Consolidated Financial Statements and Supplementary Information

CentraState Healthcare System, Inc.
Years Ended December 31, 2016 and 2015
With Report of Independent Auditors

Ernst & Young LLP

Building a better
working world

CentraState Healthcare System, Inc.

Consolidated Financial Statements and
Supplementary Information

Years Ended December 31, 2016 and 2015

Contents

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Report of Independent Auditors

The Board of Trustees
CentraState Healthcare System, Inc.

We have audited the accompanying consolidated financial statements of CentraState Healthcare System, Inc. (the System), which comprise the consolidated balance sheets as of December 31, 2016 and 2015, 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 CentraState Healthcare System, Inc. at December 31, 2016 and 2015, 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 consolidating details appearing in conjunction with the consolidated financial statements are presented for purposes of additional analysis and are not a required part of the 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 financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the 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

April 21, 2017

CentraState Healthcare System, Inc.

Consolidated Balance Sheets

	December 31 2016		December 31 2015	
	(In Thousands)			
Assets				
Current assets:				
Cash and cash equivalents	**$**	**23,978**	$	20,514
Short-term investments *(Note 4)*		**153,181**		145,217
Assets limited as to use that are required for current liabilities *(Note 4)*		**2,042**		1,830
Accounts receivable, net of allowance for doubtful accounts of $7,770 in 2016 and $7,430 in 2015		**27,585**		28,086
Other current assets		**7,265**		6,234
Total current assets		**214,051**		201,881
Assets limited as to use – noncurrent *(Note 4)*		**28,629**		33,305
Property, plant, and equipment, net *(Note 6)*		**196,895**		193,922
Noncurrent assets *(Note 5)*		**5,104**		5,527
	$	**444,679**	$	434,635
Liabilities and net assets				
Current liabilities:				
Current maturities of long-term debt and capital lease obligations *(Note 7)*	**$**	**9,413**	$	6,252
Accounts payable and accrued expenses		**39,195**		35,495
Estimated third-party payor settlements – current *(Note 3)*		**1,906**		3,905
Other current liabilities		**1,078**		1,101
Total current liabilities		**51,592**		46,753
Long-term debt and capital lease obligations, excluding current installments *(Note 7)*		**135,854**		145,127
Professional liability insurance and other noncurrent liabilities (*Note 8)*		**7,597**		9,470
Estimated third-party payor settlements – noncurrent *(Note 3)*		**5,356**		6,592
Deferred revenue and refundable advance fees		**44,190**		42,072
Total liabilities		**244,589**		250,014
Commitments and contingencies				
Net assets:				
Unrestricted		**185,116**		171,870
Temporarily restricted		**14,360**		12,137
Permanently restricted		**614**		614
Total net assets		**200,090**		184,621
	$	**444,679**	$	434,635

See accompanying notes.

CentraState Healthcare System, Inc.

Consolidated Statements of Operations

	Year Ended December 31 2016	2015
	(In Thousands)	
Revenue:		
Net patient service revenue *(Note 3)*	**$ 286,288**	$ 276,198
Provision for bad debts	**(7,965)**	(6,832)
Net patient service revenue, less provision for bad debts	**278,323**	269,366
Other revenue *(Note 12)*	**37,920**	36,167
Investment return *(Note 4)*	**5,806**	7,600
Total revenue	**322,049**	313,133
Expenses:		
Salaries and wages	**132,621**	127,101
Employee benefits	**32,330**	31,903
Professional fees	**5,802**	6,064
Supplies and other expenses	**120,808**	115,648
Depreciation and amortization	**17,918**	17,276
Interest expense and amortization of financing costs	**4,955**	4,909
Total expenses	**314,434**	302,901
Income from operations	**7,615**	10,232
Reserve for bad debt – note receivable (*Notes 5 and 7*)	**–**	(37,986)
Net change in unrealized gains and losses on investments *(Note 4)*	**5,544**	(5,773)
Excess (deficiency) of revenue over expenses	**13,159**	(33,527)
Net assets released from restrictions for capital purposes	**87**	77
Change in unrestricted net assets	**$ 13,246**	$ (33,450)

See accompanying notes.

CentraState Healthcare System, Inc.

Consolidated Statements of Changes in Net Assets

Years Ended December 31, 2016 and 2015

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
		(In Thousands)		
Net assets at January 1, 2015	$ 205,320	$ 10,600	$ 614	$ 216,534
Change in unrestricted net assets	(33,450)	–	–	(33,450)
Contributions, investment return and other	–	2,004	–	2,004
Net assets released from restrictions for operations	–	(390)	–	(390)
Net assets released from restrictions for capital purposes	–	(77)	–	(77)
Change in net assets	(33,450)	1,537	–	(31,913)
Net assets at December 31, 2015	171,870	12,137	614	184,621
Change in unrestricted net assets	**13,246**	**–**	**–**	**13,246**
Contributions, investment return and other	**–**	**2,685**	**–**	**2,685**
Net assets released from restrictions for operations	**–**	**(375)**	**–**	**(375)**
Net assets released from restrictions for capital purposes	**–**	**(87)**	**–**	**(87)**
Change in net assets	**13,246**	**2,223**	**–**	**15,469**
Net assets at December 31, 2016	**$ 185,116**	**$ 14,360**	**$ 614**	**$ 200,090**

See accompanying notes.

CentraState Healthcare System, Inc.

Consolidated Statements of Cash Flows

	Year Ended December 31	
	2016	**2015**
	(In Thousands)	
Operating activities		
Increase (decrease) in net assets	**$ 15,469**	$ (31,913)
Adjustments to reconcile increase (decrease) in net assets to net cash provided by operating activities:		
Depreciation and amortization	**17,918**	17,276
Amortization of deferred financing costs, marketing costs, bond discount and premium	**344**	350
Cash received under nonrefundable advance fee plans, net of refunds	**4,547**	3,250
Amortization of advance fees	**(3,812)**	(3,408)
Net realized gains and losses on investments and income/loss in equity of joint ventures	**(1,717)**	(3,476)
Net change in unrealized gains and losses on investments	**(5,544)**	5,773
Reserve for bad debt – note receivable	**–**	37,986
Changes in operating assets and liabilities:		
Patient accounts receivable, net	**501**	(1,633)
Other assets	**(814)**	2,257
Accounts payable and accrued expenses	**3,700**	4,411
Professional liability insurance and other liabilities	**(1,896)**	(1,767)
Estimated third-party payor settlements	**(3,235)**	995
Net cash provided by operating activities	**25,461**	30,101
Investing activities		
Acquisitions of property, plant, and equipment, net	**(20,891)**	(17,033)
Short-term investments purchased, net	**(2,333)**	(14,387)
Assets limited as to use redeemed, net	**4,464**	6,798
Distributions from investment in joint ventures	**1,854**	2,221
Investment in joint ventures	**(219)**	(245)
Net cash used in investing activities	**(17,125)**	(22,646)
Financing activities		
Payments of long-term debt and capital lease obligations	**(6,255)**	(5,937)
Cash received under refundable advance fee plans, net of refunds	**1,383**	1,583
Net cash used in financing activities	**(4,872)**	(4,354)
Net increase in cash and cash equivalents	**3,464**	3,101
Cash and cash equivalents at beginning of year	**20,514**	17,413
Cash and cash equivalents at end of year	**$ 23,978**	$ 20,514

See accompanying notes.

1. Organization and Summary of Significant Accounting Policies

CentraState Healthcare System, Inc. (CSHS), located in Freehold, New Jersey, is a not-for-profit holding corporation.

A summary of significant accounting policies follows:

Principles of Consolidation

The consolidated financial statements include the accounts of CSHS, its wholly owned or wholly controlled subsidiary corporations and not-for-profit entities. CSHS is the sole member of the following not-for-profit corporations: CentraState Medical Center, Inc. (the Medical Center), CentraState Healthcare Affiliates, Inc. d/b/a The Manor (The Manor), CentraState Assisted Living, Inc. d/b/a Monmouth Crossing (Monmouth Crossing), CentraState Healthcare Foundation, Inc. (the Foundation), and Center for Aging, Inc. d/b/a Applewood (Applewood), wholly owned by The Manor. CSHS is the sole stockholder of CentraState Healthcare Services, Inc. (Healthcare Services), a for-profit corporation. Healthcare Services owns all of the membership interests of CentraState Medical Arts Building LLC (MAB), a limited liability company. CentraState Medical Associates, P.C. (Med Associates) is a controlled subsidiary of the Medical Center. In 2012, the System formed a captive insurance company domiciled in the Cayman Islands, CentraState Captive Insurance Company Ltd., SPC (the Cayman Captive), a wholly owned subsidiary of the Medical Center. The reporting entity resulting from the consolidation of these entities is referred to herein as the "System." All significant intercompany balances and transactions have been eliminated in consolidation. Although these entities have been consolidated for financial statement presentation, there may be limitations on the use of an entity's funds by another member of the group resulting from the charitable nature of some of the entities or other factors.

Summary information related to the entities follows:

The Medical Center is an acute care hospital whose mission is to provide the highest quality patient care for the central New Jersey community it serves. The Medical Center has 276 licensed beds. Applewood is a continuing care retirement community accredited by the Continuing Care Accreditation Committee. Applewood consists of 286 independent apartments, 20 cottages, 40 residential health care units, and a 60-bed skilled nursing facility. The Manor provides skilled nursing services for 123 elderly residential units including sub-acute, rehabilitation and I.V. therapy. Monmouth Crossing owns and operates an assisted

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

living facility for the elderly consisting of 76 units. The Foundation was established for the purpose of soliciting and investing funds for the benefit of the Medical Center and other not-for-profit entities of the System. Healthcare Services was established to provide various health care and related services to the community. MAB was organized to construct, develop, equip, and operate a medical arts building which offers state of the art ambulatory clinical programs. Med Associates was established for the purpose of aligning physician practices with the System.

Use of Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets, such as estimated uncollectibles for accounts receivable for services to patients, and liabilities, such as estimated settlements with third-party payors and professional insurance liabilities, and disclosures of contingent assets and liabilities at the date of the financial statements. Estimates also affect the amounts of revenue and expenses reported during the period. There is at least a reasonable possibility that certain estimates will change by material amounts in the near term. Actual results could differ from those estimates.

Cash and Cash Equivalents

The System considers all highly liquid investments with a maturity of three months or less at date of purchase to be cash and cash equivalents, except for amounts reported within short-term investments, assets limited as to use and other assets. The System does not hold any money market funds with significant liquidity restrictions that would require the funds to be excluded from cash equivalents.

Accounts Receivable

Accounts receivable include receivables for health care and residential services. Accounts receivable related to health care services for which the System receives payment under cost reimbursement, prospective payment formulae or negotiated rates, which cover the majority of health care services, are stated at the estimated net amount receivable from payors, which are generally less than the established billing rates.

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

The amount of the allowance for doubtful accounts is based on management's assessment of historical and expected collections, business economic conditions, trends in health care coverage, and other collection indicators. Additions to the allowance for doubtful accounts result from the provision for bad debts. Accounts written off as uncollectible are deducted from the allowance for doubtful accounts.

Investments and Investment Return

Investments in marketable securities are reported in the consolidated balance sheets at fair value based on quoted market prices. Investments that are readily marketable and which are not reported as assets limited as to use are considered short-term investments and are classified as current assets in the accompanying consolidated balance sheets. All investments in marketable securities are classified as trading securities.

Investments in joint ventures, which have been entered into by Healthcare Services and the Medical Center, are accounted for using the equity method.

All investment transactions are recorded on the dates such trades take place. The realized gain or loss resulting from these transactions is the difference between the proceeds received and the average historical cost of the assets sold. Interest income is recorded as earned. Dividends are recorded on the ex-dividend date. Investment return and net change in unrealized gains and losses on investments is included in the excess of revenue over expenses unless restricted by donor or law.

Assets Limited as to Use

Assets limited as to use include investments internally designated by the Board of Trustees and various external designations. Donor restricted assets limited as to use include assets held under split-interest agreements, such as charitable gift annuity agreements, under which the Foundation pays the designated beneficiaries a predetermined annual annuity amount.

Supplies

Supplies are reported in other current assets in the accompanying consolidated balance sheets and are carried at the lower of cost or market, determined using the average cost method. Supplies are used in the provision of patient care and are not held for sale.

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

Pledges Receivable

Through the fundraising activities of the Foundation, the System is the recipient of pledges which are recorded at the time the unconditional promise to give is made, at estimated net realizable value. The net realizable value of the outstanding pledges of approximately $500,000 and $1.8 million at December 31, 2016 and 2015, respectively, are reported within other current assets in the accompanying consolidated balance sheets. The amount of the allowance for uncollectible pledges is based on management's assessment of historical and expected collections and other collection indicators. Additions to the allowance for uncollectible pledges result from the provision for uncollectible pledges. Pledges written off as uncollectible are deducted from the allowance for uncollectible pledges. Pledges are discounted to net present value based on the scheduled payment terms of each pledge using a discount rate of 2.17% for each of the years ended December 31, 2016 and 2015.

Property, Plant, and Equipment

Property, plant, and equipment are stated at cost, except for donated equipment, which is recorded at fair value at the date of the gift. The System provides for depreciation on a straight-line basis over the estimated useful lives of such assets or the lease term, whichever is shorter. Amortization of equipment financed through capitalized lease obligations is included in depreciation and amortization expense.

Deferred Financing Costs

Deferred financing costs, net, are amortized over the period the related obligation is outstanding using the effective interest method. The System adopted ASU 2015-03, *Simplifying the Presentation of Debt Issuance Costs*, retrospectively, as required. As a result unamortized deferred financing costs of approximately $1.5 million and $1.6 million at December 31, 2016 and 2015, respectively, have been reported as direct deduction from long-term debt. See Note 7 for additional information relative to debt-related matters.

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

Deferred Marketing Costs

Deferred marketing costs, net, related to Applewood, totaled approximately $400,000 and $600,000 at December 31, 2016 and 2015, respectively, and are included in noncurrent assets in the accompanying consolidated balance sheets. Such costs relate to Applewood's expansion project and represent the direct marketing and contract processing costs associated with acquiring the initial residents for the expansion project's living units. The costs have been capitalized through the date of substantial occupancy (January 2007) and are amortized using the straight-line method based on a weighted average of the expected remaining lives of the related residents. Accumulated amortization at December 31, 2016 and 2015, is approximately $2.0 million and $1.8 million, respectively.

Other marketing and advertising costs incurred by the System are expensed as incurred and amounted to approximately $3.0 million and $3.2 million for the years ended December 31, 2016 and 2015, respectively.

Professional Liability Insurance

The System is insured for professional liability insurance through a wholly owned captive insurance company. Premiums paid by the System to the captive insurance company are determined annually based on claims-made coverage for health care professional liability on an occurrence basis for general liability and are actuarially determined based on the actual and estimated experience of the System, subject to retrospective adjustment in future periods. The System records the actuarially determined liabilities for estimated insurance losses and incurred but not reported in other noncurrent liabilities in the accompanying consolidated balance sheets. Insurance premium revenue and expenses are eliminated in consolidation.

Retirement Community Obligations

Residents of Applewood are required to pay a fee to obtain a nontransferable right to lifetime occupancy at Applewood. Current residents have selected one of four continuing care contract options: Traditional Plan, 90% Refund Plan, 50% Refund Plan, or Fee for Service Plan. Applewood also offers a 100% Refund Plan. The Traditional Plan specifies that advance fees are refundable to the resident on a declining balance basis amortized at 2% per month after residency is established.

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

These advance fees are recorded as refundable advance fees upon receipt and amortized to income using the straight-line method over the estimated remaining life expectancy of the resident, adjusted annually at the beginning of each year. The Fee for Service Plan requires residents to pay for health care related services on a fee for service basis.

Under the 90% and 50% Refund Plans, 10% and 50%, respectively, of the advance fees are nonrefundable. Nonrefundable fees are recorded as deferred revenue upon receipt and amortized to income using the straight-line method over the estimated remaining life expectancy of the resident, adjusted annually. The refundable portion of these plans are fully refundable solely from the resale proceeds upon reoccupancy of the resident's unit, reduced by fees earned through the resident's use of Applewood's health center. The refundable portion of fees received is recorded as deferred revenue upon receipt.

Applewood annually calculates the present value (using a discount rate of 5% in 2016 and 2015) of the estimated net cost of future services and the use of facilities to be provided to current residents and compares that amount with the balance of deferred revenue from advance fees and refundable advance fees. No additional liability to provide future services and use of facilities was required to be recorded at December 31, 2016 and 2015.

Classification of Net Assets

The System separately accounts for and reports donor restricted and unrestricted net assets. On a stand-alone financial reporting basis, the Medical Center, Applewood, Monmouth Crossing and The Manor recognize the balance and changes in their accumulated interest in the net assets of the Foundation. Amounts reported on a stand-alone basis are eliminated in consolidation.

Unrestricted net assets are not externally restricted for identified purposes by donors. Unrestricted net assets 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. Temporarily restricted net assets are those whose use is limited by the donor. When a temporary donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, restricted net assets are reclassified to unrestricted net assets and reported as net assets released from restriction.

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

Permanently restricted net assets represent assets held in perpetuity by the Foundation on behalf of the Medical Center and Applewood, the proceeds of which are available to support the Medical Center and Applewood programs and services. The System follows the requirements of the New Jersey Uniform Prudent Management of Institutional Funds Act (NJ UPMIFA) as they relate to its permanently restricted contributions and net assets. The System's investment and spending policies for endowment assets attempt to provide a predictable stream of funding to the endowment funds.

Net Patient Service Revenue and Residential Services Revenue

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

Residential services revenue is reported at the estimated net realizable amounts from the residents for services rendered.

Functional Expenses

The System provides general health care and other services. Expenses related to providing these services are as follows (in thousands):

	Year Ended December 31	
	2016	**2015**
Program services	**$ 252,875**	$ 240,651
Management and general	**61,559**	62,250
	$ 314,434	$ 302,901

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

Performance Indicator

The accompanying consolidated statements of operations include excess (deficiency) of revenue over expenses as the performance indicator. Changes in unrestricted net assets which are excluded from the performance indicator include net assets released from restriction for capital purposes.

Transactions deemed by management to be ongoing, major or central to the provision of health care services are reported within income from operations. Peripheral or incidental transactions are excluded from income from operations.

Income Taxes

The entities comprising the System, with the exception of Healthcare Services, MAB, and Med Associates, are not-for-profit organizations 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 organizations are also exempt from state and local income taxes.

Healthcare Services and Med Associates are for-profit entities; however, income tax expense and income tax paid for 2016 and 2015 were not significant. MAB is a single member limited liability company that is not recognized as a separate entity for tax purposes. For income tax purposes, the activities of MAB are treated as a division within its parent, Healthcare Services.

The System accounts for deferred tax assets and liabilities based on the differences between the financial reporting and tax basis of assets and liabilities using enacted tax rates and laws that will be in effect when differences are expected to reverse.

Reclassifications

Certain reclassifications have been made to 2015 balances previously reported in order to conform with the 2016 presentation.

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

Recent Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2014-09, *Revenue from Contracts with Customers*. The core principle of ASU 2014-09 is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The guidance in ASU 2014-09 supersedes the FASB's current revenue recognition requirements in Accounting Standards Codification Topic 605, *Revenue Recognition*, and most industry-specific guidance. The FASB subsequently issued ASU 2015-14, *Revenue from Contracts with Customers*, which deferred the effective dates of ASU 2014-09. Based on ASU 2015-14, the provisions of ASU 2014-09 are effective for the System for annual reporting periods beginning after December 15, 2017. The System has not completed the process of evaluating the impact of ASU 2014-09 on its consolidated financial statements.

In August 2014, the FASB issued ASU 2014-15, *Presentation of Financial Statements – Going Concern,* that requires management of public and nonpublic companies to evaluate and disclose where there is substantial doubt about an entity's ability to continue as a going concern. The standard is effective for annual periods ending after December 15, 2016, and for annual periods thereafter. Management adopted ASU 2014-15 for the year ended December 31, 2016. There was no effect on the accompanying consolidated financial statements or related disclosures.

In April 2015, the FASB issued ASU 2015-05, *Customer's Accounting for Fees Paid in a Cloud Computing Arrangement* ASU 2015-05 provides guidance to customers about whether a cloud computing arrangement includes a software license. If certain criteria are met, an entity may account for such an arrangement under the internal use software guidance included in Account Standards Codification ("ASC") 205-40, *Internal Use Software*, whereby amounts are capitalized. If such criteria are not met, the cloud computing arrangement is considered a service contract and related costs are expensed as incurred. ASU 2015-05 is effective for public business entities for fiscal years beginning after December 15, 2015 with the option to apply the guidance prospectively to all arrangements entered into or materially modified after the effective date or retrospectively The System adopted ASU 2015-05 prospectively as of January 1, 2016 with no effect on the 2016 consolidated financial statements.

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

In February 2016, the FASB issued ASU 2016-02, *Leases* that will require lessees to report most leases on their statements of financial position and recognize expenses on their income statement in a manner similar to 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 or another systematic and rational basis. The provisions of ASU 2016-02 are effective for the System for annual periods beginning after December 15, 2018, and interim periods thereafter. Early adoption is permitted. The System has not completed the process of evaluating the impact of ASU 2016-02 on its consolidated financial statements.

In August 2016, the FASB issued ASU 2016-14, *Not-for-Profit Financial Statement Presentation*, which eliminates the requirement for not-for-profits (NFPs) to classify net assets as unrestricted, temporarily restricted and permanently restricted. Instead, NFPs will be required to classify net assets as net assets with donor restrictions or without donor restrictions. Among other things, the guidance also modifies required disclosures and reporting related to net assets, investment expenses and qualitative information regarding liquidity. NFPs will also be required to report all expenses by both functional and natural classification in one location. The provisions of ASU 2016-14 are effective for the System for annual periods beginning after December 15, 2017 and interim periods thereafter. Early adoption is permitted. The System has not completed the process of evaluating the impact of ASU 2016-14 on its consolidated financial statements.

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 provisions of ASU 2016-15 are effective for the System for annual periods beginning after December 15, 2018 and interim periods thereafter. Early adoption is permitted. The System does not expect ASU 2016-15 to have a significant effect on its consolidated financial statements.

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

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 provisions of ASU 2016-18 are effective for the System for annual periods beginning after December 15, 2018 and interim periods thereafter. Early adoption is permitted. The System does not expect ASU 2016-18 to have a significant effect on its consolidated financial statements.

2. Charity Care

The System provides care to patients who meet certain criteria defined by the New Jersey Department of Health and Senior Services (DOHSS) without charge or at amounts less than established rates. The Medical Center's records identify and monitor the level of charity care it provides and include the amount of charges foregone for services and supplies furnished. The current DOHSS charity care guidelines require participation and cooperation of the patient in order to be identified as a charity care account. Management believes that the present charity care guidelines understate the System's charity care amounts and overstate the level of bad debts reported because of the difficulties involved with obtaining patient cooperation. The cost of charity care includes the direct and indirect cost of providing charity care services. The cost is estimated by utilizing a ratio of cost to gross charges applied to the gross uncompensated charges associated with providing charity care. The cost of charity care provided during the years ended December 31, 2016 and 2015, was approximately \$5.7 million and \$6.1 million, respectively. The System receives partial reimbursement for the charity care it provides (see Note 3).

3. Net Patient Service Revenue

The System recognizes accounts receivable and patient service revenue associated with services provided to patients who have third-party payor coverage on the basis of contractual rates for the services rendered (see description of third-party payor payment programs below). For uninsured patients that do not qualify for charity care, the System recognizes revenue on the basis of discounted rates under the System's self-pay patient policy. Under the policy for self-pay patients, a patient who has no insurance and is ineligible for any government assistance program has his or her bill reduced to 115% of the Medicare rates as per New Jersey regulation.

3. Net Patient Service Revenue (continued)

Patient service revenue for the years ended December 31, 2016 and 2015, net of contractual allowances and discounts (but before the provision for bad debts), recognized in the period from these major payor sources, is as follows (in thousands):

	2016	2015
Third-party payors	**$ 281,304**	$ 271,096
Self-pay	**4,984**	5,102
Total all payors	**$ 286,288**	$ 276,198

Accounts receivable are also reduced by an allowance for doubtful accounts. In evaluating the collectability of accounts receivable, the System 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. Management regularly reviews data about these major payor sources of revenue in evaluating the sufficiency of the allowance for doubtful accounts.

For receivables associated with services provided to patients who have third-party coverage, the System analyzes contractually due amounts and provides an allowance for doubtful accounts and a provision for bad debts, if necessary (for example, for expected uncollectible deductibles and copayments on accounts for which the third-party payor has not yet paid, or for payors who are known to be having financial difficulties that make the realization of amounts due unlikely). For receivables associated with self-pay patients which include both patients without insurance and patients with deductible and copayment balances due for which third-party coverage exists for part of the bill, the System records a significant provision for bad debts in the period of service on the basis of its past experience, which indicates that many patients are unable or unwilling to pay the portion of their bill for which they are financially responsible. The difference between discounted rates and the amounts actually collected after all reasonable collection efforts have been exhausted is charged off against the allowance for doubtful accounts.

The System's allowance for doubtful accounts totaled approximately $7.8 million and $7.4 million at December 31, 2016 and 2015, respectively. The allowance for doubtful accounts for self-pay patients was approximately 89% and 88% of self-pay accounts receivable as of December 31, 2016 and 2015, respectively. Overall, the total of self-pay discounts and write-offs has not changed significantly for the year ended December 31, 2016. The System has not experienced significant changes in write-off trends and has not changed its charity care policy for the year ended December 31, 2016.

3. Net Patient Service Revenue (continued)

Third-Party Payment Programs

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

Medicare: The System is paid for most Medicare inpatient and outpatient services under the national prospective payment system and other methodologies of the Medicare program for certain other services. Federal regulations provide for certain adjustments to current and prior years' payment rates, based on industry-wide and hospital-specific data. Medicare cost reports of the System have been audited and settled for years through 2010 at December 31, 2016.

Medicaid: Inpatient acute care services rendered to Medicaid program beneficiaries are paid at prospectively determined rates per discharge. Outpatient services rendered to Medicaid program beneficiaries are reimbursed under cost-based and fee schedule methodologies. The System is reimbursed for outpatient services at a tentative rate, with final settlement determined after submission of annual cost reports and audits thereof by the Medicaid fiscal intermediary. The Medicaid cost reports of the System for years through 2013 have been audited and settled.

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

The System has appealed certain items in audited cost reports. The outcome of these appeals is uncertain and, therefore, potential revenue associated with these appeals is not included within the accompanying consolidated statements of operations.

Net patient service revenue was increased by approximately $2.5 million and $70,000 for the years ended December 31, 2016 and 2015, respectively, for net adjustments and settlements related to prior years.

3. Net Patient Service Revenue (continued)

Revenue from the Medicare and Medicaid programs accounted for approximately 41% and 42% of the System's net patient service revenue for the years ended December 31, 2016 and 2015, respectively.

There are various proposals at the federal and state levels that could, among other things, significantly reduce payment rates or modify payment methods. The ultimate outcome of these proposals and other market changes, including the potential effects of health care reform that have been enacted by the federal government, cannot presently be determined. Future changes in the Medicare and Medicaid programs and any reduction of funding could have an adverse impact on the System.

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

The New Jersey Health Care Subsidy Fund was established for various purposes including the distribution of charity care payments to hospitals statewide. The following subsidy amounts have been included in net patient service revenue (in thousands):

	Year Ended December 31	
	2016	**2015**
Charity care	**$ 667**	$ 1,514
Special subsidy	**419**	419
Federal alien fund/Medicaid GME	**184**	153
Delivery System Reform Incentive Payment	**914**	541
	$ 2,184	$ 2,627

4. Investments and Assets Limited as to Use

Short-term Investments

Short-term investments consist of the following (in thousands):

	December 31	
	2016	**2015**
United States government obligations	**$ 28,594**	$ 33,293
Corporate bonds	**18,024**	16,672
Common stocks	**8,029**	7,032
Mutual funds	**98,358**	88,045
	153,005	145,042
Interest receivable	**176**	175
	$ 153,181	$ 145,217

Assets Limited as to Use

Assets limited as to use consist of the following (in thousands):

	December 31	
	2016	**2015**
Cash and cash equivalents	**$ 16,553**	$ 20,802
Common stocks	**2,053**	2,838
United States government obligations	**2,842**	3,602
Corporate bonds	**4,014**	3,624
Mutual funds	**5,209**	4,269
Total assets limited as to use	**30,671**	35,135
Less current portion	**2,042**	1,830
Assets limited as to use – noncurrent	**$ 28,629**	$ 33,305

4. Investments and Assets Limited as to Use (continued)

Assets limited as to use are limited to the following uses (in thousands):

	December 31 2016	2015
As directed by the Board of Trustees	**$ 4,855**	$ 4,858
By terms of indenture agreements	**5,399**	10,345
Estimated advance fee refunds	**2,022**	2,410
Supplemental executive retirement plan	**1,461**	2,003
By donor restrictions	**9,258**	6,949
Assets held in the Cayman Captive *(Note 8)*	**7,676**	8,570
	$ 30,671	$ 35,135

A summary of assets limited as to use by terms of indenture agreement is as follows (in thousands):

	December 31 2016	2015
Debt service principal fund	**$ 315**	$ 258
Debt service interest funds	**1,276**	1,142
Project funds	**–**	5,198
Debt service reserve funds	**3,808**	3,747
	$ 5,399	$ 10,345

4. Investments and Assets Limited as to Use (continued)

Investment Return

Investment return – unrestricted consists of the following (in thousands):

	Year Ended December 31 2016	2015
Revenue from operations:		
Interest and dividends	**$ 4,089**	$ 4,124
Net realized gains and losses	**87**	1,853
Net gain in equity of joint venture investments	**1,630**	1,623
	5,806	7,600
Nonoperating revenue:		
Net change in unrealized gains and losses on investments	**5,544**	(5,773)
Total investment return – unrestricted	**$ 11,350**	$ 1,827

5. Noncurrent Assets

Noncurrent assets consist of the following (in thousands):

	December 31 2016	2015
Investments in joint ventures	**$ 1,776**	$ 1,781
Investment in Vermont RRG *(Note 8)*	**1,349**	940
Other noncurrent assets	**1,979**	2,806
	$ 5,104	$ 5,527

Included in investments in joint ventures under which Healthcare Services holds 50% ownership interests are the following companies: CentraState Fitness & Wellness Center LLC (F&W), Freehold Venture Associates, LP, and CentraState Healthcare Network. F&W leases space from the Medical Center. The remaining term of the lease with the Medical Center is 15 years, with the option to renew for three terms of 10 years each (annual rental payments of approximately $500,000 per year). Distributions received from these joint ventures totaled approximately $1.9 million and $2.2 million for 2016 and 2015, respectively.

5. Noncurrent Assets (continued)

The Medical Center has invested cash for a minority interest and a note receivable in a proton therapy center located in Somerset, New Jersey. The note receivable is payable upon certain milestones; however, no later than twelve years from its issuance date (2022). During 2015, the Medical Center has fully reserved the $37.9 million note receivable (see Note 7).

6. Property, Plant, and Equipment

Property, plant, and equipment consist of the following (in thousands):

	December 31	
	2016	**2015**
Land	**$ 16,815**	$ 16,815
Land improvements	**8,015**	7,754
Buildings and fixtures	**281,917**	271,809
Equipment	**166,092**	158,741
	472,839	455,119
Less accumulated depreciation and amortization	**283,582**	267,451
Add construction in progress	**7,638**	6,254
	$ 196,895	$ 193,922

Equipment and facilities financed through capital lease obligations are included in the amounts above, including approximately $40,000 and $100,000 of unamortized equipment and facilities costs at December 31, 2016 and 2015, respectively. During 2016 and 2015, approximately $100,000 and $300,000 was amortized for these equipment and facilities costs, respectively.

7. Long-Term Debt and Capital Lease Obligations

Long-term debt and capital lease obligations consist of the following (in thousands):

	December 31	
	2016	**2015**
Series 2014 Bonds – Medical Center (a)	**$ 42,250**	$ 44,990
Series 2006A Bonds – Medical Center (b)	**37,965**	38,480
Series 2012 Note – Medical Center (c)	**25,663**	25,838
Series 2005B Bonds – Applewood (d)	**24,775**	25,680
Series 2000 Bonds – MAB (e)	**7,645**	8,225
Series 1998 Bonds – Monmouth Crossing (f)	**4,246**	4,582
Series 2010 CAP Loan – Medical Center (g)	**3,855**	4,781
Capital lease obligations at rates varying from 4.25% to 4.47%, collateralized by leased equipment and facilities with varying maturities through 2017	**61**	139
	146,460	152,715
Unamortized bond premium	**279**	298
Less:		
Unamortized bond discount	**13**	16
Current maturities	**9,413**	6,252
Deferred financing costs, net	**1,459**	1,618
Long-term debt and capital lease obligations, excluding current installments	**$ 135,854**	$ 145,127

(a) *CentraState Medical Center* – In 1998, the New Jersey Health Care Facilities Financing Authority (NJHCFFA) issued the Series 1998 Bonds on behalf of the Medical Center with an original issue discount of $2 million. The Series 1998 Bonds consisted of serial and term bonds with interest rates ranging between 4.50% and 4.65%, maturing through July 1, 2028. On August 14, 2014, the System fully refunded the outstanding Series 1998 Bond with proceeds from the issuance of Series 2014 Bonds.

7. Long-Term Debt and Capital Lease Obligations (continued)

The NJHCFFA issued approximately $48.1 million of Series 2014 Bonds on behalf of the Medical Center. In addition to the refunding of the Series 1998 Bonds the proceeds were used to construct a new information technology building and fund certain Medical Center renovations. At December 31, 2016, the bonds consist of approximately $29.8 million of Series 2014A bonds with an interest rate of 2.9%, maturing annually through July 1, 2028; approximately $3.7 million of Series 2014B bonds with an interest rate of 1.5%, maturing annually through July 1, 2018; and approximately $8.8 million of Series 2014C bonds with an interest rate of 3%, maturing annually through July 1, 2029. The 2014 bonds are collateralized by the gross receipts of the Medical Center and a first mortgage lien on certain of the Medical Center's real property.

(b) *CentraState Medical Center* – In December 2006, the NJHCFFA issued Series 2006A and Series 2006B Bonds (collectively, the Series 2006 Bonds), on behalf of the Medical Center. The net proceeds of the Series 2006 Bonds, together with an equity contribution from the Medical Center of approximately $11.3 million, were used by the Medical Center for the following: (i) fund the construction of an ambulatory campus comprised of a three-story outpatient facility, which includes a health awareness center and a medical fitness facility; (ii) finance upgrades to an MRI facility; (iii) fund a debt service reserve fund; (iv) pay the costs of issuance incurred in connection with the Series 2006 Bonds; and (v) fund approximately $15.0 million of future capital replacement purchases of equipment. The proceeds of the Series 2006 Bonds were also used to fully repay, in 2006, an unsecured, variable rate commercial loan.

The Series 2006A Bonds were issued with a net premium of approximately $500,000. At December 31, 2016, the Series 2006A Bonds consists of approximately $2.9 million in serial bonds maturing annually through July 2021 with interest rates ranging from 3.5% to 4.25%; approximately $3.5 million 4.125% term bonds due July 1, 2026; approximately $7.3 million 5.0% term bonds due July 1, 2030; and $24.3 million 4.5% term bonds due July 1, 2037. The Series 2006 Bonds are collateralized by the gross receipts of the Medical Center and a mortgage lien on certain of the Medical Center's real property. Payment of principal and interest on the Series 2006A Bonds is commercially insured. On June 1, 2012, the Medical Center redeemed the outstanding Series 2006B variable rate bonds with proceeds from the Series 2012 Note (see below).

7. Long-Term Debt and Capital Lease Obligations (continued)

(c) *CentraState Medical Center* – On April 26, 2012, the Medical Center executed a loan agreement for an approximately $26.5 million promissory note with a bank (the Series 2012 Note). Principal payments are due annually through July 1, 2037. The Series 2012 Note bears interest at a variable rate established monthly (1.91% and 1.39% at December 31, 2016 and 2015, respectively). The interest rate can be converted to a fixed rate, at the option of the Medical Center, pursuant to the loan agreement.

(d) *Applewood* – The Series 2005A, 2005B and Series 2005C Bonds (collectively, the 2005 Bonds) were issued to fund the construction and expansion of the Applewood project and for the repayment of NJEDA Variable Rate Revenue Bonds, Applewood Center for Aging, Inc., Series 1989 Bonds. The Series 2005C Bonds matured and were paid during 2010.

On May 18, 2012, the System funded an escrow account, held by a trustee, to pay the Series 2005A Bonds bondholders at future redemptions dates. In October of 2015, a final redemption occurred in the amount of $14.1 million.

The Series 2005B Bonds bear interest at variable rates currently determined weekly based on remarketing activities and not to exceed 10%. The interest rates can be converted to fixed rates, at the option of Applewood, pursuant to the loan agreements. At December 31, 2016 the Series 2005B Bonds consist of approximately $24.8 million of serial bonds maturing annually through 2035 with a weekly variable interest rate which was 0.68% and 0.01% at December 31, 2016 and 2015, respectively.

The holders of the Series 2005B Bonds have the right to tender their bonds for purchase on a weekly basis. Applewood has irrevocable letters of credit with a bank which provide security for the payment of the principal and interest on the Series 2005B Bonds. The reimbursement terms of the letter of credit are such that in the event that a bondholder demanded repayment on the Series 2005B Bonds, and adequate funds are not available from the remarketing of such bonds, the letter of credit would be drawn and Applewood would reimburse the letter of credit bank over a long-term period. The letter of credit is available up to the outstanding principal on the Series 2005B Bonds and expires on November 21, 2017. The reimbursement terms of the letter of credit also provide that the existing letter of credit will be drawn if a replacement letter of credit has not been executed prior to expiration and is to be paid over a long-term period. The letter of credit is collateralized by a security interest in the mortgage of Applewood's property, plant, and equipment and a security interest in the gross revenues and advance fees of Applewood.

7. Long-Term Debt and Capital Lease Obligations (continued)

(e) *CentraState Medical Arts Building* – On December 28, 2000, MAB issued the Series 2000 Bonds to finance the construction and equipping of the medical arts building. The Series 2000 Bonds mature December 1, 2025, with interest at a variable rate based on remarketing activities (not to exceed 15%, while the bonds bear interest at a weekly rate or 25% if the bonds are converted to a term rate) which was 0.84% and 0.14% at December 31, 2016 and 2015, respectively. The holders of the Series 2000 Bonds have the right to tender their bonds for purchase on a weekly basis. MAB has an irrevocable letter of credit with a bank, providing security for the payment of principal and interest on the Series 2000 Bonds. The letter of credit is collateralized by a first priority lien and security interests in substantially all of MAB's real property, assets, and leases (the Medical Center leases the medical arts building and the lease payment amounts are based on MAB's debt service under the Series 2000 Bonds). The reimbursement terms of the letter of credit are such that in the event that a bondholder demanded repayment on the bonds and adequate funds are not available from the remarketing of such bonds, the letter of credit would be drawn and MAB would reimburse the bank which issued the letter of credit over a long-term period. The letter of credit has been extended through several amendments and currently expires December 31, 2017. The reimbursement terms of the letter of credit also provide that the existing letter of credit will be drawn if a replacement letter of credit has not been executed prior to expiration and is to be paid over a long-term period. The available amount of the letter of credit at December 31, 2016, is approximately $7.8 million.

(f) *CentraState Assisted Living* – On December 24, 1998, the NJHCFFA issued approximately $8.0 million of CentraState Assisted Living Issue Revenue Bonds, Series 1998 (the Monmouth Crossing Bonds). The Monmouth Crossing Bonds are collateralized by a first mortgage lien on Monmouth Crossing's real property and its gross receipts. Repayment of the Monmouth Crossing Bonds is guaranteed by CSHS through maturity. The proceeds of this issue were used to fund the construction and equipping of Monmouth Crossing. The annual debt service requirements for the Monmouth Crossing Bonds initially included: (i) interest only payments beginning January 1, 1999 through and including November 1, 2001 at 4.57%; (ii) thereafter, to and including November 1, 2008, principal and interest based on a 25-year level payment schedule with interest at 4.57%; and (iii) thereafter, to and including November 1, 2018, principal and interest based on an 18-year level payment schedule with interest to be determined based on the then current average yield on United States Treasury Securities. As allowed under the existing agreements, effective December 1, 2007, Monmouth Crossing amended the interest terms of the Monmouth Crossing Bonds such that interest is fixed at 4.40% commencing November 1, 2008 through maturity (November 1, 2018).

7. Long-Term Debt and Capital Lease Obligations (continued)

(g) *CentraState Medical Center* – On November 30, 2010, the NJHCFFA approved a $10.0 million loan through the Hospital Capital Asset Financing Program (Series 2010 CAP Loan). The loan proceeds were used by the Medical Center for the relocation and expansion of the radiation oncology department, purchase of certain equipment, and costs associated with the financing. Principal payments are payable in monthly amounts sufficient to amortize the principal balance over a ten-year period until the maturity date of December 1, 2017 at which time all unpaid balance is due. The Series 2010 CAP Loan bears variable interest, which was 3.49% and 1.93% at December 31, 2016 and 2015, respectively. The Series 2010 CAP Loan is collateralized by the gross receipts of the Medical Center and a mortgage lien on certain of the Medical Center's real property.

Debt issued by each entity of the System is the sole responsibility of that entity, except for the Monmouth Crossing Bonds, which are guaranteed by CSHS.

Principal payments on long-term debt and capital lease obligations for the next five years and thereafter are as follows (in thousands):

	Long-Term Debt	Obligations Under Capital Leases	Total
2017	$ 9,352	$ 62	$ 9,414
2018	9,250	–	9,250
2019	5,605	–	5,605
2020	5,895	–	5,895
2021	6,105	–	6,105
Thereafter	110,192	–	110,188
	146,399	62	145,461
Less amounts representing interest	–	(1)	(1)
	$ 146,399	$ 61	$ 146,460

The Medical Center has a minority interest in a proton therapy center. In 2015 the Medical Center elected to fully reserve this investment. During 2015, the related $37.9 million reserve for bad debt – note receivable included in the accompanying consolidated statements of operations was excluded from the debt service computations in accordance with a Waiver and Forbearance Agreement dated November 9, 2015, that the System received from its creditors in anticipation of recording the reserve. This waiver and forbearance agreement remained in place through third quarter of 2016. At December 31, 2016, all debt covenants were met by the Medical Center.

7. Long-Term Debt and Capital Lease Obligations (continued)

At December 31, 2016 and 2015, the entities comprising the System were in compliance with the financial covenants of their respective loan agreements.

Interest paid under all borrowings for years ended December 31, 2016 and 2015, aggregated approximately $5.0 million and $4.9 million, respectively, net of capitalized interest.

8. Professional Liability Insurance

Through April 30, 2003, the System maintained claims-made professional liability coverage through a commercial insurance carrier.

Effective May 1, 2003, the System, in conjunction with other health care entities affiliated with the Robert Wood Johnson Health Network, participated in the formation of a captive insurance company, System and Affiliate Members, Limited, a Bermuda domiciled organization (the Bermuda Captive), to provide professional liability and general liability insurance to its participants at a primary level.

Effective January 1, 2013, the System withdrew from the Bermuda Captive and beginning as of this date primary professional and general liability insurance coverage is provided by the Cayman Captive (but not including Med Associates as to professional liability), including assumption of the period of claims that were previously covered by the Bermuda Captive. As discussed in Note 1, the Cayman Captive is a wholly owned subsidiary of the Medical Center. Assets held in the Cayman Captive at December 31, 2016 and 2015, total approximately $7.7 million and $8.6 million, respectively, which consists of cash and equity securities and are included in assets limited as to use in the accompanying consolidated balance sheets.

In February 2007, the System invested in a captive insurance company domiciled in Vermont (Vermont RRG) with one other health care entity affiliated with the Robert Wood Johnson Health Network to provide voluntary attending physicians insurance coverage. Premiums for the Vermont RRG are to be paid by the participating physicians; however, the participating hospitals were responsible for funding a portion of the Vermont RRG's initial capital and surplus requirements.

8. Professional Liability Insurance (continued)

However, because the other health care entity withdrew from the Vermont RRG in 2010, but was not permitted to withdraw its capital contribution, the System contends (although it is unclear whether) it would be subject to additional capital contributions in the future if the Vermont RRG capital requirements fell below the required level, however, management believes the likelihood of a material capital call to be remote.

During 2014, the obligations of the Vermont RRG for the periods 2007 through 2012 were transferred to a newly formed segregated cell in the Cayman Captive through a process called novation. This new cell was funded by assets previously held in the Cayman Captive. The System's investment in the Vermont RRG at December 31, 2016 and 2015, is approximately $1.3 million and $900,000, respectively, and is included in noncurrent assets in the accompanying consolidated balance sheets (see Note 5).

In 2012 the System invested approximately $250,000 into PIER Practice Solutions, LLC (PIER PS), a marketing, management and brokerage entity for a 50% ownership. The remaining 50% ownership is with a limited liability company owned by a former Member of the Board of Trustees, a related party. This former Board Member waived any dividends, distribution or profits associated with his 50% ownership interest, and such waiver is memorialized in the Operating Agreement of PIER PS. PIER PS was developed to manage the Cayman Captive and Vermont RRG.

Under the professional and general liability programs, as it pertains to the System, a self-insured retention exists for primary coverage. Through April 30, 2004, the self-insured retention covered individual claims up to $250,000 or total claims aggregating $750,000. Beginning May 1, 2004, the self-insured retention was increased to $500,000 for individual claims or total claims aggregating $1.5 million. Effective May 1, 2006, the self-insured retention was increased to $1.0 million for individual claims or total claims aggregating $3 million in the policy year, and has remained at the level since then. After the self-insured retention, the System carries a $20 million buffer policy and a $10 million excess umbrella liability policy with two separate commercial insurance carriers. As required by Vermont law, the System also carries a $1.0 million excess policy, above the aforementioned $20 million, with the Vermont RRG.

In addition, the System recorded actuarially determined liabilities related to claims incurred but not reported and amounts insured above the primary insurance coverage layer of approximately $900,000 and $800,000 at December 31, 2016 and 2015, respectively. The professional liabilities are undiscounted and are included in professional liability insurance and other noncurrent liabilities at approximately $6.0 million and $7.0 million at December 31, 2016 and 2015, respectively.

8. Professional Liability Insurance (continued)

As of January 1, 2012, the System is self-insured for workers' compensation claims through a large deductible, paid loss retro program with a commercial carrier. Approximately $70,000 and $300,000 is recorded as a liability at December 31, 2016 and 2015, respectively. Prior to January 1, 2012, workers' compensation claims were commercially insured on a fixed cost basis.

The System's estimates for professional liabilities are based upon complex actuarial calculations which utilize factors such as historical claims experience for the System and related industry factors, trending models, and estimates for the payment patterns of future claims. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term. The estimated professional liabilities recorded at December 31, 2016 and 2015, are subject to revision as actual experience or other factors impacting the estimates become known or are anticipated.

9. Pension Plans

The System sponsors a defined contribution pension plan (the 401(a) Plan) covering all eligible employees. Employees are eligible to participate in the 401(a) Plan following the completion of one year of service, as defined in the 401(a) Plan document, and the attainment of age 21. The System contributes a percentage of eligible salaries on an annual basis (5% for 2015 and 2014), net of forfeitures. Eligible salaries exclude certain items such as overtime. Additionally, the System sponsors another defined contribution plan (the 403(b) Plan) which prior to 2004 included only employee contributions. Beginning in 2004, the System contributes amounts to the 403(b) Plan based on a match of employee contributions. Pension expense under both pension plans aggregated approximately $6.9 million and $6.4 million for the years ended December 31, 2016 and 2015, respectively.

The System also sponsors a defined contribution supplemental executive retirement plan (SERP) for certain employees and a 457(b) eligible deferred compensation plan available to all executives. Total pension expense under the SERP plan was approximately $300,000 and $400,000 for the years ended December 31, 2016 and 2015, respectively.

10. Concentrations of Credit Risk

At December 31, 2016 and 2015, the System has its cash, including amounts classified within short-term investments, assets limited as to use and other noncurrent assets, deposited in several financial institutions. Investments in money market funds are not guaranteed by the U.S. government. Cash held in certain interest-bearing accounts is not fully insured. Exposure to any individual financial institution does not exceed 57% of the System's total cash balance. Management considers the credit risk related to these deposits to be minimal.

The System's health care providing entities grant credit without collateral to their patients, most of whom are local residents and are insured under third-party payor agreements. Concentrations of gross accounts receivable from patients and third-party payors were as follows:

	December 31	
	2016	**2015**
Medicare	**34%**	35%
Medicaid	**6**	7
Managed care – insurance companies	**36**	36
Commercial insurance	**1**	1
Other third-party payors	**7**	8
Patients	**16**	13
	100%	100%

11. Commitments and Contingencies

Various lawsuits and claims arising in the normal course of operations are pending or are on appeal against the System. Such lawsuits and claims are either specifically covered by insurance, included in estimated liabilities for self-insured exposure levels, 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 the System's actions will not have a material adverse effect on the System's consolidated financial position or results of operations.

11. Commitments and Contingencies (continued)

The System rents certain equipment under various noncancellable operating lease agreements. The following is a schedule by years of future minimum lease payments under noncancellable operating equipment leases as of December 31, 2016 (in thousands):

2017	$	1,207
2018		873
2019		842
2020		638
Thereafter		–

Rental expense charged to operations was approximately $1.0 million for the years ended December 31, 2016 and 2015.

Applewood is regulated by the New Jersey Department of Community Affairs pursuant to the Continuing Care Retirement Community Regulation and Financial Disclosure Act (the Act). The Act requires, among other things, that Applewood establish and maintain liquid reserves which generally are equal to the greater of 15% of the projected annual operating expenses (excluding depreciation) or the principal and interest due on the bonds in the next 12 months. Applewood has complied with that requirement at December 31, 2016 and 2015.

12. Other Revenue

Other revenue consists of the following (in thousands):

	Year Ended December 31	
	2016	**2015**
Residential services revenue, including amortization income of approximately $3.8 million and $3.4 million in 2016 and 2015, respectively	**$ 25,383**	$ 23,158
Rental income	**4,336**	4,281
Grants and community health programs	**551**	495
Electronic health records incentive payments	**57**	170
Net assets released from restriction for operations	**375**	390
Other	**7,218**	7,673
	$ 37,920	$ 36,167

13. Fair Value Measurements

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

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

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

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

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

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

13. Fair Value Measurements (continued)

Financial assets and liabilities carried at fair value as of December 31, 2016 and 2015, are classified in the table below in one of the three categories described above (in thousands):

	2016			
	Level 1	**Level 2**	**Level 3**	**Total**
Assets:				
Cash and cash equivalents – held for investments	**$ 16,553**	**$ –**	**$ –**	**$ 16,553**
United States government obligations	**31,436**	**–**	**–**	**31,436**
Corporate bonds	**5,950**	**16,088**	**–**	**22,038**
Common stocks – large cap	**10,035**	**47**	**–**	**10,082**
Mutual funds:				
Fixed income	**51,088**	**–**	**–**	**51,088**
Equities – small cap	**3,401**	**–**	**–**	**3,401**
Equities – large cap	**39,632**	**–**	**–**	**39,632**
International equity	**8,883**	**563**	**–**	**9,446**
	$ 166,987	**$ 16,698**	**$ –**	**$ 183,676**

	2015			
	Level 1	**Level 2**	**Level 3**	**Total**
Assets:				
Cash and cash equivalents – held for investments	$ 18,349	$ –	$ –	$ 18,349
United States government obligations	32,731	4,169	–	36,900
Corporate bonds	2,628	15,213	–	17,841
Common stocks – large cap	9,575	–	–	9,575
Mutual funds:				
Fixed income	52,291	–	–	52,291
Equities – small cap	2,450	–	–	2,450
Equities – large cap	36,078	–	–	36,078
International equity	6,693	–	–	6,693
	$ 160,795	$ 19,382	$ –	$ 180,177

13. Fair Value Measurements (continued)

Fair value for Level 1 is based upon quoted prices in active markets. Fair value for Level 2 is based on quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active and model-based valuation techniques for which all significant assumptions are observable in the market or can be corroborated by observable market data for substantially the full term of the assets. While the System believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different estimate of fair value at the reporting date. A financial instrument's categorization within the three levels of the valuation hierarchy is not indicative of the investment risk associated with the underlying assets.

The carrying values of cash, patient receivables, accounts payable and accrued expenses, other current assets and liabilities are reasonable estimates for fair value due to the short-term nature of these financial instruments. Carrying value approximates fair value for other noncurrent financial instruments, including notes receivable. At December 31, 2016 and 2015, the fair value of long-term debt obligations totaled approximately $152.1 million and $153.7 million at December 31, 2016 and 2015, respectively, excluding capital leases and unamortized premium and discount (see carrying value of long-term debt in Note 7). The fair value of long-term debt is classified as Level 2 in the fair value hierarchy, using techniques consistent with the market approach. The carrying value for the notes payable are reasonable estimates for fair value. Valuations for long-term debt are based on quoted market prices for related bonds.

14. Events Subsequent to December 31, 2016

Subsequent events have been evaluated through April 21, 2017, which is the date the consolidated financial statements were issued. No subsequent events have occurred that require disclosure in or adjustment to the consolidated financial statements.

Supplementary Information

CentraState Healthcare System, Inc.

Consolidating Balance Sheet

December 31, 2016
(With Comparative Consolidated Amounts at December 31, 2015)
(In Thousands)

							CentraState Healthcare Services, Inc.							
	CentraState Healthcare System, Inc.	**CentraState Medical Center, Inc.**	**Center for Aging, Inc.**	**CentraState Healthcare Affiliates, Inc.**	**CentraState Assisted Living, Inc.**	**CentraState Healthcare Foundation, Inc.**	**CentraState Healthcare Services, Inc.**	**CentraState Medical Arts Building LLC**	**Eliminations**	**CentraState Healthcare Services, Inc. Consolidated Total**	**CentraState Medical Associates, P.C.**	**Eliminations**	**CentraState Healthcare System, Inc. Consolidated Total 2016**	**2015**
Assets														
Current assets:														
Cash and cash equivalents	$ 37	$ 7,236	$ 4,841	$ 5,432	$ 1,432	$ 3,984	$ 385	$ 436	4 –	$ 821	$ 195	$ –	$ 23,978	$ 20,514
Short-term investments	–	126,777	23,239	2,850	315	–	–	–	–	–	–	–	153,181	145,217
Assets limited as to use-required for current liabilities	–	1,331	–	–	260	451	–	–	–	–	–	–	2,042	1,830
Accounts receivable, net	–	24,932	715	1,456	48	–	–	–	–	–	434	–	27,585	28,086
Due from affiliates	–	6,431	–	–	–	–	–	50	–	50	–	(6,481)	–	–
Other current assets	–	5,087	523	292	14	506	738	–	–	738	105	–	7,265	6,234
Total current assets	37	171,794	29,318	10,030	2,069	4,941	1,123	486	–	1,609	734	(6,481)	214,051	201,881
Assets limited as to use – noncurrent	–	17,800	2,022	–	–	8,807	–	–	–	–	–	–	28,629	33,305
Due from affiliates – noncurrent	–	4,829	–	–	–	273	2,186	2,649	–	4,835	–	(9,937)	–	–
Investment in subsidiary	–	–	–	–	–	–	3,834	–	(3,834)	–	–	–	–	–
Interest in CentraState Healthcare Foundation	–	11,692	3,209	67	6	–	–	–	–	–	–	(14,974)	–	–
Property, plant and equipment, net	–	128,573	47,005	3,022	6,008	132	4,034	7,993	–	12,027	128	–	196,895	193,922
Other assets – noncurrent	–	10,059	401	–	–	788	1,192	–	–	1,192	56	(7,392)	5,104	5,527
	$ 37	$ 344,747	$ 81,955	$ 13,119	$ 8,083	$ 14,941	$ 12,369	$ 11,128	$ (3,834)	$ 19,663	$ 918	$ (38,784)	$ 444,679	$ 434,635

CentraState Healthcare System, Inc.

Consolidating Balance Sheet (continued)

December 31, 2016
(With Comparative Consolidated Amounts at December 31, 2015)
(In Thousands)

							CentraState Healthcare Services, Inc.							
	CentraState Healthcare System, Inc.	CentraState Medical Center, Inc.	Center for Aging, Inc.	CentraState Healthcare Affiliates, Inc.	CentraState Assisted Living, Inc.	CentraState Healthcare Foundation, Inc.	CentraState Healthcare Services, Inc.	CentraState Medical Arts Building LLC	Eliminations	CentraState Healthcare Services, Inc. Consolidated Total	CentraState Medical Associates, P.C.	Eliminations	CentraState Healthcare System, Inc. Consolidated Total 2016	CentraState Healthcare System, Inc. Consolidated Total 2015
Liabilities and net assets														
Current liabilities:														
Current maturities of long-term debt and capital lease obligations	$ –	$ 7,506	$ 940	$ –	$ 347	$ –	$ –	$ 620	$ –	$ 620	$ –	$ –	$ 9,413	$ 6,252
Accounts payable and accrued expenses	–	34,608	1,750	1,221	542	113	44	81	–	125	836	–	39,195	35,495
Due to affiliates – current	–	50	425	351	163	3,278	1,420	–	–	1,420	794	(6,481)	–	–
Estimated third-party payer settlements, current	–	1,906	–	–	–	–	–	–	–	–	–	–	1,906	3,905
Other current liabilities	–	998	–	–	–	80	–	–		–	–	–	1,078	1,101
Total current liabilities	–	45,068	3,115	1,572	1,052	3,471	1,464	701	–	2,165	1,630	(6,481)	51,592	46,753
Long-term debt and capital lease obligations, excluding current installments	–	101,463	23,549	–	3,876	–	–	6,966	–	6,966	–	–	135,854	145,127
Due to affiliates – non-current	–	2,649	–	–	–	–	5,102	–	–	5,102	2,186	(9,937)	–	–
Professional liability insurance and other noncurrent liabilities	–	7,558	–	–	–	–	39	–	–	39	–	–	7,597	9,470
Estimated third-party payer settlements, noncurrent	–	5,201	111	44	–	–	–	–	–	–	–	–	5,356	6,592
Deferred rev from advance fees and ref advanced fees	–	–	51,582	–	–	–	–	–	–	–	–	(7,392)	44,190	42,072
Total liabilities	–	161,939	78,357	1,616	4,928	3,471	6,605	7,667	–	14,272	3,816	(23,810)	244,589	250,014
Commitments and contingencies														
Net assets:														
Unrestricted	37	171,116	389	11,436	3,149	(3,504)	5,764	3,461	(3,834)	5,391	(2,898)	–	185,116	171,870
Temporarily restricted	–	11,192	3,095	67	6	14,360	–	–	–	–	–	(14,360)	14,360	12,137
Permanently restricted	–	500	114	–	–	614	–	–	–	–	–	(614)	614	614
Total net assets	37	182,808	3,598	11,503	3,155	11,470	5,764	3,461	(3,834)	5,391	(2,898)	(14,974)	200,090	184,621
	$ 37	$ 344,747	$ 81,955	$ 13,119	$ 8,083	$ 14,941	$ 12,369	$ 11,128	$ (3,834)	$ 19,663	$ 918	$ (38,784)	$ 444,679	$ 434,635

CentraState Healthcare System, Inc.

Consolidating Statement of Operations

Year Ended December 31, 2016
(With Comparative Consolidated Amounts for the Year Ended December 31, 2015)
(In Thousands)

							CentraState Healthcare Services, Inc.						CentraState Healthcare System, Inc. Consolidated Total	
	CentraState Healthcare System, Inc.	**CentraState Medical Center, Inc.**	**Center for Aging, Inc.**	**CentraState Healthcare Affiliates, Inc.**	**CentraState Assisted Living, Inc.**	**CentraState Healthcare Foundation, Inc.**	**CentraState Healthcare Services, Inc.**	**CentraState Medical Arts Building LLC**	**Eliminations**	**CentraState Healthcare Services, Inc. Consolidated Total**	**CentraState Medical Associates, P.C.**	**Eliminations**	**2016**	**2015**
Revenue:														
Net patient service revenue	$ –	$ 266,927	$ –	$ 15,182	$ –	$ –	$ –	$ –	$ –	$ –	$ 4,179	$ –	$ 286,288	$ 276,198
Provision for bad debts	–	(7,654)	–	(311)	–	–	–	–	–	–	–	–	(7,965)	(6,832)
Net patient service revenue, less provision for bad debt accounts	–	259,273	–	14,871	–	–	–	–	–	–	4,179	–	278,323	269,366
Other revenue	–	8,037	21,510	54	5,346	39	1,763	1,230		2,993	1,471	(1,530)	37,920	36,167
Investment return	–	3,542	764	81	5	112	1,754		–	1,754	(221)	(231)	5,806	7,600
Total revenue	–	270,852	22,274	15,006	5,351	151	3,517	1,230	–	4,747	5,429	(1,761)	322,049	313,133
Expenses:														
Salaries and wages	–	111,271	7,771	6,360	2,608	–	–	–	–	–	4,611	–	132,621	127,101
Employee benefits	–	27,074	1,939	1,637	741	–	–	–	–	–	939	–	32,330	31,903
Professional fees	–	5,802	–	–	–	–	–	–	–	–	–	–	5,802	6,064
Supplies and other expenses	–	103,111	7,568	5,044	1,177	1,088	3,628	433	–	4,061	289	(1,530)	120,808	115,648
Depreciation and amortization	–	13,895	2,498	503	423	39	195	314	–	509	51	–	17,918	17,276
Interest expense and amortization of financing costs	–	3,589	783	–	209	–	232	191	–	423	182	(231)	4,955	4,909
Total expenses	–	264,742	20,559	13,544	5,158	1,127	4,055	938	–	4,993	6,072	(1,761)	314,434	302,901
Income (loss) from operations	–	6,110	1,715	1,462	193	(976)	(538)	292	–	(246)	(643)	–	7,615	10,232
Reserve for bad debt – note receivable	–	–	–	–	–	–	–	–	–	–	–	–	–	(37,986)
Net change in unrealized gains and losses on investments	–	4,757	642	3	1	141	–	–	–	–	–	–	5,544	(5,773)
(Deficiency) excess of revenue over expenses	–	10,867	2,357	1,465	194	(835)	(538)	292	–	(246)	(643)	–	13,159	(33,527)
Net assets released from restrictions for capital purposes	–	87	–	–	–	–	–	–	–	–	–	–	87	77
Change in unrestricted net assets	$ –	$ 10,954	$ 2,357	$ 1,465	$ 194	$ (835)	$ (538)	$ 292	$ –	$ (246)	$ (643)	$ –	$ 13,246	$ (33,450)

CentraState Healthcare System, Inc.

Consolidating Statement of Changes in Net Assets

Year Ended December 31, 2016
(With Comparative Consolidated Amounts for the Year Ended December 31, 2015)
(In Thousands)

							CentraState Healthcare Services, Inc.							
	CentraState Healthcare System, Inc.	CentraState Medical Center, Inc.	Center for Aging, Inc.	CentraState Healthcare Affiliates, Inc.	CentraState Assisted Living, Inc.	CentraState Healthcare Foundation, Inc.	CentraState Healthcare Services, Inc.	CentraState Medical Arts Building LLC	Eliminations	CentraState Healthcare Services, Inc. Consolidated Total	CentraState Medical Associates, P.C.	Eliminations	CentraState Healthcare System, Inc. Consolidated Total 2016	2015
Unrestricted														
Net assets as of beginning of year	$ 37	$ 160,162	$ (1,968)	$ 9,971	$ 2,955	$ (2,669)	$ 6,302	$ 3,169	$ (3,834)	$ 5,637	$ (2,255)	$ –	$ 171,870	$ 205,320
Change in unrestricted net assets	–	10,954	2,357	1,465	194	(835)	(538)	292	–	(246)	(643)	–	13,246	(33,450)
Net assets as of end of year	$ 37	$ 171,116	$ 389	$ 11,436	$ 3,149	$ (3,504)	$ 5,764	$ 3,461	$ (3,834)	$ 5,391	$ (2,898)	$ –	$ 185,116	$ 171,870
Temporarily restricted														
Net assets as of beginning of year	$ –	$ 9,949	$ 2,118	$ 65	$ 5	$ 12,137	$ –	$ –	$ –	$ –	$ –	$ (12,137)	$ 12,137	$ 10,600
Change in beneficial interest in CentraState Healthcare Foundation, Inc.	–	1,243	977	2	1		–	–	–	–	–	(2,223)	–	–
Contributions, Investment return and other	–	–	–	–	–	2,685	–	–	–	–	–	–	2,685	2,004
Net assets released from restrictions used for operations	–	–	–	–	–	(375)	–	–	–	–	–	–	(375)	(390)
Net assets released from restrictions for capital purposes	–	–	–	–	–	(87)	–	–	–	–	–	–	(87)	(77)
Change in net assets	–	1,243	977	2	1	2,223	–	–	–	–	–	(2,223)	2,223	1,537
Net assets as of end of year	$ –	$ 11,192	$ 3,095	$ 67	$ 6	$ 14,360	$ –	$ –	$ –	$ –	$ –	$ (14,360)	$ 14,360	$ 12,137
Permanently restricted														
Net assets at beginning of year	$ –	$ 500	$ 114	$ –	$ –	$ 614	$ –	$ –	$ –	$ –	$ –	$ (614)	$ 614	$ 614
Change in net assets	–	–	–	–	–	–	–	–	–	–	–	–	–	–
Net assets as of end of year	$ –	$ 500	$ 114	$ –	$ –	$ 614	$ –	$ –	$ –	$ –	$ –	$ (614)	$ 614	$ 614

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