of the Series 2010 Bonds were used by 200 Hospital Plaza to finance a portion of project costs associated with the design and construction of a mixed-use parking/retail structure. 200 Hospital Plaza is subject to certain operating covenants under its Master Indenture Agreement and the maintenance of certain financial ratios. At December 31, 2019 and 2018, 200 Hospital Plaza was in compliance with such financial covenants.
- (d) The Passaic Authority Series 2017 County Guaranteed Parking Revenue Bonds (the PA Series 2017 Bonds) bear interest at rates ranging from 2.0% to 5.0%. The PA Series 2017 Bonds mature between 2018 and 2042. The proceeds of the PA Series 2017 Bonds were used by 200 Hospital Plaza to advance refund the Series 2010 Bonds and pay certain costs of issuance relating to the PA Series 2017 Bonds.

St. Joseph's Health, Inc.

Notes to Consolidated Financial Statements (continued)

8. Long-Term Debt (continued)

- (e) Surgery Management entered into a loan agreement to purchase equipment and to make leasehold improvements to the surgical facility. On June 1, 2015, the amount advanced was converted to a loan payable over a five-year period bearing interest equal to the five-year US Treasury rate of 3.79% plus 2.25%. The loan is collateralized by substantially all of the assets of Surgery Management and guaranteed by all members as contained in the loan agreement. The System is not a guarantor of this loan. The loan is subject to a debt service coverage ratio, which is tested annually. Management is not aware of any noncompliance with this ratio as of December 31, 2019 and 2018.
- (f) The System has guaranteed an equipment lease for a joint venture with a balance of \$1.6 million and \$2.3 million as of December 31, 2019 and 2018, respectively.

The Series 2016 Bonds and Series 2017 Bonds are secured by (i) amounts held in the revenue fund created under the Master Indenture Agreement, (ii) the gross receipts of the Obligated Group, and (iii) a first mortgage lien on various properties of SJUMC and Wayne Medical Center as defined in the Master Indenture Agreement. The Obligated Group is subject to various operating covenants under the Master Indenture Agreement and maintenance of certain financial ratios. At December 31, 2019 and 2018, the Obligated Group was in compliance with such financial covenants.

Required principal payments on long-term debt for the next five years and thereafter as of December 31, 2019 are as follows (in thousands):

Years Ending December 31	
2020	\$ 5,366
2021	5,715
2022	46,358
2023	5,295
2024	5,560
Thereafter	274,655
	<u>\$ 342,949</u>

At December 31, 2019, the System has unused letters of credit of: \$0.7 million, expiring in March 2021; \$1.3 million, expiring in January 2021; \$2.4 million, expiring in January 2021; \$1.7 million expiring in January 2021; \$1.1 million expiring in January 2021; and \$0.3 million, expiring in February 2021.

St. Joseph's Health, Inc.

Notes to Consolidated Financial Statements (continued)

8. Long-Term Debt (continued)

The System maintains a line of credit (currently with an available amount of \$1.0 million) which expires in February 2021, with interest at LIBOR plus 0.75%. There are no amounts outstanding as of December 31, 2019 and 2018.

9. Retirement Plans

The Medical Center maintains a noncontributory defined benefit pension plan (the Plan) covering substantially all of the employees of the Medical Center. The Plan provides benefits based on the participant's years of service and compensation. The Plan is operated as a church plan under the Code. Under church plan status, the Plan is not subject to the minimum funding or other requirements of the Employee Retirement Income Security Act of 1974. In addition, benefits under the Plan are not covered by the Pension Benefit Guaranty Corporation.

The Medical Center has been involved with litigation challenging the church plan status of the Plan which was settled in 2018. The settlement does not make the Plan subject to ERISA.

The System issued long-term debt in September 2017 (see Note 8) with net proceeds of approximately \$80.0 million, the purpose of which was to provide funding for additional contributions paid into the Plan. In addition to the 2017 funding into the Plan, management froze the Plan and closed it to new participants effective December 31, 2017, initiated a defined contribution retirement program on January 1, 2018, and intends to continue annual funding to the Plan so that in conjunction with investment earnings thereon, the plan assets will exceed the projected benefit obligation by the year 2028.

The Medical Center contributed approximately \$6.0 million to the Plan in 2019 and expects to contribute approximately \$12.0 million to the Plan in 2020.

The defined contribution plan established January 1, 2018 provides for annual contributions for eligible employees of between 2% and 5% of pay based on the employee's years of service with a matching contribution of 1% to 1.5%. Eligible employees begin to accrue benefits from their hire or rehire date. The System funds the defined contribution expense on a current basis. The Medical Center contributed \$11.3 million and \$10.5 million to the defined contribution plan for the years ended December 31, 2019 and 2018, respectively.

St. Joseph's Health, Inc.

Notes to Consolidated Financial Statements (continued)

9. Retirement Plans (continued)

The funded status of the Plan as of December 31, 2019 and 2018 is set forth as follows (in thousands):

	<u>2019</u>	<u>2018</u>
Change in benefit obligation:		
Projected benefit obligation – beginning of year	\$ 433,614	\$ 465,927
Administrative expenses	–	1,368
Interest cost	19,818	18,547
Actuarial loss (gain)	81,412	(36,201)
Benefit payments and expected expenses	<u>(16,249)</u>	<u>(16,027)</u>
Projected benefit obligation – end of year	518,595	433,614
Change in Plan assets:		
Fair value of Plan assets – beginning of year	333,336	354,500
Actual return on Plan assets	73,696	(20,548)
Employer contributions	6,000	15,000
Benefit payments and actual expenses	<u>(16,249)</u>	<u>(15,616)</u>
Fair value of Plan assets – end of year	<u>396,783</u>	<u>333,336</u>
Accrued pension liability	<u>\$ 121,812</u>	<u>\$ 100,278</u>
Accumulated benefit obligation	<u>\$ 518,595</u>	<u>\$ 433,614</u>

At December 31, 2019 and 2018, net assets without donor restrictions include unrecognized losses of \$133.6 million and \$106.8 million, respectively. Approximately \$2.7 million of unrecognized losses are expected to be recognized in net periodic benefit costs in 2020.

The actuarial loss (gain) amounts primarily resulted from a decrease (increase) in the discount rate assumption in 2019 and 2018, respectively. Additionally, the mortality table was changed from the RP-2014 Mortality Tables with blue collar adjustments adjusted backwards to 2006 with scale MP-2014 and projected with improvement scale MP-2018 at December 31, 2018, to the PRI-2012 Amount-Weighted Mortality Tables with blue collar adjustments projected from 2012 with improvement scale MP-2019 at December 31, 2019.

St. Joseph's Health, Inc.

Notes to Consolidated Financial Statements (continued)

9. Retirement Plans (continued)

Weighted-average assumptions used in determining the benefit obligation as of December 31, 2019 and 2018 were as follows:

	<u>2019</u>	<u>2018</u>
Discount rate	3.38%	4.64%
Rate of compensation increase	N/A	N/A

Net periodic pension cost (benefit) for the years ended December 31, 2019 and 2018 are as follows (in thousands):

	<u>2019</u>	<u>2018</u>
Interest cost	\$ 19,818	\$ 18,547
Expected return on Plan assets	(21,181)	(22,917)
Amortization of net loss	2,112	1,778
Net periodic pension cost (benefit)	<u>\$ 749</u>	<u>\$ (2,592)</u>

Weighted-average assumptions used in determining the net periodic pension cost (benefit) for the years ended December 31, 2019 and 2018 were as follows:

	<u>2019</u>	<u>2018</u>
Discount rate	4.64%	4.03%
Expected long-term return on Plan assets	6.75	6.75
Rate of compensation increase	N/A	N/A

St. Joseph's Health, Inc.

Notes to Consolidated Financial Statements (continued)

9. Retirement Plans (continued)

The discount rate was determined using the hypothetical portfolio method at December 31, 2019 and 2018.

To develop the expected long-term rate of return on Plan assets, the System considered the historical returns and the future expectations for returns for each asset class, as well as the target asset allocation of the pension portfolio. This approach resulted in the selection of the 6.75% long-term rate of return on Plan assets' assumption for 2019 and 2018.

The date used to determine the Plan's measurements is December 31.

The Plan's weighted-average asset allocation as of December 31, 2019 and 2018, by asset category, is as follows:

Asset Category	2019	2018
Equity securities	60.2%	55.8%
Debt securities	39.4	43.7
Alternative investments	0.4	0.5
	100.0%	100.0%

The Plan's investment policy includes the following asset allocation guidelines:

Asset Category	Target	Range
Domestic equity	35.0%	6-36%
International equity	23.0	4-24
Fixed income	40.0	40-90
Alternative investments	2.0	0-5

St. Joseph's Health, Inc.

Notes to Consolidated Financial Statements (continued)

9. Retirement Plans (continued)

The asset allocation policy was developed in consideration of the long-term financial objectives of the Plan, which include ensuring that there is an adequate level of assets to support benefit obligations and maintaining liquidity sufficient to cover current benefit obligations.

In addition to the broad asset allocation guidelines described above, the following policies apply to individual asset classes:

- Fixed-income investments are oriented toward risk-adverse, investment-grade securities with an average quality of "A" or higher. Up to 10% of the portfolio may be invested in bonds rated below investment grade. With the exception of US government securities, fixed-income investments are diversified among individual securities and sectors.
- Equity investments are diversified among industries and economic sectors. International equity holdings are also diversified by country. Limitations are placed on the overall allocation to any individual security.

Pension benefit payments, which reflect expected future service and salary, as appropriate, are expected to be paid as follows (in thousands):

Years Ending December 31	
2020	\$ 19,228
2021	20,509
2022	21,706
2023	22,908
2024	23,807
2025–2029	130,590

St. Joseph's Health, Inc.

Notes to Consolidated Financial Statements (continued)

10. Professional Liability Insurance

Effective February 1, 2007, the Insurance Captive began providing SJUMC with claims-made professional and general liability insurance. The Insurance Captive policy provides coverage of \$1 million per occurrence and \$3 million annual aggregate. The Insurance Captive has a self-insurance program for a first excess layer above the primary layer. The first excess layer is on a claims-made basis with retentions of \$4 million for individual claims and \$17 million in the aggregate. The Insurance Captive maintains a self-insurance reserve trust as the funding vehicle for the self-insurance program (see Note 4). The Insurance Captive has a second excess layer of insurance of \$10 million annual aggregate, a third excess layer of insurance of \$20 million annual aggregate, and a fourth layer of \$15 million annual aggregate each maintained with separate commercial carriers.

The Insurance Captive is registered under the Bermuda Insurance Act of 1978 and the Related Regulations (the Insurance Act) and is obliged to comply with various provisions of the Insurance Act regarding solvency and liquidity. The minimum statutory capital and surplus at December 31, 2019 and 2018 was \$3.5 million and \$3.1 million, respectively, and the actual statutory capital and surplus was \$6.2 million and \$1.9 million, respectively. As the actual statutory capital and surplus was less than the minimum requirement at December 31, 2018, the Insurance Captive received additional loss funding contributed by the System in 2019 to restore the statutory compliance regarding solvency. In addition, a minimum liquidity ratio must be maintained whereby relevant assets, as defined by the Insurance Act, must exceed 75% of relevant liabilities. As of December 31, 2019 and 2018, the liquidity ratio was met.

Prior to the inception of the Insurance Captive, SJUMC maintained its primary professional liability insurance coverage of \$1 million for individual claims and \$3 million in the aggregate on a claims-made basis with a commercial carrier. The first excess layer was on a claims-made basis with retentions of \$4 million for individual claims and \$7 million in the aggregate. A second excess layer of coverage was maintained with a commercial carrier.

Effective March 1, 2009, the Insurance Captive began providing Wayne Medical Center with claims-made professional and general liability insurance, and Wayne Medical Center began participating in the self-insurance program for a first excess layer above the primary layer. Prior to March 1, 2009, Wayne Medical Center maintained primary professional liability insurance coverage on a claims-made basis with a commercial carrier.

St. Joseph's Health, Inc.

Notes to Consolidated Financial Statements (continued)

10. Professional Liability Insurance (continued)

The estimated undiscounted professional liabilities for asserted claims and for incidents that have been incurred but not reported included in the consolidated balance sheets as of December 31, 2019 and 2018 are as follows (in thousands):

	<u>2019</u>	<u>2018</u>
Estimated professional liability claims payable, included in accrued salaries and expenses	\$ 9,396	\$ 7,225
Noncurrent estimated professional liability claims payable	34,650	32,412
Total estimated professional liability claims payable	<u>\$ 44,046</u>	<u>\$ 39,637</u>

The System's estimates for professional liability for asserted claims and for incidents that have been incurred but not reported are based upon complex actuarial calculations, which utilize factors such as historical claim experience for the System and related industry factors, trending models, estimates for the payment patterns of future claims, and present value discounting factors. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term. Revisions to estimated amounts resulting from actual experience differing from project expectations are recorded in the period the information becomes known.

11. Concentrations of Credit Risk

The System grants credit without collateral to its patients, most of whom are insured under third-party payer agreements. Major concentrations of net accounts receivable from patients and third-party payers as of December 31, 2019 and 2018 are as follows:

	<u>2019</u>	<u>2018</u>
Medicare	20%	20%
Medicaid	10	9
Horizon Blue Cross Blue Shield of New Jersey	10	2
Amerigroup	4	4
Aetna	4	4
Managed care organizations and other third-party payers	49	57
Self-pay patients	3	4
	<u>100%</u>	<u>100%</u>

St. Joseph's Health, Inc.

Notes to Consolidated Financial Statements (continued)

11. Concentrations of Credit Risk (continued)

The System invests its surplus operating funds in fixed-income funds. These funds generally invest in highly liquid U.S. government and agency obligations. Investments in fixed-income funds are not insured or guaranteed by the U.S. government. The System deposits cash with various financial institutions in which the amounts may exceed federally insured limits.

12. Other Revenue

Other revenue at December 31, 2019 and 2018 consists of the following (in thousands):

	2019	2018
Physician billing revenue	\$ 57,748	\$ 51,044
Grant income	14,098	13,336
Qualcare sale of stock	80	322
Equity in earnings of joint ventures	3,191	2,778
Rental income	4,007	3,597
ACO gainsharing	532	6,798
Parking revenue	3,937	4,060
Contributions	4,294	2,516
Fundraising	2,031	5,052
Other	6,176	3,923
Total	\$ 96,094	\$ 93,426

In June 2019, SJH's participation in a shared savings program, Next Generation Accountable Care Organization (ACO), terminated. ACO gainsharing included in other revenue for the years ended December 31, 2019 and 2018, was approximately \$0.5 million and \$6.8 million, respectively.

St. Joseph's Health, Inc.

Notes to Consolidated Financial Statements (continued)

13. Operating Leases

The System leases equipment and office space under various noncancelable operating leases. Future minimum payments due under noncancelable operating leases with a term of one year or greater as of December 31, 2019 are as follows (in thousands):

2020	\$ 5,988
2021	4,807
2022	4,320
2023	4,276
2024	3,027
Thereafter	10,190

Payments made under operating leases amounted to approximately \$7.7 million in 2019 and \$6.0 million in 2018.

14. Net Assets With Donor Restrictions

Net assets with donor restrictions which are available for future periods or for specific purposes as of December 31, 2019 and 2018, are available for the following purposes (in thousands):

	2019	2018
Capital acquisitions and improvements	\$ 1,032	\$ 726
Scholarship fund	-	75
Research	907	954
Other health care programs	9,874	9,131
	\$ 11,813	\$ 10,886

At December 31, 2019 and 2018, net assets with donor restrictions for permanent endowment in the amount of approximately \$8.1 million and \$7.5 million, respectively, consist of endowment funds to be held in perpetuity, and the beneficial interest in perpetual trusts. The assets in the perpetual trusts are held and managed by an independent trustee. The income earned on the beneficial interest in the perpetual trusts does not have donor restrictions. The income from the endowment funds is expendable to support health care services.

St. Joseph's Health, Inc.

Notes to Consolidated Financial Statements (continued)

14. Net Assets With Donor Restrictions (continued)

The Board classifies donor-restricted assets based upon the explicit directions of the donor and the provisions of the New Jersey Uniform Prudent Management of Institutional Funds Act (UPMIFA). The Board has determined that, absent donor stipulations to the contrary, the provisions of New Jersey State law do not impose a donor restriction on the income or capital appreciation derived from the original gift.

15. Functional Expenses

The System's functional expenses for the years ended December 31, 2019 and 2018 are as follows (in thousands):

	2019		
	Health Care Program Expenses	General and Administrative Expenses	Total Expenses
Salaries and wages	\$ 352,396	\$ 62,948	\$ 415,344
Employee benefits	60,429	10,911	71,340
Physician fees	15,700	2,786	18,486
Supplies and other	275,585	–	275,585
Interest	12,287	1,928	14,215
Depreciation and amortization	30,972	5,203	36,175
	\$ 747,369	\$ 83,776	\$ 831,145

	2018		
	Health Care Program Expenses	General and Administrative Expenses	Total Expenses
Salaries and wages	\$ 332,383	\$ 53,372	\$ 385,755
Employee benefits	61,559	12,489	74,048
Physician fees	19,516	3,077	22,593
Supplies and other	280,853	–	280,853
Interest	10,284	1,480	11,764
Depreciation and amortization	29,485	4,395	33,880
	\$ 734,080	\$ 74,813	\$ 808,893

The accompanying consolidated financial statements report certain expense categories that are attributable to more than one health care service or support function. Costs not directly attributable to a function are allocated on a functional basis using internal records and estimates.

St. Joseph's Health, Inc.

Notes to Consolidated Financial Statements (continued)

16. Commitments and Contingencies

Various lawsuits and claims arising in the normal course of operations are pending or are in progress against the System. Such lawsuits and claims are either specifically covered by insurance, provided for through estimated self-insurance liabilities, or are not material. While the outcome of these lawsuits cannot be determined at this time, management believes that any loss, which may arise from these actions will not have a material adverse effect on the consolidated financial position or results of operations of the System.

17. Subsequent Events

The System has evaluated subsequent events through June 19, 2020, the date the accompanying consolidated financial statements were issued. Except as disclosed below and in Note 1, no subsequent events have occurred that require disclosure in or adjustment to the consolidated financial statements.

Due to the global viral outbreak caused by Coronavirus Disease 2019 (COVID-19) in 2020, there have been resulting effects which could negatively impact the System's financial condition, including significant stock market exchange volatility, such as various temporary volatility trading halts which commenced initially on March 9, 2020 due to market declines, various temporary business closures and event cancellations, decisions to defer elective procedures and other medical treatments at the System and other effects which could result in supply chain disruptions. Management continues to closely monitor the impact of COVID-19 in many respects. The ultimate impact of these matters to the System and its financial condition is presently unknown. To enhance liquidity, the System is participating in the Centers for Medicare & Medicaid Services' Accelerated and Advance Payment Program under which it received approximately \$82.5 million in April 2020 in expedited payments for future services on an interest-free basis. The majority of the advance payment amount will be reconciled with Medicare after submission of the System's cost report in May 2021. The System also received grant distributions under the Coronavirus Aid, Relief, and Economic Security (CARES) Act totaling \$153.7 million through June 19, 2020. Management of the System anticipates that additional funding from other governmental agencies, such as the Federal Emergency Management Agency, may be available to the System. The accompanying consolidated financial statements as of and for the year ended December 31, 2019 do not reflect the effects of these subsequent events.

Supplementary Information

St. Joseph's Health, Inc.

Consolidating Balance Sheet (In Thousands)

December 31, 2019

	St. Joseph's University Medical Center and Subsidiaries	St. Joseph's Hospital and Medical Center Foundation, Inc.	VHS Management, Inc. and Subsidiary	200 Hospital Plaza Corp.	St. Joseph's Health, Inc.	SJHS Insurance Limited	Eliminations	Total
Assets								
Current assets:								
Cash and cash equivalents	\$ 59,062	\$ 1,451	\$ -	\$ 273	\$ -	\$ -	\$ -	\$ 60,786
Investments	236,203	5,106	-	-	-	-	-	241,309
Current portion of assets whose use is limited	9,132	-	-	1,766	-	9,396	-	20,294
Patient accounts receivable, net	68,772	-	-	-	-	-	-	68,772
Contributions and pledges receivable	-	1,245	-	-	-	-	-	1,245
Prepaid expenses and other current assets	40,613	58	-	15	-	1,973	(1,026)	41,633
Due from affiliates	1,508	-	-	231	-	-	(1,739)	-
Total current assets	415,290	7,860	-	2,285	-	11,369	(2,765)	434,039
Assets whose use is limited – less current portion	13,043	6,939	-	3,361	-	32,178	-	55,521
Property and equipment – net	346,677	-	-	20,947	-	-	-	367,624
Beneficial interest in perpetual trusts	-	6,196	-	-	-	-	-	6,196
Equity investments in joint ventures	28,050	-	-	-	-	-	-	28,050
Other noncurrent assets	42,567	441	-	-	3,178	-	(38,727)	7,459
Total assets	\$ 845,627	\$ 21,436	\$ -	\$ 26,593	\$ 3,178	\$ 43,547	\$ (41,492)	\$ 898,889

The System presents its interests in its controlled affiliates using the cost method of accounting.

St. Joseph's Health, Inc.

Consolidating Balance Sheet (continued)
(In Thousands)

December 31, 2019

	St. Joseph's University Medical Center and Subsidiaries	St. Joseph's Hospital and Medical Center Foundation, Inc.	VHS Management, Inc. and Subsidiary	200 Hospital Plaza Corp.	St. Joseph's Health, Inc.	SJHS Insurance Limited	Eliminations	Total
Liabilities and net assets								
Current liabilities:								
Current portion of long-term debt	\$ 4,676	\$ -	\$ -	\$ 690	\$ -	\$ -	\$ -	\$ 5,366
Accounts payable	59,723	142	-	-	-	1,810	(1,214)	60,461
Accrued salaries and expenses	80,164	-	-	5	-	9,396	-	89,565
Accrued interest payable	6,955	-	-	178	-	-	-	7,133
Due to affiliates	-	1,359	-	190	-	-	(1,549)	-
Deferred revenue	425	131	-	-	-	-	-	556
Current portion of estimated third-party payer settlements	3,675	-	-	-	-	-	-	3,675
Total current liabilities	155,618	1,632	-	1,063	-	11,206	(2,763)	166,756
Long-term debt – net of current portion	332,427	-	-	25,982	-	-	-	358,409
Estimated third-party payer settlements – net of current portion	15,909	-	-	-	-	-	-	15,909
Accrued pension liability	121,812	-	-	-	-	-	-	121,812
Estimated professional liability claims payable – net of current portion	24,494	-	-	-	-	26,054	(15,898)	34,650
Other liabilities	7,033	63	-	75	-	-	-	7,171
Total liabilities	657,293	1,695	-	27,120	-	37,260	(18,661)	704,707
Commitments and contingencies								
Net assets:								
Net assets without donor restrictions	167,935	6,483	-	(527)	3,178	6,287	(9,663)	173,693
Net assets with donor restrictions	19,823	13,258	-	-	-	-	(13,168)	19,913
Total St. Joseph's Health, Inc. net assets	187,758	19,741	-	(527)	3,178	6,287	(22,831)	193,606
Non-controlling interests in joint ventures	576	-	-	-	-	-	-	576
Total net assets including non-controlling interests	188,334	19,741	-	(527)	3,178	6,287	(22,831)	194,182
Total liabilities and net assets	\$ 845,627	\$ 21,436	\$ -	\$ 26,593	\$ 3,178	\$ 43,547	\$ (41,492)	\$ 898,889

St. Joseph's Health, Inc.

Consolidating Statement of Operations (In Thousands)

Year Ended December 31, 2019

	St. Joseph's University Medical Center and Subsidiaries	St. Joseph's Hospital and Medical Center Foundation, Inc.	VHS Management, Inc. and Subsidiary	200 Hospital Plaza Corp.	St. Joseph's Health, Inc.	SJHS Insurance Limited	Eliminations	Total
Operating revenues:								
Net patient service revenue	\$ 729,784	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ 729,784
Other revenue	91,337	2,065	(240)	3,937	—	6,669	(7,674)	96,094
Net assets released from restrictions – operations	—	1,768	—	—	—	—	—	1,768
Total operating revenues	821,121	3,833	(240)	3,937	—	6,669	(7,674)	827,646
Operating expenses:								
Salaries and wages	415,296	769	—	48	—	—	(769)	415,344
Employee benefits	71,340	185	—	—	—	—	(185)	71,340
Physician fees	18,486	—	—	—	—	—	—	18,486
Supplies and other	262,923	7,292	—	1,213	—	10,877	(6,720)	275,585
Interest	13,119	—	—	1,096	—	—	—	14,215
Depreciation and amortization	34,560	—	—	1,615	—	—	—	36,175
Total operating expenses	815,724	8,246	—	3,972	—	10,877	(7,674)	831,145
Operating income (loss)	5,397	(4,413)	(240)	(35)	—	(4,208)	—	(3,499)
Non-operating gains and losses:								
Investment return	7,066	435	—	—	—	649	—	8,150
Net change in unrealized gains and losses on equity investments	8,968	—	—	—	—	—	—	8,968
Net periodic pension cost	(749)	—	—	—	—	—	—	(749)
Excess of revenues over expenses	20,682	(3,978)	(240)	(35)	—	(3,559)	—	12,870
Less: net gain attributable to non-controlling interests in joint ventures								
	525	—	—	—	—	—	—	525
Excess of revenues over expenses	20,157	(3,978)	(240)	(35)	—	(3,559)	—	12,345
Other changes in net assets without donor restrictions:								
Change in net unrealized gains and losses on investments	4,959	451	—	—	—	2,877	—	8,287
Pension-related adjustments	(26,785)	—	—	—	—	—	—	(26,785)
Net assets released from restrictions – capital acquisitions	192	—	—	—	—	—	—	192
Transfer of assets from (to) captive	(5,000)	—	—	—	—	5,000	—	—
Change in interest in net assets without donor restrictions of St. Joseph's Hospital and Medical Center Foundation, Inc.	(3,527)	—	—	—	—	—	3,527	—
Change in net assets without donor restrictions	\$ (10,004)	\$ (3,527)	\$ (240)	\$ (35)	\$ —	\$ 4,318	\$ 3,527	\$ (5,961)

The System presents its interests in its controlled affiliates using the cost method of accounting.

St. Joseph's Health, Inc.

Consolidating Statement of Changes in Net Assets (In Thousands)

Year Ended December 31, 2019

	St. Joseph's University Medical Center and Subsidiaries	St. Joseph's Hospital and Medical Center Foundation, Inc.	VHS Inc. and Subsidiary	200 Hospital Plaza Corp.	St. Joseph's Health, Inc.	SJHS Insurance Limited	Eliminations	Total
Net assets without donor restrictions:								
Change in net assets without donor restrictions	\$ (10,004)	\$ (3,527)	\$ (240)	\$ (35)	\$ –	\$ 4,318	\$ 3,527	\$ (5,961)
Net assets with donor restrictions:								
Contributions, grants, investment income, and other support	(689)	3,535	–	–	–	–	6	2,852
Changes in interest in restricted net assets of St. Joseph's Hospital and Medical Foundation, Inc.	1,768	–	–	–	–	–	(1,768)	–
Net assets released from restrictions – operations	–	(1,768)	–	–	–	–	–	(1,768)
Net assets released from restrictions – capital acquisitions	(192)	–	–	–	–	–	–	(192)
Change in net unrealized gains and losses on investments held in perpetual trusts	662	666	–	–	–	–	(662)	666
Change in net assets with donor restrictions	1,549	2,433	–	–	–	–	(2,424)	1,558
Change in St. Joseph's Health, Inc. net assets	(8,455)	(1,094)	(240)	(35)	–	4,318	1,103	(4,403)
Non-controlling interests in joint ventures:								
Net gain attributable to non-controlling interests in joint ventures	525	–	–	–	–	–	–	525
Distributions to non-controlling interests in joint ventures, net	(533)	–	–	–	–	–	–	(533)
Decrease in non-controlling interests	(8)	–	–	–	–	–	–	(8)
Change in net assets including non-controlling interests	(8,463)	(1,094)	(240)	(35)	–	4,318	1,103	(4,411)
Net assets at beginning of year	196,797	20,835	240	(492)	3,178	1,969	(23,934)	198,593
Net assets at end of year	\$ 188,334	\$ 19,741	\$ –	\$ (527)	\$ 3,178	\$ 6,287	\$ (22,831)	\$ 194,182

The System presents its interests in its controlled affiliates using the cost method of accounting.

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