Hunterdon Medical Center

Financial Statements

December 31, 2015 and 2014

BAKER TILLY

Candor. Insight. Results.

Hunterdon Medical Center

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December 31, 2015 and 2014

BAKER TILLY

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Independent Auditors' Report

The Board of Trustees
Hunterdon Medical Center

Report on the Financial Statements

We have audited the accompanying financial statements of Hunterdon Medical Center (the "Medical Center"), which comprise the balance sheet as of December 31, 2015 and 2014, and the related statements of operations, changes in net assets, and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free from 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 financial position of Hunterdon Medical Center as of December 31, 2015 and 2014, and the results of its operations, changes in its net assets and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Baker Tilly Virchow Krause, LLP

Clark, New Jersey
May 13, 2016

Hunterdon Medical Center

Balance Sheet

December 31, 2015 and 2014

	2015	2014
Assets		
Current Assets		
Cash and cash equivalents	$ 31,959,719	$ 38,132,865
Short-term investments	46,577,328	41,144,213
Patient accounts receivable, net of allowance for doubtful accounts of $15,617,000 and $14,539,000 in 2015 and 2014, respectively	25,060,809	28,039,113
Assets whose use is limited	1,015,768	-
Inventories	1,724,257	1,456,375
Other receivables, net	1,026,297	2,512,952
Due from affiliates	954,131	-
Prepaid expenses and other current assets	2,657,899	2,306,608
Total current assets	110,976,208	113,592,126
Assets whose use is limited (exclusive of current portion):		
Board-designated funds	42,227,960	42,457,199
Donor-restricted assets	15,814,326	17,434,118
Funds held by trustee under bond indenture agreement	1,042,085	6,073,897
Total assets whose use is limited, net	59,084,371	65,965,214
Due from affiliates	2,544,362	1,827,120
Property and equipment, net	137,099,376	129,003,602
Beneficial interest in trusts	2,084,024	2,201,575
Beneficial interest in net assets of Hunterdon Medical Center Foundation, Inc.	6,282,831	7,528,362
Deferred financing costs, net	518,792	533,494
Real estate held for investment	213,099	213,099
Other assets	16,222,451	13,750,100
Total assets	$ 335,025,514	$ 334,614,692

	2015	2014
Liabilities and Net Assets		
Current Liabilities		
Current portion of long-term debt	$ 1,418,054	$ 1,388,406
Current portion of capital lease obligation	478,379	467,994
Accounts payable and accrued expenses	19,235,550	18,131,651
Accrued payroll and payroll taxes	7,124,811	11,543,646
Estimated third-party payor settlements	1,296,034	1,176,419
Due to affiliates	-	116,358
Accrued interest payable	1,058,979	24,317
Total current liabilities	30,611,807	32,848,791
Estimated third-party payor settlements, net	3,375,156	4,251,376
Long-term debt, net	69,749,508	71,245,721
Capital lease obligation, net	923,818	1,401,653
Pension liability	35,515,199	37,543,554
Other liabilities	9,341,495	6,722,843
Total liabilities	149,516,983	154,013,938
Net Assets		
Unrestricted	161,327,350	159,603,519
Temporarily restricted	5,895,398	2,468,753
Permanently restricted	18,285,783	18,528,482
Total net assets	185,508,531	180,600,754
Total liabilities and net assets	$ 335,025,514	$ 334,614,692

See notes to financial statements

Hunterdon Medical Center

Statement of Operations
Years Ended December 31, 2015 and 2014

	2015	2014
Revenues		
Patient service revenue (net of contractual allowances and discounts)	$ 267,728,589	$ 263,250,012
Less provision for bad debts	8,038,918	13,420,545
Net patient service revenue less provision for bad debts	259,689,671	249,829,467
Other revenue	16,373,979	14,592,870
Net assets released from restrictions	672,267	686,643
Total revenues	276,735,917	265,108,980
Expenses		
Salaries and benefits	157,605,903	154,934,694
Physicians' fees	6,165,810	6,265,646
Supplies and services	88,104,579	81,522,264
Depreciation and amortization	14,365,172	13,502,788
Interest	2,387,327	2,301,085
Total expenses	268,628,791	258,526,477
Operating income	8,107,126	6,582,503
Nonoperating Revenues and Gains (Losses)		
Interest and dividend income	1,319,261	1,331,547
Net realized gains on investments	831,745	144,811
Change in value of derivative financial instruments	84,487	37,377
Gain on sale of assets	1,850	7,592
Total nonoperating revenues and gains (losses), net	2,237,343	1,521,327
Excess of revenues and gains over expenses and losses before loss on extinguishment of debt	10,344,469	8,103,830
Loss on Extinguishment of Debt	-	(2,819,101)
Excess of revenues and gains over expenses and losses	10,344,469	5,284,729
Change in Net Unrealized Gains and Losses on Investments, Other Than Trading Securities	(2,451,085)	2,040,160
Net Asset Transfer	(4,666,820)	-
Net Transfers to Affiliates	-	(2,458,114)
Pension-related Changes Other Than Net Periodic Pension Cost	(3,165,567)	(48,090,522)
Net Assets Released from Restrictions for Capital Acquisitions	1,662,834	1,647,550
Increase (decrease) in unrestricted net assets	$ 1,723,831	$ (41,576,197)

See notes to financial statements

Hunterdon Medical Center

Statement of Changes in Net Assets
Years Ended December 31, 2015 and 2014

	2015	2014
Unrestricted Net Assets		
Excess of revenues and gains over expenses and losses	$ 10,344,469	$ 5,284,729
Change in net unrealized gains and losses on investments, other than trading securities	(2,451,085)	2,040,160
Net asset transfer	(4,666,820)	-
Net transfers to affiliates	-	(2,458,114)
Pension-related changes other than net periodic pension cost	(3,165,567)	(48,090,522)
Net assets released from restrictions for capital acquisitions	1,662,834	1,647,550
Increase (decrease) in unrestricted net assets	1,723,831	(41,576,197)
Temporarily Restricted Net Assets		
Grants and contributions	23,537	4,141
Investment income from donor-restricted assets	229,049	197,186
Net realized gains on investments	181,851	6,663
Net asset transfer	4,666,820	-
Net assets released from restrictions	(2,335,101)	(2,334,193)
Change in net unrealized gains and losses on investments	(144,531)	34,104
Change in value of beneficial interest in net assets of Hunterdon Medical Center Foundation, Inc.	805,020	1,037,615
Increase (decrease) in temporarily restricted net assets	3,426,645	(1,054,484)
Permanently Restricted Net Assets		
Net realized gains on investments	1,269,103	57,220
Change in net unrealized gains and losses on investments	(1,394,251)	580,607
Change in value of beneficial interest in net assets of Hunterdon Medical Center Foundation, Inc.	-	1,200,000
Change in value of beneficial interest in trusts	(117,551)	(42,544)
(Decrease) increase in permanently restricted net assets	(242,699)	1,795,283
Increase (decrease) in net assets	4,907,777	(40,835,398)
Net Assets, Beginning	180,600,754	221,436,152
Net Assets, Ending	$ 185,508,531	$ 180,600,754

See notes to financial statements

Hunterdon Medical Center

Statement of Cash Flows
Years Ended December 31, 2015 and 2014

	2015	2014
Cash Flows from Operating Activities		
Increase (decrease) in net assets	$ 4,907,777	$ (40,835,398)
Adjustments to reconcile increase (decrease) in net assets to net cash provided by operating activities:		
Depreciation and amortization	14,365,172	13,502,788
Net transfers to affiliates	-	2,458,114
Accretion of bond premium, net of amortization of bond discount	(78,137)	(34,027)
Provision for bad debts, net	8,038,918	13,420,545
Net realized gains on investments	(2,282,699)	(208,694)
Loss on extinguishment of debt	-	2,819,101
Gain on sale of assets	(1,850)	(7,592)
Pension-related changes other than net periodic pension cost	3,165,567	48,090,522
Change in net unrealized losses (gains) on investments, other than trading securities	3,989,867	(2,654,871)
Change in value of derivative financial instruments	(84,487)	(37,377)
Change in value of beneficial interest in Foundation and trusts, net	1,363,082	(196,900)
Changes in assets and liabilities:		
Increase in patient accounts receivable	(5,060,614)	(11,544,405)
Increase in due from affiliates	(1,887,731)	(1,265,994)
(Increase) decrease in inventories, other receivables, prepaid expenses and other current assets and other assets	(1,688,491)	519,223
Decrease in estimated third-party payor settlements	(756,605)	(3,217)
Decrease in accounts payable and accrued expenses, accrued payroll and payroll taxes, accrued interest payable, pension benefit liabilities and other liabilities	(4,771,057)	(3,025,526)
Net cash provided by operating activities	19,218,712	20,996,292
Cash Flows from Investing Activities		
Purchases of assets whose use is limited and short-term investments, net	(1,275,208)	(3,392,685)
Purchases of property, plant, and equipment	(22,240,093)	(34,516,101)
Proceeds from sale of assets	1,850	26,850
Issuance of loan receivable, net	21,388	20,686
Purchase of physician practices	(105,150)	(201,785)
Net cash used in investing activities	(23,597,213)	(38,063,035)
Cash Flows from Financing Activities		
Proceeds from issuance of long-term debt	-	72,634,127
Payment of deferred financing costs	(38,767)	(876,712)
Repayment of long-term debt	(1,388,428)	(48,352,602)
Repayment of capital lease obligations	(467,450)	(359,521)
Repayment of a note receivable	100,000	100,000
Net cash (used in) provided by financing activities	(1,794,645)	23,145,292
Net (decrease) increase in cash and cash equivalents	(6,173,146)	6,078,549
Cash and Cash Equivalents, Beginning	38,132,865	32,054,316
Cash and Cash Equivalents, Ending	$ 31,959,719	$ 38,132,865
Supplemental Disclosure of Cash Flow Information		
Interest paid	$ 1,352,665	$ 3,273,301
Supplemental Disclosure of Non-Cash Investing and Financing Activities		
Acquisition of property, plant and equipment through capital lease obligations	$ -	$ 1,500,000

See notes to financial statements

1. Organization and Summary of Significant Accounting Policies

Hunterdon Medical Center (the “Medical Center”), located in Flemington, New Jersey, is a not-for-profit acute care medical center. The Medical Center provides inpatient, outpatient and emergency care services for the residents of Hunterdon County and surrounding areas. The Medical Center is an affiliated member of Hunterdon Healthcare System, Inc. (the “System”). The System is also the controlling entity for Hunterdon Medical Center Foundation, Inc. (the “Foundation”); Hunterdon Regional Community Health, Inc. (“HRCH”); and Midjersey Health Corporation (“Midjersey”). The System owns 100% of the outstanding stock of Midjersey Health Corporation and 50% of the outstanding stock of Hunterdon Health Care, LLC, which are for-profit entities. Only the Medical Center’s financial statements are presented herein.

In 2015 the Hunterdon Medical Center Board of Trustees authorized the creation of three professional corporations (“Captive PCs”); Hunterdon Primary Care, P.C., Hunterdon Specialty Care, P.C., and Hunterdon Urgent Care, P.C.

These Captive PCs, which are controlled by the Medical Center, employ certain physicians, nurse practitioners and physician assistants that were previously employed by the Medical Center directly. The Captive PCs became operational January 1, 2016 and will provide services at primary care and specialty practices owned by the Medical Center.

The following items comprise the significant accounting policies which are followed by the Medical Center.

Use of Estimates

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

Cash and Cash Equivalents

Cash and cash equivalents include cash on hand and highly liquid investments with an original maturity of twelve months or less.

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

Patient Accounts Receivable

Patient accounts receivable are reported at net realizable value. Accounts are written off when they are determined to be uncollectible based upon management's assessment of individual accounts. In evaluating the collectability of patient accounts receivable, the Medical Center analyzes its past history and identifies trends for each of its major payor sources of revenue to estimate the appropriate allowance for doubtful accounts and provision for bad debts. For receivables associated with services provided to patients who have third-party coverage, the Medical Center analyzes contractual amounts due and provides an allowance for doubtful accounts and a provision for bad debts, if necessary. For receivables associated with self-pay patients, the Medical Center records a significant provision for bad debts in the period of service on the basis of its past experience, which indicates that patients are unable or unwilling to pay the portion of their bill for which they are financially responsible. The difference between the billed rates and the amounts actually collected after all reasonable collection efforts have been exhausted is charged off against the allowance for doubtful accounts.

The Medical Center's allowance for doubtful accounts for self-pay patients was 99% and 97% of self-pay accounts receivable at December 31, 2015 and December 31, 2014, respectively. In addition, the Medical Center's self-pay account write-offs (net of recoveries) decreased to $6,238,918 in 2015 from $9,560,465 in 2014. The decrease is primarily due to the Medical Center implementing a new policy in May 2014 to apply a discount to self-pay accounts and recording the adjustment as a contractual allowance.

Net Patient Service Revenue

The Medical Center has agreements with third-party payors that provide for payment at amounts different from its established rates. Payment arrangements include prospectively determined rates per discharge, reimbursed costs, discounted charges, and per diem payments. The Medical Center recognizes patient service revenue associated with services provided to patients who have third-party payor coverage on the basis of these established rates for the services rendered. For uninsured patients that do not qualify for charity care, the Medical Center recognizes revenues on the basis of its standard rates, discounted in accordance with the Medical Center's policy. On the basis of historical experience, a significant portion of the Medical Center's uninsured patients will be unable or unwilling to pay for the services provided. Thus, the Medical Center records a significant provision of bad debts related to uninsured patients in the period the services are provided. Patient service revenues, net of contractual allowances and discounts and patient service revenues, net of contractual allowances and discounts and provision for bad debts, recognized in 2015 and 2014 from these major payor sources, are as follows:

	Patient Service Revenues (Net of Contractual Allowances and Discounts)			
	Third-Party Government Payors	Third-Party Commercial Payors	Self-Pay	Total
December 31, 2015	$ 90,355,903	$ 171,256,775	$ 6,115,911	$ 267,728,589
December 31, 2014	$ 84,240,004	$ 168,480,008	$ 10,530,000	$ 263,250,012

	Patient Service Revenues (Net of Contractual Allowances and Discounts and Provision for Bad Debts)			
	Third-Party Government Payors	**Third-Party Commercial Payors**	**Self-Pay**	**Total**
December 31, 2015	$ 89,369,122	$ 166,939,487	$ 3,381,062	$ 259,689,671
December 31, 2014	$ 82,616,118	$ 164,453,845	$ 2,759,504	$ 249,829,467

Inventories

Inventories are stated at the lower of cost, determined using the first-in, first-out method, or market.

Short-Term Investments, Assets Whose Use is Limited and Investment Risk

Assets whose use is limited primarily include assets held by trustees under indenture agreements; designated assets set aside by the Board of Trustees for future capital improvements, over which the Board retains control and may at its discretion subsequently use for other purposes; and donor-restricted assets. Amounts required to meet current liabilities of the Medical Center have been classified as current assets.

Investments in equity securities with readily determinable fair values and all investments in debt securities are measured at fair value. Investments in commingled funds are recorded at fair value based on the net asset value of the fund as estimated by the external investment managers. The Medical Center reviews and evaluates the values provided by the external investment managers for reasonableness. Investment income or loss (including realized gains and losses on investments and interest and dividends) is included in excess of revenues and gains over expenses and losses unless donor stipulation or law restricts the income or loss. Gains and losses on the sale of investments are based on an identified cost basis. Unrealized gains and losses on investments are excluded from excess of revenues and gains over expenses and losses unless the investments are trading securities. Donated investments are reported at fair value at the date of receipt.

A decline in the fair value below the cost that is deemed to be other than temporary results in a reduction in carrying amount to fair value. The impairment is charged to excess of revenues and gains over expenses and losses and a new cost basis for the security is established.

The Medical Center’s investments are comprised of a variety of financial instruments and are managed by investment advisors. The fair values reported in the balance sheet are subject to various risks including changes in the equity markets, the interest rate environment, and general economic conditions. Due to the level of risk associated with certain investment securities and the level of uncertainty related to changes in the fair value of investment securities, it is reasonably possible that the amounts reported in the accompanying financial statements could change materially in the near term.

Property and Equipment

Property and equipment are carried at cost, except donated assets, which are recorded at fair market value at the date of donation. Equipment under capital lease obligations is amortized using the straight-line method over the shorter period of the lease term or the estimated useful life of the equipment. Depreciation expense is calculated on all depreciable assets using the straight-line method based on estimated useful lives ranging from 3 to 40 years.

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 and Long-Lived Assets to Be Disposed of

Long-lived assets, such as property and equipment and purchased intangibles subject to amortization, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to estimated undiscounted future net cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge is recognized by the amount by which the carrying amount of the asset exceeds the fair value of the asset. Assets to be disposed of would be separately presented in the balance sheet and reported at the lower of the carrying amount or fair value less costs to sell and are no longer depreciated. The assets and liabilities of a disposed group classified as held for sale would be presented separately in the appropriate asset and liability sections of the balance sheet.

Beneficial Interests in Trusts

Beneficial interests in trusts are arrangements whereby a donor establishes and funds a trust, and the assets are held in perpetuity with the income earned distributed annually to the Medical Center for both restricted and unrestricted use. The Medical Center recognizes the contribution and receivable as permanently restricted net assets in the period the trust is established at its present value, which equals the fair value of the underlying assets. The fair value of these assets is based on the net asset values reported by the fund manager, which are reviewed by management for reasonableness. Adjustments to the receivable to reflect changes in fair value are recognized as additional contributions to permanently restricted net assets.

Deferred Financing Costs

Deferred financing costs consist principally of debt acquisition costs, which are being amortized over the life of the related debt using the effective interest method.

Goodwill

Goodwill is a result of acquisitions of physician practices and is included in other assets in the accompanying balance sheet and amounts to approximately $3,471,000 and $3,423,000 at December 31, 2015 and 2014, respectively. The Medical Center does not amortize the carrying value of goodwill. Rather, an impairment test is performed at least annually on the recorded amounts.

Self Insured Health Benefits

The Medical Center is self insured for employee health benefits. The provision for estimated employee health benefits includes estimates for the ultimate cost for both reported claims and claims incurred but not reported and is included in accounts payable and accrued expenses in the accompanying balance sheet.

Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets are those whose use by the Medical Center has been limited by donors to a specific time period or purpose. Permanently restricted net assets have been restricted by donors to be maintained by the Medical Center in perpetuity.

The Foundation raises or holds contributions on behalf of the Medical Center and other affiliates. The Medical Center periodically requests funds from the Foundation for capital and other needs. The Medical Center’s beneficial interest in the temporarily and permanently restricted net assets of the Foundation and its share of the change in those net assets are reported in the accompanying financial statements in temporarily restricted and permanently restricted net assets, respectively.

Donor-Restricted Gifts

Unconditional promises to give cash and other assets are reported at fair value at the date the promise is received. The gifts are reported as either temporarily or permanently restricted support if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified as unrestricted net assets and reported in the statement of operations as net assets released from restrictions. In the absence of donor specification that income and gains on donated funds are restricted, such income and gains are reported as unrestricted nonoperating revenues and gains.

Excess of Revenues and Gains Over Expenses and Losses

The statement of operations includes the excess of revenues and gains over expenses and losses, which is the performance indicator. Changes in unrestricted net assets that are excluded from the performance indicator, consistent with industry practice, include unrealized gains and losses on investment securities other than trading securities, permanent transfers of assets to and from affiliates for other than goods and services, pension-related changes other than net periodic pension cost, and contributions of long-lived assets (including assets acquired using contributions that by donor restriction were to be used for the purposes of acquiring such assets).

Estimated Medical Malpractice Liability

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

Derivative Instruments and Hedging Activities

Derivative financial instruments are utilized to manage risks. The principal financial instruments used for cash flow hedging purposes are interest rate swaps. The Medical Center enters into interest rate swap agreements to manage its exposure to interest rate changes. The Medical Center recognizes all financial instruments in the balance sheet at fair value. Changes in the fair value of derivatives are recognized either within the performance indicator or in other changes in unrestricted net assets, which is excluded from the performance indicator, depending on whether the derivative financial instrument qualifies for hedge accounting. Gains and losses on derivatives designated as cash flow hedges, to the extent they are effective, are recorded in other changes in the statement of operations and statement of changes in net assets. Changes in the fair value of derivatives not qualifying for hedge accounting, and for any portion of a hedge that is ineffective, are reported within the performance indicator.

Income Taxes

The Medical Center is a not-for-profit corporation as described in Section 501(c)(3) of the Internal Revenue Code and is exempt from federal income taxes on its exempt income under Section 501(a) of the Code.

The Medical Center accounts for uncertainty in income taxes by prescribing a recognition threshold of more-likely-than-not to be sustained upon examination by the appropriate taxing authority. Measurement of the tax uncertainty occurs if the recognition threshold has been met. There were no tax uncertainties that met the recognition threshold in 2015 or 2014.

The Medical Center's federal tax-exempt organization business income tax returns are no longer subject to examination by the Internal Revenue Service for years before 2012.

Reclassifications

Certain amounts in the 2014 financial statements have been reclassified to conform to the current year's presentation.

Subsequent Events

The Medical Center evaluated subsequent events for recognition or disclosure through May 13, 2016, the date the financial statements were issued.

New Accounting Standards

Revenue from Contracts with Customers

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2014-09, Revenue from Contracts with Customers (Topic 606). ASU No. 2014-09 supersedes the revenue recognition requirements in Topic 605, Revenue Recognition, and most industry-specific guidance. Under the requirements of ASU No. 2014-09, the core principle is that entities should recognize revenue to depict the transfer of promised goods or services to customers (patients) in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The Medical Center will be required to retrospectively adopt the guidance in ASU No. 2014-09 for years beginning after December 15, 2017. The Medical Center has not yet determined the impact of adoption of ASU No. 2014-09 on its financial statements.

Leases

In February 2016, the FASB issued Accounting Standards Update ("ASU") No. 2016-02, Leases (Topic 842). ASU No. 2016-02 was issued to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. Under the provisions of ASU No. 2016-02, a lessee is required to recognize a right-to-use asset and lease liability, initially measured at the present value of the lease payments, in the balance sheet. In addition, lessees are required to provide qualitative and quantitative disclosures that enable users to understand more about the nature of the Medical Center's leasing activities. The Medical Center will be required to retrospectively adopt the guidance in ASU No. 2016-02 for years beginning after December 15, 2018. The Medical Center has not yet determined the impact of adoption of ASU No. 2016-02 on its financial statements.

2. Charity and Uncompensated Care

In furtherance of its charitable purpose, the Medical Center provides a wide variety of benefits to the community, including offering various community-based programs, such as lifeline, health screenings, training for emergency service personnel, social service, support counseling for patients and families, pastoral care, and crisis intervention. Additionally, a large number of health-related educational programs are provided for the benefit of the community, including health enhancements and wellness, classes on specific conditions, and telephone information services designed to improve the general standards of the health of the community.

The Medical Center also provides medical care without charge or at reduced costs to residents of its community who meet the criteria under state regulation for charity care. The Medical Center's definition of charity care includes services provided at no charge or at a reduced charge to patients who are uninsured or underinsured. The Medical Center maintains records to identify and monitor the level of charity care it provides. These records include the amount of charges forgone for services and supplies furnished under its charity care policy. An overall cost to charge ratio was applied to arrive at the cost of charity care, and as a result the cost of charity care amounted to $4,315,047 and $5,434,595 in 2015 and 2014, respectively. Because the Medical Center does not pursue collection of amounts determined to qualify as charity care, they are not reported as revenue.

The state provides certain subsidy payments to qualified hospitals to partially fund uncompensated care and certain other costs. Subsidy payments recognized as revenue amounted to $1,610,513 and $1,551,369 and 2015 and 2014, respectively, and are included in other revenue in the accompanying statement of operations.

3. Net Patient Service Revenue

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

- **Medicare:** Inpatient acute care and outpatient services rendered to Medicare program beneficiaries are paid at prospectively determined rates. These rates vary according to patient classification systems that are based on clinical, diagnostic, and other factors. In addition, the Medical Center is reimbursed for certain cost reimbursable items at tentative interim rates, with final settlement determined after submission of annual cost reports by the Medical Center and audits thereof by the Medicare fiscal intermediary. The Medical Center's Medicare cost reports have been settled by the Medicare fiscal intermediary through December 31, 2011 with the exception of the 2005 cost report, which has not been settled.

- **Medicaid:** Inpatient acute care services rendered to Medicaid program beneficiaries are paid at prospectively determined rates per discharge. These rates vary according to a patient classification system that is based on clinical, diagnostic, and other factors. Outpatient services are paid based on a published fee schedule, with final settlement determined after submission of annual cost reports. The Medicaid cost reports have been settled through December 31, 2012.

- **Other Payors:** The Medical Center has also entered into payment agreements with certain commercial insurance carriers, health maintenance organizations, and preferred provider organizations. The basis for payment to the Medical Center under these agreements includes prospectively determined rates per discharge, discounts from established charges, prospectively determined daily rates, and various other prospectively determined rates.

Revenue received under third-party arrangements is subject to audit and retroactive adjustments. Net patient service revenues include favorable adjustments of approximately $1,204,000 in 2015 and $328,000 in 2014 related to tentative and/or final settlements of prior year cost reports and other third-party payor adjustments. In the opinion of management, adequate provision has been made for any adjustments which may result from the final settlement of open cost reports.

4. Short-term Investments and Assets Whose Use is Limited

The composition of short-term investments and assets whose use is limited at December 31, 2015 and 2014 is set forth in the following table:

	2015	2014
Short-term investments:		
Cash and cash equivalents	$ 146,334	$ 312,797
Certificates of deposit	3,866,117	3,832,566
Government bonds	4,764,065	1,599,657
Investment-grade corporate bonds	32,230,343	29,893,761
Mutual funds - fixed income	5,528,121	5,475,837
Accrued interest receivable	42,348	29,595
Total short-term investments	$ 46,577,328	$ 41,144,213
Assets whose use is limited:		
Board-designated funds,		
Cash and cash equivalents	$ 4,003,766	$ 3,993,238
Certificates of deposit	2,415,767	2,386,596
Mutual funds - international equity	5,629,064	4,308,696
Mutual funds - fixed income	11,670,299	11,023,057
Mutual funds - domestic equity	18,487,172	20,720,131
Accrued interest receivable	21,892	25,481
Total	42,227,960	42,457,199
Donor-restricted assets,		
Cash and cash equivalents	1,174,226	2,651,516
Commingled funds - U.S. large cap equities	1,859,199	5,196,296
Commingled funds - U.S. bonds	3,503,275	3,352,636
Mutual funds - international equity	2,141,236	1,935,630
Mutual funds - fixed income	1,293,346	1,267,881
Mutual funds - domestic equity	5,843,044	3,030,159
Total	15,814,326	17,434,118
Funds held by trustee under bond indenture agreements,		
Cash and cash equivalents	2,057,853	6,073,897
Total assets whose use is limited	60,100,139	65,965,214
Less current portion	1,015,768	-
Noncurrent portion of assets whose use is limited	$ 59,084,371	$ 65,965,214

Funds held by trustee under bond indenture agreements are maintained for the following purposes:

	2015	2014
Construction fund	$ 1,042,085	$ 6,020,409
Other trustee-held funds	-	53,488
Debt service funds for principal and interest	1,015,768	-
Total funds held by trustee under bond indenture agreement	2,057,853	6,073,897
Less current portion	1,015,768	-
Noncurrent portion	$ 1,042,085	$ 6,073,897

Investment return includes the following for the years ended December 31, 2015 and 2014:

	2015	2014
Interest and dividend income	$ 1,548,310	$ 1,528,733
Net realized gains on investments	2,282,699	208,694
Change in net unrealized gains (losses) on investments, other than trading securities	(3,989,867)	2,654,871
Total investment return	$ (158,858)	$ 4,392,298

5. Fair Value Measurements and Financial Instruments

The Medical Center measures its short-term investments and assets whose use is limited on a recurring basis in accordance with accounting principles generally accepted in the United States of America.

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

The levels of the fair value hierarchy are as follows:

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

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

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

The following tables present financial instruments measured at fair value at December 31, 2015 and 2014:

	Fair Value as of December 31, 2015			
	Total	Level 1	Level 2	Level 3
Reported at Fair Value				
Assets:				
Short-term investments:				
Cash and cash equivalents	$ 188,682	$ 188,682	$ -	$ -
Certificates of deposit	3,866,117	3,866,117	-	-
Government bonds	4,764,065	-	4,764,065	-
Investment-grade corporate bonds	32,230,343	-	32,230,343	-
Mutual funds - fixed income	5,528,121	5,528,121	-	-
Assets whose use is limited:				
Cash and cash equivalents	7,257,737	7,257,737	-	-
Certificates of deposit	2,415,767	2,415,767	-	-
Mutual funds - international equity	7,770,300	7,770,300	-	-
Mutual funds - fixed income	12,963,645	12,963,645	-	-
Mutual funds - domestic equity	24,330,216	24,330,216	-	-
Commingled funds - U.S. large cap equities	1,859,199	-	1,859,199	-
Commingled funds - U.S. bonds	3,503,275	-	3,503,275	-
Beneficial interest in trusts	2,084,024	-	-	2,084,024
Total assets	$ 108,761,491	$ 64,320,585	$ 42,356,882	$ 2,084,024

	Fair Value as of December 31, 2015			
	Total	**Level 1**	**Level 2**	**Level 3**
Liabilities:				
Swap agreements	$ 533,193	$ -	$ 533,193	$ -
Disclosed at Fair Value				
Cash and cash equivalents	$ 31,959,719	$ 31,959,719	$ -	$ -
Long-term debt (carrying value of $71,167,562)	$ 74,480,341	$ -	$ 48,313,768	$ 26,166,573

	Fair Value as of December 31, 2014			
	Total	**Level 1**	**Level 2**	**Level 3**
Reported at Fair Value				
Assets:				
Short-term investments:				
Cash and cash equivalents	$ 312,797	$ 312,797	$ -	$ -
Certificates of deposit	3,832,566	3,832,566	-	-
Government bonds	1,599,657	-	1,599,657	-
Investment-grade corporate bonds	29,893,761	-	29,893,761	-
Mutual funds - fixed income	5,475,837	5,475,837	-	-
Assets whose use is limited:				
Cash and cash equivalents	12,718,651	12,718,651	-	-
Certificates of deposit	2,386,596	2,386,596	-	-
Mutual funds - international equity	6,244,326	6,244,326	-	-
Mutual funds - fixed income	12,290,938	12,290,938	-	-
Mutual funds - domestic equity	23,750,290	23,750,290	-	-
Commingled funds - U.S. large cap equities	5,196,296	-	5,196,296	-
Commingled funds - U.S. bonds	3,352,636	-	3,352,636	-
Beneficial interest in trusts	2,201,575	-	-	2,201,575
Total assets	$ 109,255,926	$ 67,012,001	$ 40,042,350	$ 2,201,575

	Fair Value as of December 31, 2014			
	Total	**Level 1**	**Level 2**	**Level 3**
Liabilities:				
Swap agreements	$ 617,680	$ -	$ 617,680	$ -
Disclosed at Fair Value				
Cash and cash equivalents	$ 38,132,865	$ 38,132,865	$ -	$ -
Long-term debt (carrying value of $72,634,127)	$ 75,895,230	$ -	$ 48,340,230	$ 27,555,000

Fair Value of Financial Instruments

The carrying amounts of cash and cash equivalents and certificates of deposit approximate fair value at December 31, 2015 and 2014 due to the short maturity of those financial instruments.

Mutual funds are valued at the net asset value (“NAV”) of shares held by the Medical Center at year end.

Government bonds and investment-grade corporate bonds are valued at fair value, which are the amounts reported in the balance sheet, based on quoted market prices, if available, or estimated using quoted market process of similar securities.

The Medical Center measures its commingled funds at fair value based on the net asset value of the fund held at the end of the year. The fair value is based on the funds' underlying investments using observable inputs (Level 2) in accordance with accounting principles generally accepted in the United States of America.

Beneficial interest in perpetual trusts is valued using discounted cash flow methodologies.

The fair value of the interest rate swap derivative financial instruments is determined by an independent third party valuation specialist based on proprietary models of discounted cash flow. The fair value takes into consideration the prevailing interest rate environment and the specific terms and conditions of the derivative financial instruments and the credit risk of the Foundation. The value represents the estimated exit price the Medical Center would pay or receive upon termination of the agreements.

The fair value of long-term debt is calculated based on quoted market prices, if available, or estimated using quoted market prices of similar securities using a discount rate that a market participant would demand.

Changes to the beneficial interest in trusts in 2015 and 2014 were as follows:

	2015	2014
Beginning balance	$ 2,201,575	$ 2,244,119
Investment income from beneficial interest in trusts	103,369	126,349
Distributions from beneficial interest in trusts	(103,369)	(126,349)
Change in value of beneficial interest in trusts	(117,551)	(42,544)
Ending balance	$ 2,084,024	$ 2,201,575

Change in value of beneficial interest in trusts is reported as changes in permanently restricted net assets within the statement of changes in net assets.

6. Property and Equipment

Property and equipment and accumulated depreciation at December 31, 2015 and 2014 are as follows:

	2015	2014
Land	$ 6,796,849	$ 6,796,849
Land improvements	6,834,040	6,715,739
Buildings	133,811,298	106,845,225
Fixed equipment	41,028,766	38,707,581
Major moveable equipment	135,183,778	121,143,301
Leasehold improvements	4,519,816	3,389,139
Minor equipment	51,244	51,244
Construction in progress	1,033,878	23,350,615
	329,259,669	306,999,693
Less accumulated depreciation and amortization	192,160,293	177,996,091
Property and equipment, net	$ 137,099,376	$ 129,003,602

7. Long-Term Debt and Capital Lease Obligations

Bonds Payable

Bonds payable at December 31, 2015 and 2014 consist of the following:

	2015	2014
New Jersey Health Care Facilities Financing Authority ("Authority") Revenue and Refunding Bonds, Series 2014A, Serial Bonds payable annually through July 1, 2030, bearing interest at a rate of 5% (a)	$ 1,845,000	$ 1,845,000
Authority Revenue and Refunding Bonds, Series 2014A, Serial Bonds, maturing July 1, 2031, bearing interest at a rate of 5% (a)	1,940,000	1,940,000
Authority Revenue and Refunding Bonds, Series 2014A, Serial Bonds, maturing July 1, 2032, bearing interest at a rate of 5% (a)	2,035,000	2,035,000
Authority Revenue and Refunding Bonds, Series 2014A, Serial Bonds, maturing July 1, 2033, bearing interest at a rate of 5% (a)	2,140,000	2,140,000
Authority Revenue and Refunding Bonds, Series 2014A, Serial Bonds, maturing July 1, 2034, bearing interest at a rate of 5% (a)	2,245,000	2,245,000
Authority Revenue and Refunding Bonds, Series 2014A, Term Bonds, maturing July 1, 2036, bearing interest at a rate of 4% (a)	4,805,000	4,805,000
Authority Revenue and Refunding Bonds, Series 2014A, Term Bonds, maturing July 1, 2045, bearing interest at a rate of 5% (a)	18,225,000	18,225,000
Authority Revenue and Refunding Bonds, Series 2014A, Term Bonds, maturing July 1, 2045, bearing interest at a rate of 4% (a)	9,500,000	9,500,000
Authority Refunding Bonds, Series 2014B, payable monthly through December 1, 2029, bearing interest at a fixed rate of 2.44% (a)	16,260,000	16,260,000
Authority Refunding Bonds, Series 2014C, payable monthly through December 1, 2019, bearing interest at a variable rate of .09% (a)	5,155,161	6,360,000
Authority Refunding Bonds, Series 2014D, payable monthly through December 1, 2034, bearing interest at a variable rate of 1.08% (a)	4,751,412	4,935,000
	68,901,573	70,290,000
Less current portion due within one year	1,418,054	1,388,406
Plus unamortized bond premium, net of original issue discount	2,265,989	2,344,127
Long-term portion	$ 69,749,508	$ 71,245,721

Capital Lease Obligations

Capital lease obligations at December 31, 2015 and 2014 consist of the following:

	2015	2014
Siemens/Lumins Agile (c)	$ 163,529	$ 264,134
Siemens/Symbia S-Series (d)	221,969	298,360
TD Equipment Finance/Davinci Robot (e)	1,016,699	1,307,153
Subtotal	1,402,197	1,869,647
Less portion due within one year	478,379	467,994
Long-term portion	$ 923,818	$ 1,401,653

(a) On December 1, 2014, the Medical Center issued $42,735,000 of Revenue and Refunding Bonds, Series 2014A ("Series 2014A bonds") pursuant to a loan agreement between the Medical Center and the Authority. The Series 2014A Bonds include $10,205,000 of Serial Bonds maturing July 1, 2030 through 2034, bearing interest at 5% and $32,530,000 of Term Bonds maturing July 1, 2036 through 2045, with interest ranging from 4% to 5%. Interest is payable semiannually on July 1 and January 1.

The Medical Center also entered into a Master Trust Indenture and First Supplemental Indenture, both dated as of December 1, 2014 ("Master Trust Indenture"), with U.S. Bank National Association, as Master Trustee in connection with the issuance of the Series 2014A Bonds. As security for the repayment of the bonds, the Medical Center has granted a security interest in and a first lien on its gross revenues. The Master Trust Indenture requires the Medical Center to comply with certain covenants and ratios.

Proceeds from the Series 2014A bonds were used to refund and redeem the Series 2006A bonds and approximately $15,204,000 of 2014 Bonds issued by the Authority on January 1, 2014; to finance a portion of the costs of various capital improvements to the Medical Center's acute care facility; and to pay costs of issuance of the Series 2014A bonds.

The Medical Center also issued $16,260,000, $6,360,000 and $4,935,000 of Refunding Bonds, Series 2014B, C and D, respectively, ("Series 2014B-D bonds") pursuant to a loan agreement between the Medical Center and the Authority on December 1, 2014. The Series 2014B-D bonds were special and limited obligations of the Authority, payable in monthly installments ranging from $14,000 to $153,000 from January 2015 to December 2034.

TD Bank N.A. (the "Bank") purchased the Series 2014B-D Bonds pursuant to a Direct Bond Purchase Agreement dated December 23, 2014. The Medical Center has entered into a Continuing Covenants Agreement with the Bank which requires the Medical Center to comply with certain covenants and ratios.

Proceeds from the Series 2014B and C bonds were used to refund and redeem the Series 2006B bonds and Series 2009 bonds, respectively and the proceeds from the Series 2014D bonds were used to refinance an existing bank loan issued by Midjersey.

In connection with the refunding of the Series 2006A, 2006B, 2009 and 2014 Bonds, the Medical Center recognized a loss on extinguishment of debt of approximately $2,819,000.

Effective December 11, 2009, the Medical Center entered into an interest rate swap exchange agreement with TD Bank, N.A. On December 23, 2014, the Medical Center entered into a novation agreement with TD Bank, N.A. and the Toronto-Dominion Bank for the interest rate swap. The Toronto-Dominion Bank replaced TD Bank, N.A. as the counterparty, under this agreement. The novated swap agreement has a notional amount of $5,256,171 and requires the Medical Center to pay a fixed rate of 2.21% to the bank in exchange for the bank agreeing to pay the Medical Center a variable rate equal to 69% of one-month LIBOR (0.29% at December 31, 2015).

Effective December 23, 2014, the Medical Center entered into a novation agreement with TD Bank, N.A. and the Toronto-Dominion Bank. Under this agreement, an interest rate swap was transferred from Midjersey to the Medical Center and The Toronto-Dominion Bank replaced TD Bank, N.A. as the counterparty. The novated swap agreement has a notional amount of $4,935,000 and requires the Medical Center to pay a fixed rate of 2.5% to the bank in exchange for the bank agreeing to pay the Medical Center a variable rate equal to 69% of one-month LIBOR (0.29% at December 31, 2015).

At December 31, 2015 and 2014, the fair value of the derivative financial instruments is $(533,193) and $(617,680), respectively, and is included in other liabilities in the accompanying balance sheet. The change in fair value recognized during the years ended December 31, 2015 and 2014, in the amount of $84,487 and $37,377 is recorded in the statement of operations and is included in the performance indicator. As a result of the novation and transfer of the interest rate swap agreement from Midjersey to the Medical Center, the Medical Center recorded a net asset transfer of $358,114 in 2014, which is included in net transfers to affiliates in the statement of changes in net assets.

Future principal debt payments at December 31, 2015 are as follows:

Years ending December 31:	
2016	$ 1,418,054
2017	1,454,272
2018	1,500,375
2019	1,547,941
2020	205,873
Thereafter	62,775,058
Total	$ 68,901,573

(b) The Medical Center has a $6,000,000 unsecured line of credit with a bank. The interest rate at December 31, 2015 and 2014 is 4.0% and the term was extended to December 31, 2016. There are no amounts outstanding on the line of credit as of December 31, 2015 and 2014.

(c) During 2012, the Medical Center entered into a capital lease with Siemens for a piece of radiology equipment. The term of the lease is five years with lease payments of $8,753, including interest, required monthly beginning August 22, 2012. The lease includes interest at 2.03% and a purchase option of $1 at the end of the term.

(d) During 2013, the Medical Center entered into two capital leases with Siemens for two pieces of radiology equipment. The terms of both leases is five years with a total monthly lease payment of $6,883, including interest, required monthly beginning October 11, 2013. The leases include interest at 2.93% and purchase options of $1 each at the end of the terms.

(e) During 2014, the Medical Center entered in a capital lease with TD Equipment Finance for a Davinci Surgical System. The term of the lease is five years with a total monthly lease payment of $26,406, including interest, required monthly beginning May 1, 2014. The lease includes interest at 2.25% and a purchase option of $10 at the end of the term.

8. Pension Plans

Defined Benefit Pension Plan

The Medical Center sponsors a noncontributory defined benefit pension plan (the “Plan”) that covers all eligible employees. The plan provides for benefits to be paid to eligible employees at retirement, based primarily upon years of service and compensation. Contributions are intended to provide not only for benefits attributed to service to date but also for those expected to be earned in the future. The Medical Center’s funding policy is to contribute annually an amount equal to or greater than the minimum funding requirements of the Employee Retirement Income Security Act of 1974 (ERISA). The Medical Center uses a December 31 measurement date. In November 2013, the Board of Trustees approved an amendment to freeze the Plan effective January 15, 2014.

The Medical Center recognizes the funded status of the benefit plan, which is measured as the difference between plan assets at fair value and the benefit obligation, in the balance sheet. Additionally, the Medical Center recognizes changes in the funded status of the Plan in the year in which the changes occur through a separate line within changes in unrestricted net assets, apart from expenses, to the extent those changes are not included in the net periodic benefit cost.

The following tables set forth the plan's funded status, amounts recognized in the Medical Center's balance sheet, and components of net periodic pension cost for 2015 and 2014.

	2015	2014
Change in benefit obligation:		
Benefit obligation at beginning of year	$ 239,201,524	$ 189,538,007
Interest cost	9,725,021	9,382,744
Benefits paid	(6,713,545)	(5,992,610)
Actuarial (gain) loss	(15,080,333)	46,273,383
Benefit obligation at end of year	227,132,667	239,201,524
Change in plan assets:		
Fair value of plan assets at beginning of year	201,657,970	194,189,177
Actual (loss) return on plan assets	(3,326,957)	13,461,403
Benefits paid	(6,713,545)	(5,992,610)
Fair value of plan assets at end of year	191,617,468	201,657,970
Funded status	(35,515,199)	(37,543,554)
Amounts recognized in accumulated unrestricted net assets consist of:		
Net actuarial loss	$ 55,166,691	$ 52,001,124

The actuarial gain of $15,080,333 in 2015 is primarily attributed to an increase in the discount rate and change in mortality table. The actuarial loss of $46,273,383 in 2014 is primarily attributed to a decrease in the discount rate and change in the mortality table.

The accumulated benefit obligation for the Plan was $227,132,667 and $239,201,524 at December 31, 2015 and 2014, respectively.

	2015	2014
Weighted average assumptions used to determine benefit obligations at December 31:		
Discount rate	4.39 %	4.10 %
Rate of compensation increases	N/A	N/A
Weighted average assumptions used to determine net periodic benefit cost:		
Discount rate	4.10 %	5.00 %
Expected long-term rate of return on plan assets	8.00	8.00
Rate of compensation increases	N/A	N/A
Components of net periodic benefit credit:		
Interest cost	$ 9,725,021	$ 9,382,744
Expected return on plan assets	(15,842,454)	(15,278,542)
Amortization of unrecognized actuarial loss	923,511	-
Net periodic benefit (credit) cost	$ (5,193,922)	$ (5,895,798)
Amounts recognized as changes in unrestricted net assets consist of:		
Net actuarial loss	$ 3,165,567	$ 48,090,522

The estimated net actuarial loss that is expected to be amortized from other changes in unrestricted net assets into net pension cost for the year ending December 31, 2016 is $1,055,053.

The expected long-term rate of return on pension assets is selected by taking into account the expected duration of the projected benefit obligation ("PBO") for the plan and the asset mix of the plan. The rate of return is expected to be the rate earned over the period until the benefits represented by the current PBO are paid. The expected return on plan assets is based on the Medical Center's expectation of historical long-term average rates of return on the different asset classes held in the pension fund. This is reflective of the current and projected asset mix of the funds and considers the historical returns earned on the Medical Center's asset allocation and the duration of the plan liabilities. Thus, the Medical Center has taken a historical approach to the development of the expected return on asset assumption. The Medical Center believes the fundamental changes in the markets cannot be predicted over the long term. Rather, historical returns, realized across numerous economic cycles, should be representative of the market return expectations applicable to the funding of a long-term benefit obligation.

Actual year-by-year returns can deviate substantially from the long-term expected return assumption. However, over time it is expected that the amount of over-performance will equal the amount of under-performance.

The fair value hierarchy for the Medical Center's pension plan assets at December 31, 2015 are as follows:

	Fair Value	Level 1	Level 2	Level 3
Pension assets:				
Mutual funds - domestic fixed income	$ 67,544,807	$ 67,544,807	$ -	$ -
Mutual funds - domestic equity	104,746,325	104,746,325	-	-
Mutual funds - international equity	18,630,180	18,630,180	-	-
Cash and cash equivalents	696,156	696,156	-	-

The fair value hierarchy for the Medical Center's pension plan assets at December 31, 2014 are as follows:

	Fair Value	Level 1	Level 2	Level 3
Pension assets:				
Mutual funds - domestic fixed income	$ 69,891,215	$ 69,891,215	$ -	$ -
Mutual funds - domestic equity	112,793,182	112,793,182	-	-
Mutual funds - international equity	18,335,280	18,335,280	-	-
Cash and cash equivalents	638,293	638,293	-	-

The Plan's actual weighted average asset allocations and target asset allocations by asset category are as follows:

Asset Category	2015 Target Allocations	2015	2014 Target Allocations	2014
Mutual funds invested in equity securities	64 %	65 %	64 %	65 %
Mutual funds invested in debt securities	36	35	36	35
Other	-	-	-	-
		100 %		100 %

In determining the asset allocation, the Medical Center's investment manager recognizes its desire for funding and expense stability, the long-term nature of the pension obligation, and current and projected cash needs for retiree benefit payments. An asset allocation analysis is performed to determine the long-term targets for the major asset classes of equity, debt and cash using an efficient frontier model. The asset allocation is reviewed quarterly and rebalanced if the variance to the targets exceeds 2.5%.

The Medical Center does not expect to contribute to the Plan during 2016.

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid as follows:

Years ending December 31:	
2016	$ 8,209,483
2017	8,842,204
2018	9,698,993
2019	10,608,129
2020	11,352,593
Thereafter	65,697,984

In addition to the defined benefit plan, the Medical Center also provides a deferred compensation plan for certain employees and physicians. At December 31, 2015 and 2014, the assets related to this plan are included in other assets and the related liability is included in other liabilities in the amount of $1,863,573 and $2,124,368, respectively.

In addition, certain of the Medical Center's key employees participate in a split dollar life insurance plan. Under the insurance policy, all premium payments are divided between the participant's portion and the Medical Center's portion. Any withdrawal or death benefit must first be used to repay the Medical Center's portion of the policy. At December 31, 2015 and 2014, the assets related to this plan are included in other assets in the amount of $4,307,165 and $4,386,966, respectively.

Defined Contribution Pension Plan

On January 1, 2010, the System established the Hunterdon Healthcare 403(B) Retirement Savings Plan. Certain System employees are eligible for participation in the plan. The System will make a core annual contribution between 2% and 4% of each employee's annual compensation based on years of service and a 50% match of each employee's annual individual contribution to the plan to a maximum of 2%. Total expense recorded by the Medical Center for contributions into the plan in 2015 and 2014 was approximately $4,879,000 and $4,776,000, respectively.

9. Related-Party Transactions

Distributions of restricted funds from the Foundation are recorded as decreases to beneficial interest in net assets of Hunterdon Medical Center Foundation, Inc. in the balance sheet. These restricted distributions consisted of the following for the years ended December 31, 2015 and 2014:

	2015	2014
Restricted for capital acquisitions	$ 1,500,000	$ 1,500,000
Restricted for program support	550,551	498,171
Total	$ 2,050,551	$ 1,998,171

The Medical Center has entered into various financing and operating arrangements with its affiliates. Interest is not charged under these arrangements. The following net amounts are due from (to) affiliates at December 31, 2015 and 2014:

	2015	2014
Hunterdon Healthcare System, Inc.	$ 1,734,827	$ 1,827,120
Hunterdon Medical Center Foundation, Inc.	488,058	(82,979)
Hunterdon Regional Community Health, Inc.	1,188,216	105,158
Midjersey Health Corporation and Subsidiaries	87,392	(138,537)
	3,498,493	1,710,762
Less amounts classified as current (liabilities) assets	954,131	(116,358)
Total noncurrent due from affiliates	$ 2,544,362	$ 1,827,120

The System has entered into a noninterest-bearing loan agreement with the Medical Center. The System used the funds borrowed to purchase all of the outstanding stock of Midjersey Health Corporation. The outstanding balance of this note is $730,000 and $830,000 at December 31, 2015 and 2014, respectively. The System makes payments on this note to the Medical Center as Midjersey Health Corporation declares dividends to the System. Payments made during 2015 and 2014 were $100,000. The remaining balance owed by the System of $998,295 and $997,120 at December 31, 2015 and 2014, respectively, primarily represents operating expenses paid by the Medical Center on the System's behalf.

The amounts due from the Foundation, HRCH, and Midjersey primarily represent salaries and benefits paid by the Medical Center on the affiliate organization's behalf. In 2014 the Medical Center recorded equity transfers to the Foundation in the amount of $700,000. These transfers pertained to the reduction of amounts due to the Medical Center from the Foundation. The Medical Center recorded equity transfers to HRCH in the amount of $1,400,000 in 2014 related to the forgiveness of intercompany balances.

HRCH provides certain services on behalf of the Medical Center. Fees associated with these services in the amounts of $397,818 and $398,588 were recorded by the Medical Center during 2015 and 2014, respectively, and are included in supplies and services expenses in the accompanying statement of operations. HRCH also provides various services such as building maintenance and other services to the Medical Center. The Medical Center recorded fees of $50,347 and $58,678 for the years ended December 31, 2015 and 2014, respectively, that are included in supplies and services expenses in the accompanying statement of operations. These amounts represent fair value for services charged.

Midjersey provides services to the Medical Center. Fees associated with the services provided under this agreement in the amounts of $3,103,575 and $3,941,509 for the years ended December 31, 2015 and 2014, respectively, were recorded by the Medical Center and are included in supplies and services expenses in the accompanying statement of operations.

On May 13, 2016, Midjersey entered into a loan agreement with Fulton Bank of New Jersey to finance leasehold improvements in the System's secondary service area. These leasehold improvements include the fit-out of several physician practices which will be operated by the Medical Center. On behalf of Midjersey, the Medical Center is the guarantor of the loan. The guaranty is limited to $10,200,000 in principal, together with any scheduled interest thereon and shall continue to be effective for the life of the loan, currently a term of twenty years.

10. Professional Liability Insurance

The Medical Center has annually purchased a claims-made professional liability insurance policy, which provides coverage of $1,000,000 per occurrence and $3,000,000 annual aggregate. In addition, the Medical Center has purchased an additional layer of insurance above the base policy of $15,000,000. Each individual employed physician is provided an individual limit of coverage in the amount of $3,000,000 per occurrence and $5,000,000 annual aggregate through a group purchased policy. Employed physicians are not covered by the Medical Center's policy or additional layer of insurance. The Medical Center has estimated losses and recorded an undiscounted liability of $1,343,000 at December 31, 2015 and 2014, relating to unasserted claims and incidents not yet reported to the insurance carrier, which are included in other liabilities in the accompanying balance sheet. In addition, the Medical Center has recorded a receivable (included in other assets), and related claim liability (included in other liabilities), for anticipated insurance recoveries of approximately $2,308,000 and $2,589,000 at December, 2015 and 2014, respectively.

11. Operating Leases

The Medical Center is obligated under noncancelable operating leases with terms in excess of one year for certain office space and equipment. Rental expense was $5,763,097 and $5,570,970 during 2015 and 2014, respectively. The required minimum lease payments at December 31, 2015 are as follows (rounded):

Years ending December 31:	
2016	$ 3,694,809
2017	2,737,862
2018	1,928,125
2019	1,578,881
2020	839,060
Thereafter	7,369,287
Total	$ 18,148,024

12. Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets in the amount of $5,895,398 and $2,468,753 at December 31, 2015 and 2014, respectively, are available for use by the Medical Center, as specified by the donor, for capital acquisitions, research, and education. Permanently restricted net assets of $18,285,783 and $18,528,482 at December 31, 2015 and 2014, respectively, are funds to be held in perpetuity by the Medical Center and consist of the Medical Center's beneficial interest in trusts and permanently restricted endowments. The income earned on these funds is expendable either to support patient care services or as specified by the donor. Realized gains and losses are retained in either unrestricted net assets or permanently restricted net assets in accordance with the donors' wishes. During 2015, the Medical Center made a $4,666,820 net asset transfer from unrestricted net assets to temporarily restricted net assets to properly reflect the donors' intent.

The Medical Center's endowment consists of eight funds that have been established by the Medical Center and are invested by the Medical Center and two funds that have been established by the Medical Center and are invested by the Foundation on behalf of the Medical Center. The endowment also includes three trusts where the Medical Center has a beneficial interest only and for which the funds have been invested based upon the trust's direction. These funds are invested by the Medical Center and Foundation. As required by generally accepted accounting principles, net assets associated with endowment funds are classified and reported based upon the existence or absence of donor-imposed restrictions.

From time to time, the fair value of assets associated with individual donor restricted endowment funds may fall below the level that the donor requires the Medical Center to retain as a fund of perpetual duration. In accordance with generally accepted accounting principles, deficiencies of this nature are to be reported in unrestricted net assets as of year-end. There were no such deficiencies as of December 31, 2015 and 2014.

Interpretation of Relevant Law

The Board of Trustees of the Medical Center and the Foundation have interpreted the New Jersey Uniform Prudent Management of Institutional Funds Act as requiring the preservation of the fair value of the original gift as of the gift date of the donor-restricted endowment funds absent explicit donor stipulations to the contrary. The Medical Center classifies as permanently restricted net assets (a) the original value of gifts donated to the permanent endowment, (b) the original value of subsequent gifts to the permanent endowment, and (c) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund. The interest and dividend income earned on the accumulations to the permanently restricted endowment funds is classified as temporarily restricted net assets until the donor-imposed restrictions have been met and the amounts have been appropriated for expenditure.

Spending Policy

The Foundation distributes to the Medical Center funds from its endowment account when donor-imposed restrictions have been met. The Medical Center spends earnings on donor-restricted endowment funds when expenses have been incurred that satisfy the donor-imposed restrictions.

Return Objectives and Risk Parameters

The Foundation and Medical Center have adopted investment and spending policies for endowment assets that attempt to provide a predictable stream of income and growth, while seeking to maintain the purchasing power of the endowment assets. Endowment assets include those assets of donor-restricted funds that the Medical Center and Foundation must hold in perpetuity under this policy, as approved by the Medical Center’s and Foundation’s Boards of Trustees, the endowment assets are invested in a manner that is intended to produce moderate to high rates of return while assuming a moderate to low level of investment risk.

The Medical Center has no board-designated endowment funds. The following represents the net asset classes of the Medical Center's donor-restricted endowment funds at December 31, 2015 and 2014:

	2015		
	Temporarily Restricted	**Permanently Restricted**	**Total**
Donor-restricted endowment funds	$ 1,697,930	$ 16,201,759	$ 17,899,689
	2014		
Donor-restricted endowment funds	$ 1,661,096	$ 16,326,907	$ 17,988,003

The following table presents changes in endowments for the years ended December 31, 2015 and 2014:

	Temporarily Restricted	**Permanently Restricted**	**Total**
Endowment net assets at December 31, 2013	$ 1,658,952	14,489,080	$ 16,148,032
Contributions and net asset transfers	-	1,200,000	1,200,000
Investment income	75,166	-	75,166
Change in net unrealized gains (losses) on investments	-	580,607	580,607
Net realized gains on investments	-	57,220	57,220
Appropriation of endowment assets for expenditure	(73,022)	-	(73,022)
Endowment assets at December 31, 2014	1,661,096	16,326,907	17,988,003
Contributions and net asset transfers	-	-	-
Investment income	64,207	-	64,207
Change in net unrealized gains (losses) on investments	-	(1,394,251)	(1,394,251)
Net realized gains on investments	-	1,269,103	1,269,103
Appropriation of endowment assets for expenditure	(27,373)	-	(27,373)
Endowment net assets at December 31, 2015	$ 1,697,930	$ 16,201,759	$ 17,899,689

13. Functional Expenses

The Medical Center provides general healthcare services to residents within its geographic location. Expenses related to providing these services for the years ended December 31, 2015 and 2014 are as follows:

	2015	2014
Health services	$ 232,906,197	$ 224,918,034
General and administrative	35,722,594	33,608,443
Total	$ 268,628,791	$ 258,526,477

14. Concentration of Risk

The Medical Center grants credit without collateral to its patients, most of whom are local residents and are insured under third-party agreements. The significant concentrations of accounts receivable for services to patients include the following at December 31, 2015 and 2014:

	2015	2014
Medicare	27.0 %	25.5 %
Medicaid	3.0	3.9
Blue Cross	18.8	18.6
Aetna	12.7	11.6
HMO/PPO payors	20.2	15.3
Other third-party payors	4.7	5.0
Self-pay patients	13.6	20.1
	100 %	100 %

15. Contingencies

The health care industry is subject to numerous laws and regulations of federal, state, and local governments. Compliance with these laws and regulations is subject to future government review and interpretation as well as regulatory actions unknown or unasserted at this time. Government activity continues to increase with respect to investigations and allegations concerning possible violations by health care providers of fraud and abuse statues and regulations, which could result in the imposition of significant fines and penalties as well as significant repayments for patient services previously billed. Management is not aware of any material incidents of noncompliance; however, the possible future financial effects of this matter on the Medical Center, if any, are not presently determinable.

16. Meaningful Use of Electronic Health Records

The American Recovery and Reinvestment Act of 2009 established one-time incentive payments under the Medicare and Medicaid programs for hospitals that meaningfully use certified electronic health records ("EHR") technology. In general, a hospital may receive an incentive payment for up to four years, provided it successfully demonstrates meaningful use of certified EHR technology for the EHR reporting period. The key component of receiving the EHR incentive payments is "demonstrating meaningful use," which means meeting a series of objectives that make use of an EHR's potential related to the improvement of quality, efficiency, and patient safety. Meaningful use will be assessed on a year-by-year basis.

Once the Medical Center meets the requirements for an incentive payment, a preliminary payment is made by The Centers for Medicare & Medicaid Services based on discharge data from the Hospital's most recently filed cost report. The final amount of the payment is determined at the time the cost report for the period beginning in the payment year is settled, based on discharge data from that cost report. The Medical Center recognized EHR incentive funds of $1,633,000 and $294,000 for the years ended December 31, 2015 and 2014, respectively. The EHR incentive funds are included in other revenue in the statement of operations.

The other revenue recognized is based on management's estimate and it is reasonably possible that the estimates used could change materially in the near term. Any such changes would affect operations in the period in which they occur. The Medical Center's attestation as a meaningful user is subject to audit by the Federal Government or its designee.