

University Hospital
(A Component Unit of the State of New Jersey)

Secondary Disclosure Statement

March 31, 2018

The quarterly financial reports of University Hospital (the Hospital) are intended to reasonably reflect the financial condition of the Hospital as of the end of each quarter of the fiscal year. **THE QUARTERLY REPORTS ARE NOT BASED UPON AUDITED FINANCIAL INFORMATION.** Each quarterly report includes all known adjustments to present a fair statement of the Hospital's results of operations and financial position at the end of the quarter. While the Hospital makes reasonable good faith efforts to prepare these reports to reflect the financial condition at the end of each quarter, the reader must be aware that there may be subsequent adjustments made at the end of the fiscal year, including any adjustments made during the Hospital's annual audit, that relate back to prior quarters. Certain of the discussions included in the FY2018 Revenue and Expense Budget Assumptions of the quarterly report may include —forward-looking statements which involve known and unknown risks and uncertainties inherent in the operation of healthcare facilities. In particular, statements preceded by, followed by or that include the words expected, anticipated, or possible or other similar expressions are or may constitute forward-looking statements. No information or statement in this report is intended to suggest or guarantee any future performance or results in future quarters. The Hospital does not intend to update any forward-looking statements and undertakes no duty to any person to provide any such update under any circumstances.

UNIVERSITY HOSPITAL
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Balance Sheet

March 31, 2018

Unaudited

Assets	Business-Type Activities - UH March 31, 2018	Business-Type Activities - UH June 30, 2017	Increase/(Decrease)
Current assets:			
Cash	\$ 66,252	\$ 76,211	\$ (9,959)
Restricted investments	3,026	6,042	(3,016)
Patient accounts receivable, net	85,618	78,814	6,804
Due from State of New Jersey	5,187	5,806	(619)
Supplies	17,847	18,231	(384)
Grants receivable	2,105	1,292	813
Other current assets	35,020	30,299	4,721
Total current assets	215,055	216,695	(1,640)
Noncurrent assets:			
Restricted investments, net	100,418	104,849	(4,431)
Prepaid Bond Insurance	16,290	16,730	(440)
Capital assets, net	197,557	196,299	1,258
Total noncurrent assets	314,265	317,878	(3,613)
Total assets	529,320	534,573	(5,253)
Deferred Outflows of Resources			
Change in pension plan assumptions and deferred contributions	127,597	151,245	(23,648)
	656,917	685,818	(28,901)
Liabilities			
Current liabilities:			
Accounts payable and accrued expenses	29,478	32,545	(3,067)
Accrued salaries and related payroll taxes	15,710	12,698	3,012
Accrued vacation and sick pay	12,561	12,614	(53)
Due to Rutgers University	36,025	24,709	11,316
Current portion of accrued claims liability	4,971	4,971	-
Estimated third-party payor settlements, net	2,404	3,914	(1,510)
Current portion of long-term debt and capital lease obligation	133	207	(74)
Other current liabilities	39	249	(210)
Total current liabilities	101,321	91,907	9,414
Noncurrent liabilities:			
Accrued claims liability, net of current portion	21,695	21,695	-
Capital lease obligation, net of current portion	76,487	76,497	(10)
Long-term debt, net	269,312	269,983	(671)
Pension liability	581,452	552,097	29,355
Total noncurrent liabilities	948,946	920,272	28,674
Total liabilities	1,050,267	1,012,179	38,088
Deferred Inflows of Resources			
Net difference between projected and actual earnings on pension plan investments	997	-	997
	997	-	997
Net Position			
Net position:			
Net investment in capital assets	14,524	12,558	1,966
Restricted for debt service	3,026	6,022	(2,996)
Unrestricted	(411,897)	(344,941)	(66,956)
Total net position	(394,347)	(326,361)	(67,986)
Total liabilities and net position	\$ 656,917	\$ 685,818	\$ (28,901)

UNIVERSITY HOSPITAL
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Statements of Revenue, Expenses and Changes in Net Position

	Business-Type Activities - UH For the Nine Months Ended March 31, 2018	Business-Type Activities - UH For the Nine Months Ended March 31, 2017	Increase/(Decrease)
Operating revenues:			
Net patient service revenue	\$ 383,306	\$ 369,162	\$ 14,144
Grants revenue	3,614	3,244	370
Other revenue	13,726	18,857	(5,131)
Total operating revenues	<u>400,646</u>	<u>391,263</u>	<u>9,383</u>
Operating expenses:			
Personnel services	194,790	184,016	10,774
Contracted physician and resident fees	60,258	58,182	2,076
Fringe benefits	75,900	74,398	1,502
Pension	54,000	22,500	31,500
Supplies and other expenses	162,288	158,251	4,037
Depreciation	17,070	14,985	2,085
Total operating expenses	<u>564,306</u>	<u>512,332</u>	<u>51,974</u>
Operating loss	(163,660)	(121,069)	(42,591)
Nonoperating income (expenses):			
Appropriations from State of New Jersey	105,780	97,381	8,399
Interest income	662	184	478
Interest expense	(11,386)	(11,398)	12
Loss before other changes in net position	<u>(68,604)</u>	<u>(34,902)</u>	<u>(33,702)</u>
Other changes in net position:			
Capital contributions funded by grantors and donors	618	929	(311)
Total other changes in net position	<u>618</u>	<u>929</u>	<u>(311)</u>
Decrease in net position	(67,986)	(33,973)	(34,013)
Net position at beginning of year	(326,361)	(264,507)	(61,854)
Net position at 03/31/2018	<u>\$ (394,347)</u>	<u>\$ (298,480)</u>	<u>\$ (95,867)</u>

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Notes to the Financial Statements

As of and for the Nine Month Period Ended March 31, 2018

(1) Organization

In accordance with Public Law 2012, c. 45, the New Jersey Medical and Health Sciences Education and Restructuring Act (the Restructuring Act), effective July 1, 2013, University Hospital (the Hospital or UH), a public institution of healthcare and a body politic of the State of New Jersey (the State) was separated from University of Medicine and Dentistry of New Jersey (UMDNJ) as a new stand-alone entity and will continue to be the primary teaching hospital for the Newark-based schools of the Rutgers School of Biomedical and Health Sciences. The Hospital shall maintain its public mission to provide a comprehensive healthcare program and services to the greater Newark community, including outreach and mobile health services as well as services in collaboration with the Newark-based schools of the Rutgers School of Biomedical and Health Sciences. The Hospital is committed to act in accordance with the spirit and intent of the “Agreements Reached between Community and Government Negotiators Regarding New Jersey College of Medicine and Dentistry and Related Matters of April 30, 1968.”

The Hospital is a component unit of the State of New Jersey, and accordingly, its financial statements are included in the State of New Jersey’s Comprehensive Annual Financial Report.

The financial statements does not include Newark AIDS Consortium, Inc. (d/b/a Broadway House for Continuing Care) and Subsidiary (BHCC) which was incorporated in April 1992. BHCC and its consolidated subsidiary are exempt from federal, state, and local income taxes as 501(c) (3) organizations under the Internal Revenue Code. The Hospital is the sole corporate member and appoints a voting majority of the governing board of BHCC. The Hospital has the ability to impose its will on BHCC.

(2) Summary of Significant Accounting Policies

The Hospital’s significant accounting policies are as follows:

(a) Basis of Presentation

The financial statements have been prepared on the accrual basis using the economic resources measurement focus.

(b) Cash

Cash represent operating cash that is unrestricted with original maturities of three months or less at the date of purchase. The carrying amount of cash approximates fair value due to short-term nature.

(c) Restricted Investments

Restricted investment primarily includes assets held by a trustee, TD Bank, National Association under bond resolution. Amounts required to meet current liabilities of the Hospital have been classified as current assets in the statement of net position. Interest income earned on restricted investments is included in non-operating income (expenses).

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Restricted investments at March 31, 2018 and June 30, 2017, are invested in U.S. Treasury Obligations and are recorded at fair value based on quoted market prices, which are Level 1 investments in the FV hierarchy.

(d) *Charity Care*

The Hospital provides care to patients who meet certain criteria under its charity care policy at amounts less than its charges or established rates. The Hospital does not pursue collection of amounts determined to qualify as charity care, and they are not reported as revenue.

(e) *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 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 may differ from those estimates.

(f) *Classifications of Revenues and Expenses*

All transactions deemed by management to be ongoing, major, or central to the provision of healthcare services are considered to be operating activities and are reported as operating revenues and operating expenses. Appropriations from State of New Jersey, interest income, and interest expense are reported as non-operating income and expenses. Other changes in net position, which are excluded from income before other changes in net position, consist of capital contributions funded by grantors or donors.

(g) *Patient Accounts Receivable and Net Patient Service Revenue*

The Hospital has agreements with certain third-party payers that provide for payments at amounts different from its charges or established rates. Payment arrangements include prospectively determined rates, discounted charges, and per diem payments. Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payers, and others for services rendered, including estimated third-party payer settlements resulting from audits, reviews, and investigations. These estimated third-party payer settlements are accrued in the period in which the related services are rendered and adjusted in future periods as revised information becomes known or as years are no longer subject to such audits and reviews. For the fiscal nine month period ending March 31, net patient revenue is reported net of the provision for bad debts of \$114.8 million in 2018 and \$100.6 million in 2017.

The allowance for doubtful patient accounts is the Hospital's estimate of the amount of probable credit losses in its patient accounts receivable. The Hospital determines the allowance based on collection studies and historical write-off experience. Past-due balances are reviewed individually for collectability. Account balances are charged off against the allowance after all means of collection have been exhausted and the potential for recovery is considered remote. The allowance for estimated doubtful accounts at March 31, 2018 is \$229.7 million and at June 30, 2017 is \$229.2 million.

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(h) *Appropriations from State of New Jersey*

State appropriation revenues are recognized in the fiscal year during which the State appropriates the funds for the Hospital. The Hospital is fiscally dependent upon these appropriations. Funds appropriated from the State are payments, either directly or indirectly, for services rendered by the Hospital. The Hospital classifies them as non-operating revenues.

The Hospital records both revenues and expenses in an amount equal to expenditures made on its behalf by the State, that is, fringe benefits of the Hospital's employees.

The State pays on behalf of the Hospital for fringe benefits of employees, medical malpractice settlements, negligence, and other torts. The fringe benefits of employees paid by the State for the nine month period ending March 31, 2018 were \$72.9 million and for the nine month period ending March 31, 2017 were \$72.0 million. The State paid the Hospital appropriations of \$32.8 million for the nine month period ending March 31, 2018 and \$25.4 million for the nine month period ending March 31, 2017 to support Hospital operations.

All State aid to the Hospital is subject to and dependent upon appropriations being made for such purpose by the New Jersey State Legislature (the "State Legislature"). The State Legislature has no legal obligation to make such appropriations.

(i) *Government and Private Grants and Contracts*

Grants and contracts revenues comprise mainly funds received from grants and contracts from federal, state, other governments and private sources and are recognized when all eligibility requirements for revenue recognition are met, which is generally the period in which the related expenses are incurred.

(j) *Prepaid Bond Insurance*

Prepaid bond insurance costs of \$17.6 million represent costs incurred in connection with the issuance of Series 2015A bonds and are amortized on a straight-line method over the life of the bonds. Accumulated amortization of prepaid bond insurance costs amounted to \$1.3 million and \$0.9 million at March 31, 2018 and June 30, 2017, respectively.

(k) *Capital Assets and Depreciation*

Capital assets are recorded at cost or in the case of donated assets at fair value at the date of acquisition. Major renewals and improvements are capitalized while maintaining repairs are expensed when incurred. The State retains legal title to the land, buildings and improvements as of July 1, 2013 and thereafter and subleases them to the Hospital for \$1 until June 30, 2089. The Hospital is sole beneficiary as to the use of the capital assets and is responsible for their control and maintenance. Accordingly, the capital assets have been capitalized in the accompanying statement of net position.

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Depreciation is computed on a straight-line basis using estimated useful lives in accordance with American Hospital Association guidelines:

Land improvements	2 to 25 years
Buildings and leasehold improvements	5 to 40 years
Equipment	3 to 25 years

Capital assets under capital lease obligations are depreciated over either the lease term or the estimated useful life.

(l) Supplies

Supplies are stated at the lower of cost (first-in, first-out method) or market (net realizable value).

(m) Income Taxes

The Hospital qualifies as a governmental entity not subject to federal income tax, by reason of the organization being a state or political subdivision thereof, or an integral part of a state or political subdivision thereof; or, an entity all of whose income is excluded from gross income for federal income tax purposes under section 115 of the Internal Revenue Code of 1986. Accordingly, no provision for income taxes has been made in the accompanying financial statements.

(n) Due from State of New Jersey

Due from State of New Jersey represents reimbursements due for fringe benefits paid by the Hospital for employees covered by the State of New Jersey benefit plans.

(o) Grants Receivable

Grants receivable relate to various healthcare provision programs under contract with the State and other grantors. Grants receivable, which are reimbursed to the Hospital for providing such services, relate to Urban Security Initiative, North Star, and New Jersey Department of Health grants.

(p) Net Position

Net positions of the Hospital are classified in various components. *Net investment in capital assets* consist of capital assets net of accumulated depreciation and reduced by outstanding borrowings used to finance the purchase or construction of those assets. *Restricted expendable net position* are noncapital net assets that must be used for a particular purpose, as specified by creditors, grantors, or donors external to the Hospital, including amounts deposited with trustee as required by bond indentures, discussed in note 6. *Unrestricted net position* is remaining net position that does not meet the definition of *Net investment in capital assets or restricted*. The Hospital first applies restricted resources when unrestricted resources are available for the same purpose.

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(q) *Compensated Absences*

The Hospital's employees earn vacation and holiday days at varying rates depending on years of service and title. Generally, vacation and holiday time may accumulate up to specified maximums, depending on title. Upon resignation or retirement, employees are paid for unused vacation and holiday days, most at the current rate. Employees accrue sick leave at a fixed rate and there is no accumulation limit on sick leave.

(r) *Retirement Plans*

Under GASB 68, *Accounting and Financial Reporting for Pensions*, the Hospital recorded pension expense, pension liability, deferred outflows of resources and deferred inflows of resources related to cost sharing multi-employer pension plan for its proportionate share of collective pension expense, collective pension liability, and collective deferred outflows of resources and deferred inflows of resources.

(s) *Accrued Claims Liability*

Accrued claims liability represents estimated amounts payable related to workers compensation claims.

(t) *Fair Value*

Management determines fair value of financial instruments as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Management utilizes valuation techniques that maximize the use of observable inputs (Levels 1 and 2) and minimize the use of unobservable inputs (Level 3) within the fair value hierarchy established by GASB. Financial assets and liabilities carried at fair value are classified and disclosed in one of the following categories:

Level 1: Fair value measurements using unadjusted quoted market prices in active markets for identical, unrestricted assets or liabilities.

Level 2: Fair value measurements using observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities, quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially that full term of the assets or liabilities. Level 2 assets and liabilities include debt securities with quoted market prices that traded less frequently than exchange-traded instruments.

Level 3: Fair value measurements using significant inputs that are not readily observable in the market and are based on internally developed models or methodologies utilizing significant inputs that are generally less readily observable.

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As of and for the Nine Month Period Ended March 31, 2018

(3) Cash

Custodial credit risk is the risk that, in the event of a bank failure, the Hospital's deposits may not be returned to it. At March 31, 2018 the actual amount of cash and cash equivalents in the Hospital's bank accounts was \$69.2 million (with \$2.9 million in outstanding checks). As of May 29, 2015 a Tri-Party collateral agreement was established between the Hospital, the Bank of America, N.A. and the Bank of New York Mellon to collateralize the Hospital's cash.

(4) Charity Care

The Hospital maintains records to identify and monitor the level of charity care it provides. These records include the amount of charges forgone for services furnished under its charity care policy and the estimated cost of those services. The amount of uncompensated care provided to indigent and the broader community for the nine month period ended March 31, are as follows:

	March 31, 2018	March 31, 2017
<i>Charity Care:</i>		
Charges foregone, based upon established rates	\$ 194,097	\$ 173,315
Estimated cost incurred to provide charity care	54,310	45,062

The following information measures the level of charges and cost as related to bad debts for the nine month period ended March 31, are as follows:

	March 31, 2018	March 31, 2017
<i>Provision for Bad Debt:</i>		
Charges foregone, based upon established rates	\$ 114,851	\$ 100,634
Estimated cost incurred to provide bad debt	32,137	26,165

The Hospital only includes charges for patient services in this category for individuals who complied with the New Jersey Department of Health's criteria for qualification into the Charity Care Subsidy formula. These criteria require a patient's cooperation and documentation to participate. The Hospital believes that a large number of its patient accounts that default to bad debts are in fact, charity care cases, but due to a patients' unwillingness or inability to provide the documentation, such cases do not qualify.

The Hospital received \$36.1 million and \$30.3 million from the State's Charity Care Subsidy Fund for the fiscal nine month period ended March 31, 2018 and 2017, respectively, of reimbursement associated with cost of bad debt and charity care.

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(5) Patient Accounts Receivable, net and Net Patient Service Revenue

Most of the Hospital's net patient service revenue is from funds received on behalf of patients under governmental health insurance plans. Revenue from these governmental plans is based upon relevant reimbursement principles and is subject to audit by the applicable payers. Certain payers have performed audits and have proposed various disallowances, which other payers may similarly assert.

Included in net patient service revenue are adjustments to prior year estimated third-party payer settlements that were originally recorded in the period the related services were rendered. The adjustments to prior year estimates and other third-party reimbursement receipts or recoveries that relate to prior years resulted in an increase to net patient service revenues.

The components of net patient service revenue for the nine month period ended March 31, are as follows:

	<u>March 31, 2018</u>	<u>March 31, 2017</u>
Gross Charges	\$ 2,016,741	\$ 1,969,382
Additions (deductions) from gross charges:		
Health Care Subsidy Fund Payments	50,341	40,724
Contractual and other allowances	(1,568,925)	(1,540,310)
Provision for bad debt	(114,851)	(100,634)
Subtotal	(1,633,435)	(1,600,220)
Net patient service revenue	<u>\$ 383,306</u>	<u>\$ 369,162</u>

Net patient service revenue for the nine month period ended March 31, are as follows:

	<u>March 31, 2018</u>	<u>March 31, 2017</u>
Medicaid and Medicaid HMO	\$ 136,856	\$ 134,660
Medicare	94,822	65,688
Other third-party payers	91,711	121,521
Self-Pay	9,576	6,569
	<u>332,965</u>	<u>328,438</u>
Health Care Subsidy Revenue	50,341	40,724
Net Patient Service Revenue	<u>\$ 383,306</u>	<u>\$ 369,162</u>

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The Hospital provides services to its patients, most of who are insured under third-party payer agreements. Patient accounts receivable, net were as follows:

	<u>March 31, 2018</u>		<u>June 30, 2017</u>	
Medicaid and Medicaid HMO	\$ 32,999	38.5%	\$ 27,426	34.8%
Medicare	7,944	9.3%	9,125	11.6%
Other third-party payers	39,776	46.5%	36,310	46.1%
Self-Pay	4,899	5.7%	5,953	7.6%
Total Net Patient Accounts Receivable	<u>\$ 85,618</u>	<u>100.0%</u>	<u>\$ 78,814</u>	<u>100.0%</u>

(6) Restricted Investments

Restricted investments consist of the following:

Restricted investments under the terms of the bond resolutions are to provide for debt service requirements and the acquisition of capital assets. Terms of the bond resolutions provide that assets be maintained in separate funds held by the trustee, TD Bank, National Association.

(7) Long-Term Debt and Capital Lease Obligations

Long-term debt consists of the following:

	<u>March 31, 2018</u>		<u>June 30, 2017</u>	
Working Capital Fund	\$ 152		\$ 248	
Capital Reserve Fund	76,239		87,337	
Debt Service Reserve Fund	17,290		17,264	
Debt Service Fund	9,763		6,042	
	103,444		110,891	
Less Current Portion of Restricted Investments	3,026		6,042	
	<u>\$ 100,418</u>		<u>\$ 104,849</u>	

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As of and for the Nine Month Period Ended March 31, 2018

	March 31, 2018	June 30, 2017
Bonds and Lease Payable		
New Jersey Health Care Facilities Financing Authority		
(NJHCFFA) Series 2015A Bond, bearing interest at fixed rates to be paid semi-annually, with principal payments to be paid annually and set to commence on July 1, 2021 (a)	\$254,975	\$254,975
(NJHCFFA) Series 2015A Bond Net Premium and amortized over the 30 year life of the bond (a)	14,093	14,671
New Jersey Educational Facilities Authority (NJEFA)	244	426
Higher Education Capital Improvement Fund, Series 2000 annual payments		
Capital Lease Obligations ©	76,487	76,615
	345,799	346,687
Less Current Installments	133	207
Total Debt	\$345,666	\$346,480

- (a) On December 22, 2015 University Hospital issued \$255 million of New Jersey Healthcare Facilities Financing Authority Series 2015A Bonds. Total proceeds from the sale were \$295.8 million and included a net premium of \$15.8 million as well as \$25.0 million from trustee-held debt service and reserve funds. Proceeds from the sale were used for the purpose of: (i) the defeasance of \$150 million of BAN debt (ii) funding current debt service reserve requirements of \$17.3 million; (iii) funding capital projects of \$102.8 million, including Information Services & Technology capital, Heating, Ventilation and Air Conditioning improvements, operating room renovations, Cancer Center expansion and routine and emergency capital needs; (iv) funding bond insurance costs of \$17.6 million; (v) and paying bond issuance costs of \$2.7 million. The Series 2015A Notes were placed by and between the Authority and TD Bank, National Association, as Trustee. The Hospital entered into a Loan Agreement (the Loan Agreement) with the Authority relating to the Series 2015A bond. A security feature for this obligation is provided by a lock box arrangement with the Trustee, TD Bank, N.A. Debt service requirements will be funded by unrestricted state appropriations including state charity pools, Delivery System Reform Incentive Payments (DSRIP), Graduate Medical Education (GME) and individual state supplemental appropriations that will flow through the lock box. Any excess funds will then be released to the Hospital for operations.

Principal payments on the bonds will be due annually and are not set to commence until July 1, 2021. Interest will be paid semi- annually on July 1 and January 1, in which the first payment was due July 1, 2016. The bonds are set at fixed interest rates and are as follows: (i) \$65,250 in serial bonds at 5.000%; (ii) \$78,220 in term bonds at 4.125% and (iii) \$111,505 in term bonds at 5.000%.

- (b) In addition on July 1, 2013, the Hospital assumed a portion of the UMDNJ obligation of the New Jersey Educational Authority's, Higher Education Capital Improvement fund, Series 2000 A

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(as revised) in the amount of \$0.7 million. The debt bears interest at a fixed rate of 5.0% and requires principal payments until August 2020.

- (c) On July 1, 2013, the Hospital entered into five capital lease agreements with Rutgers, the State University of New Jersey for space in various locations on its Newark campus. The agreements are for 76 years and require monthly rent payments in advance. The Hospital has capitalized the present value of the lease payments using a discount factor of 5.1%, based on the Hospital's incremental borrowing rate, and will amortize the asset over the estimated useful life of each of the buildings.

(8) Employee Benefits

Retirement Plans

The Hospital has primarily two retirement plans available to its employees, the State of New Jersey Public Employees Retirement System (PERS), a defined benefit plan, and the Alternate Benefit Program (ABP), a defined contribution plan. Under these plans, participants make annual contributions, and the State of New Jersey, in accordance with State statutes, makes employer contributions on behalf of the Hospital for these plans. The Hospital is charged for contributions on behalf of employees through a fringe benefits charge assessed by the State which is included within fringe benefits in the accompanying statement of revenues, expenses, and changes in net position.

Postemployment Benefits Other Than Pension

In addition to providing pension benefits, the State provides certain health care and life insurance benefits for the Hospital's retired employees, in accordance with State statutes. Full health coverage is provided to eligible employees retiring with 25 years of service credited on or before June 30, 1997 in one of the State of New Jersey's mandatory pension plans. Employees retiring with 25 years of service credited after June 30, 1997 may share in the cost of the health care provided under the State Plan according to the terms specified in the appropriate bargaining unit agreement in effect at the time the employee reaches 25 years of credited service. The rules governing the contribution rate are the same as that for active employees. Since the costs of these programs are the responsibility of the State and the retired employees, the amounts are not available to the Hospital and no expenses or liabilities for these benefits are reflected in the Hospital's financial statements.

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(9) Commitments and Contingencies

(a) Reimbursement

The Hospital derives significant third-party revenues from the Medicare and Medicaid programs. Medicare reimburses most inpatient acute services on a prospectively determined rate per discharge, based on diagnosis-related groups (DRGs) of illnesses, i.e., the Prospective Payment System (PPS). For outpatient services, Medicare payments are based on service groups called ambulatory payment classifications (APCs).

Medicare adjusts the reimbursement rates for capital, medical education, costs related to treating a disproportionate share of indigent patients, and some physician services are reimbursed on a cost basis. Due to these adjustments and other factors, final determination of the reimbursement

settlement for a given year is not known until Medicare performs its annual audit. The Hospital's costs reports have been settled by the Medicare fiscal intermediary through June 30, 2014, except for years 2005, 2010 and 2013. The Hospital's Medicaid cost report have been audited and settled with the Medicaid fiscal intermediary through June 30, 2015.

The Hospital has also entered into payment agreements with certain commercial insurance carriers, health maintenance organizations and preferred provider organizations. The basis for payment to the Hospital under these agreements includes prospectively determined rates per day/case and discounts from established charges.

Revenues received under the various reimbursement systems and agreements are subject to audit and adjustment. Accordingly, provisions for estimated adjustments resulting from audit, final settlement, and changes in estimates have been recorded. Differences between the provisions and the amounts settled are recorded in the year of settlement.

The Hospital is in varying stages of appeals relating to third-party payers' reimbursement rates. Management routinely provides for the effects of all determinable prior year appeals, settlements, and audit adjustments and records estimates based upon existing regulations, past experience, and discussions with third-party payers. However, since the ultimate outcomes for various appeals are not presently determinable, no provision has been made in the accompanying financial statements for such issues.

There are various proposals at the federal and state levels that could, among other things, reduce reimbursement rates, modify reimbursement methods, or increase managed care penetration, including Medicare and Medicaid. The ultimate outcome of these proposals and other market changes cannot presently be determined at this time.

Laws and regulations governing Medicaid and Medicare are complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term. The Hospital believes that it is in compliance with all applicable regulations and that any pending or possible investigations involving allegations of potential wrongdoing will

UNIVERSITY HOSPITAL
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Notes to the Financial Statements

As of and for the Nine Month Period Ended March 31, 2018

not materially impact the accompanying financial statements. While certain regulatory inquiries have been made, compliance with the regulations can be subject to future government review and interpretation as well as significant regulatory action, i.e., fines, penalties, and possible exclusion from Medicaid and Medicare, in the event of noncompliance. In accordance with recent trends in healthcare financial operations, the Hospital has established a Corporate Compliance Committee and appointed a Corporate Compliance Officer to monitor adherence to laws and regulations.

(b) *Legal Matters*

There are outstanding legal claims against the Hospital for alleged negligence, medical malpractice, and other torts, and for alleged breach of contract. Pursuant to the Agreement, the Hospital is indemnified by the State for such costs. The Hospital records these costs when settled by the State as appropriations from the State and as other than personal services expenses in the accompanying financial statements. Accordingly, no provision has been made in the accompanying financial statements for unsettled claims, whether asserted or not.

(c) *Accrued Claims Liability*

The Hospital is self-insured for workers' compensation benefits. At March 31, 2018 and June 30, 2017, the accrual for estimated workers' compensation claims was \$26.7 million. This was based on an independent actuary's estimate at June 30, 2017, which includes undiscounted estimates for both reported claims and claims incurred but not reported. The amount is included in accrued claims liability in the accompanying statement of net position. The actuarial estimate is revised at fiscal year-end. In addition, the Hospital maintains an excess Workers Compensation Policy with a commercial insurance company.

(d) *Operating Leases*

The Hospital leases equipment, off-site clinic space, and office space under various operating leases. Total rental expense for operating leases was approximately \$2.9 million and \$2.8 million for the nine month period ended March 31, 2018 and 2017, respectively.

(e) *Rutgers University and the State*

The Hospital entered into a master affiliation agreement, various real estate agreements, transition service agreement, continuing service agreement, various operational agreements with Rutgers University and the State. The agreements include various real estate leases, information technology services, clinical services, research affiliation, medical education, and other services.

(10) *Subsequent Event*

Management evaluated all events and transactions that occurred after March 31, 2018 through May 14, 2018, and the Hospital did not have any known material recognizable subsequent events during the period.

UNIVERSITY HOSPITAL
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Operating Utilization Data

March 31, 2018

Table 6-A University Hospital Percent (%) of ED Cases by Payer

Payer Class	2014	2015	2016	2017	Qtr Ending Sept 30, 2017	Qtr Ending Dec 31, 2017	Qtr Ending Mar 31, 2018
Medicare	6.0%	6.0%	5.8%	5.6%	5.0%	5.0%	4.9%
Medicaid	7.4%	7.2%	5.2%	4.2%	3.3%	3.6%	3.5%
NJBC	4.2%	4.1%	4.0%	3.8%	3.6%	3.3%	3.5%
Other BC	0.5%	0.5%	0.5%	0.5%	0.6%	0.5%	0.5%
Commercial	2.1%	2.5%	2.4%	1.9%	2.1%	2.5%	2.5%
HMO-Medicare	1.7%	1.8%	2.4%	3.2%	4.5%	4.3%	4.5%
HMO-Medicaid	40.4%	43.8%	45.1%	47.2%	43.5%	44.8%	46.3%
HMO-Comm.	2.6%	2.7%	2.6%	2.8%	3.2%	3.0%	3.2%
Other (WC)	1.2%	1.1%	1.0%	1.0%	1.0%	0.9%	0.9%
Other (NF)	1.9%	1.8%	1.7%	1.7%	2.1%	1.2%	1.3%
Self-pay	25.0%	23.0%	24.1%	21.6%	24.8%	26.5%	24.5%
Charity Care	6.7%	5.2%	4.9%	6.2%	6.0%	4.1%	4.0%
Champus	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%
Other	0.2%	0.2%	0.2%	0.2%	0.2%	0.3%	0.3%
<u>Total</u>	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%

Source: University Hospital Healthquest data, prepared by O'Conco Healthcare Consultants

UNIVERSITY HOSPITAL
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Operating Utilization Data

March 31, 2018

Table 6-B University Hospital Percent (%) of Inpatient Cases by Payer

Payer Class	2012	2013	2014	2015	2016	2017	Qtr. Ending Sept 30, 2017	Qtr. Ending Dec 31, 2017	Qtr. Ending Mar 31, 2018
Medicare	18.0%	17.3%	17.1%	17.0%	16.3%	16.1%	14.6%	15.1%	14.4%
Medicaid	15.7%	14.7%	17.8%	16.8%	16.3%	12.7%	16.1%	13.5%	13.3%
Managed Care *	33.0%	34.5%	38.4%	42.5%	43.9%	46.0%	44.3%	46.8%	46.9%
Other Third Party Payers	12.7%	12.6%	13.4%	11.8%	11.7%	10.8%	11.8%	10.9%	10.0%
Self-pay & Charity	20.6%	20.9%	13.3%	11.9%	11.8%	14.4%	13.2%	13.7%	15.4%
<u>Total</u>	<u>100.0%</u>	<u>100.0%</u>	<u>100.0%</u>	<u>100.0%</u>	<u>100.0%</u>	<u>100.0%</u>	<u>100.0%</u>	<u>100.0%</u>	<u>100.0%</u>

* includes Managed Medicare/ Medicaid

Source: University Hospital Healthquest data, prepared by O'Conco Healthcare Consultants

Table 6-C All New Jersey Hospitals Percent (%) of Inpatient Cases by Payer

Payer Class	<u>2010</u>	<u>2011</u>	<u>2012</u>	<u>2013</u>	<u>2014</u>	<u>2015</u>	<u>2016</u>
Medicare	35.3%	35.5%	34.6%	34.3%	34.9%	35.5%	34.7%
Medicaid	5.3%	5.2%	4.6%	4.7%	6.9%	7.5%	7.8%
Managed Care	29.1%	29.4%	30.8%	30.8%	31.9%	32.7%	33.6%
Other Third Party Payers	20.7%	20.2%	20.1%	20.2%	20.0%	20.0%	19.8%
Self-pay & Charity	9.6%	9.7%	9.9%	10.0%	6.3%	4.3%	4.1%
<u>Total</u>	<u>100.0%</u>	<u>100.0%</u>	<u>100.0%</u>	<u>100.0%</u>	<u>100.0%</u>	<u>100.0%</u>	<u>100.0%</u>

Source: New Jersey Discharge Data Collection System (NJDDCS) final Statewide data prepared by O'Conco Healthcare Consultants.

UNIVERSITY HOSPITAL
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Operating Utilization Data

March 31, 2018

Sources of Hospital Revenue

Hospital revenue other than state subsidy arising from inpatient discharges is sourced as follows:

Source	Fiscal Year 2015 (7/1/14- 6/30/15)		Fiscal Year 2016 (7/1/15- 6/30/16)		Fiscal Year 2017 (7/1/16- 6/30/17)		FY 2018- 1st Qtr. (7/1/17 - 9/30/17)		FY 2018- 2nd Qtr. (10/1/17 -12/31/17)		FY 2018- 3rd Qtr. (1/1/18 -3/31/18)	
	Discharges	Percentage	Discharges	Percentage	Discharges	Percentage	Discharges	Percentage	Discharges	Percentage	Discharges	Percentage
Medicare and Medicare HMO	3,426	20.7%	3,576	20.9%	3,834	22.4%	950	22.0%	1,012	23.5%	1,022	22.9%
Medicaid and Medicaid HMO	8,755	53.0%	9,218	53.8%	8,351	48.9%	2,172	50.3%	2,155	50.1%	2,128	47.8%
Other Third-Party Payers	2,634	16.0%	2,584	15.1%	2,435	14.3%	651	15.1%	599	13.9%	618	13.9%
Self-pay & Charity Care	1,708	10.3%	1,760	10.2%	2,463	14.4%	546	12.6%	534	12.4%	686	15.4%
Totals	16,523	100.0%	17,138	100.0%	17,083	100.0%	4,319	100.0%	4,300	100.0%	4,454	100.0%

Source: University Hospital Healthquest data, prepared by O'Conco Healthcare Consultants

State Appropriations

Historical Unrestricted State Aid to University Hospital (in thousands)

Historical Unrestricted State Aid to University Hospital (\$000's)

	Actual 2014	Actual 2015	Actual 2016	Actual 2017	Budget 2018	Actual PE 9/30/17	Actual PE 12/31/17	Actual PE 3/31/18
Charity Care	99,003.2	76,230.6	53,483.6	40,436.3	48,147.8	12,036.9	12,036.9	12,036.9
DSRIP/HRSF	13,715.2	13,000.5	10,907.0	15,920.0	12,000.0	5,400.0	4,542.0	3,772.1
Mental Health	718.1	718.1	718.1	718.1	718.1	179.4	179.6	179.6
GME (Medicaid)	16,459.3	16,083.6	19,224.5	25,685.7	31,215.9	7,804.0	7,804.0	7,804.0
University Hospital (Specific Line Item)	18,841.0	43,841.0	43,841.0	33,841.0	43,841.0	10,960.0	10,960.0	10,960.0
Health Care Stabilization Fund	4,900.0	-	-	-	-	-	-	-
Total	153,636.8	149,873.8	128,174.2	116,601.1	135,922.8	36,380.3	35,522.5	34,752.6

Notes:

- All State aid to the Hospital is subject to and dependant upon appropriations being made for such purpose by the New Jersey State Legislature.
The State Legislature has no legal obligation to make any such appropriations.
- Includes DSRIP adjustment as related to successful prior year appeals.
- State of New Jersey reduced UH specific appropriation in FY 2017 by \$10.0 million. See Note 2(h).

UNIVERSITY HOSPITAL
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Operating Utilization Data

March 31, 2018

Utilization Data

The following table sets forth selected historical utilization statistics for the Hospital's 2014 -2018 fiscal years.

	Fiscal Years Ended June 30,				Fiscal Nine Months Ended March 31,	
	2014	2015	2016	2017	2017	2018
Inpatient Discharges:						
Adult (Non-ICU)	10,212	10,936	11,410	11,694	8,718	9,083
Pediatrics	1,095	1,357	1,393	1,253	946	1,021
ICU	789	874	903	1,081	813	555
OB/GYN	1,819	1,704	1,738	1,570	1,232	1,302
Newborn Nursery	1,307	1,190	1,234	1,094	866	844
NICU	414	462	460	391	309	327
Total	15,636	16,523	17,138	17,083	12,884	13,132
Patient Days	93,696	102,472	106,929	109,567	83,031	78,995
Average Length of Stay	6.0	6.2	6.2	6.4	6.4	6.0
Average Daily Census	256.7	280.7	292.2	300.2	303.0	288.3
Occupancy Percentage	72.9	79.7	83.0	85.3	86.1	81.9%
Maintained Beds	352	352	352	352	352	352
Medicare Case Mix Index	1.874	1.870	1.843	1.879	1.852	1.910
All Payer Case Mix Index	1.641	1.666	1.681	1.712	1.709	1.730
Emergency Department visits	91,026	89,978	90,760	90,575	67,823	68,415
Clinic Visits	171,909	160,466	172,455	165,251	124,436	125,227
Outpatient Same Day Surgeries	8,502	9,050	9,586	9,375	6,942	6,656
Inpatient Surgeries	3,918	4,180	4,648	4,569	3,391	3,418
Liver Transplants	33	42	42	36	32	4

UNIVERSITY HOSPITAL
(A Component Unit of the State of New Jersey)

Operating Budget

FY 2018

FY 2018 Revenue and Expenses Budget

	FY 2018 Budget
Revenue	
Net Patient Services Revenue before Subsidies	\$ 445,318
Patient Subsidy	58,866
Net Patient Services Revenue	504,184
Fring Benefits	97,200
Special State Appropriation	43,841
Miscellaneous Income	21,325
Total Revenue	666,550
Expenses	
Salaries & Wages	253,830
Contracted MD's	60,528
Contracted Residents	20,388
Fringe Benefits	101,200
Supplies and Services	201,643
Interest Expense	15,780
Facility Service/LeaseAgreements	16,705
Depreciation & Amortization	22,000
Total Operating Expense	692,074
Deficit from Operations	(25,524)
Performance Improvement Initiatives	9,326
Deficit from Operations and Performance Improvement	(16,198)
Higher Education Trust Fund Grant	12,450
Deficit from Operations & Capital Projects	(3,748)
GASB 68 State Pension related costs	(33,150)
Deficit from Operations, Capital Projects & Pension Expense	\$ (36,898)

UNIVERSITY HOSPITAL
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Operating Budget

FY 2018

FY 2018 Revenue Budget Assumptions

The FY 2017 projected year end actuals include a \$10.0 million reduction in the Special State appropriation from the original FY 2017 State budget. This unanticipated reduction was partially offset by \$5.8 million in expense reductions relating to workers compensation and payroll liability accounts. Other specific assumptions relating to the FY 2018 budget are as follows:

- Other than inpatient volumes related to the Liver Transplant program, inpatient volumes are projected to remain unchanged from the FY 2017 year-end projections. Similarly, volumes for the Observation Unit as well as all other outpatient volumes are projected to remain flat. Additionally, all revenue variables such as case mix, patient type and payer mix are also anticipated to remain consistent with those experienced in FY 2017.
- An average increase of 3% in charges is proposed to be implemented August 1, 2017. This increase is projected to increase net revenues by \$1.3 million for indemnified payers and has been included in the proposed revenue budget.
- Recently Medicare/CMS has finalized a ruling that significantly increases funding of the national uncompensated care pool. This rule allocates additional funding to those hospitals that serve a disproportionately high share of Medicaid and uninsured patients. This increase results in an additional \$4.6 million in net patient service revenue for University Hospital. Other contractual rate adjustments, averaging 1.3%, increase net revenues in FY 2018 by an additional \$3.6 million. However, these increases are offset by the loss of \$3.1 million in revenue due to the temporary six month suspension of the Hospital's Liver Transplant program. When offset by the liver expense, the total net loss for the program is anticipated to be \$2.1 million for the year.
- University Hospital's Charity Care subsidy is anticipated to increase by \$7.7 million in FY 2018. Additionally, Medicaid GME payments are projected to increase by \$5.5 million. It has been projected that University Hospital's State Appropriation will remain at \$43.8 million.
- The proposed FY 2018 budget assumes \$2.4 million in revenue from the City of Newark, however no contract is in place. Other miscellaneous revenue sources are anticipated to decrease by \$6.7 million when compared to the prior year. This decrease is a result of one-time UH/RBHS reconciliation adjustments experienced in FY 2017.

UNIVERSITY HOSPITAL
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Operating Budget

FY 2018

FY 2018 Expense Budget Assumptions

- The proposed FY 2018 budget includes a provision of \$4.9 million for wage and salary increases in FY 2018. An additional \$3.2 million is associated with incorporating a full year of new positions related to performance improvement programs initiated in the prior year. These initiatives were developed to increase volumes while improving patient outcomes and patient satisfaction scores.
- The Clinical Service Agreements with Rutgers have been projected to increase by \$2.3 million as compared to FY 2017. This is a result of the elimination of all FY 2017 performance based credits, as Rutgers physicians are expected to fulfill all performance obligations in FY 2018. The Graduate Medical Education (GME) portion is anticipated to increase \$1.0 million. This is a result of funding nine additional residents for the Internal Medicine and Neurology Programs.
- Supplies and Facility Service agreements with RBHS are projected to increase by \$5.3 million or 2.4% as compared to FY 2017. This is a result of economic factor adjustments, offset by anticipated savings in rent and utility payments.
- University Hospital interest payments have been projected using amortization tables for the \$255 million bond, offset by the bond premium calculated at the effective interest rate.
- Depreciation expense is projected to be \$22.0 million in FY 2018. This is a result of an increase in FY 2018 projected operating capital expenditures of \$8 million for routine and emergency capital needs, IT capital purchases of \$15.0 million for the Data Center as well as \$16 million in other capital needs related to OR suite expansion, the Cancer Center and Radiology capital. Additional capital expenditures of \$12.5 million have also been projected for the Higher Education Trust Fund Grant.



cutting through complexity

Presentation to the Audit Committee

University Hospital

SDMD
March 31, 2018

This report is intended solely for the information and use of University Hospital management, Board of Directors and Audit Committee and is not intended to be and should not be used by anyone other than these specified parties.



Results

Status of our procedures over Secondary Market Disclosure as of March 31, 2018

The following limited procedures were performed:

- Balance sheet - analytical procedures
 - 3/31/18 (interim) vs. 6/30/17 (audited)
- Statement of operations - analytical procedures
 - 9 months ended 3/31/18 (annualized) vs. 12 months ended 6/30/17
- Review reconciliation of general ledger to financial statements for both 3/31/18 and 3/31/17.
- Inquiries with management
- Reading of board minutes
- Reading footnote disclosure and providing recommendation/observations

Significant Accounting Policies

No significant non-routine transactions noted during the quarter ended March 31, 2018

Results (continued)

Follow up on Prior Observations / Recommendations

- We continue to recommend that a cash flow statement be included in the Secondary Market Disclosure.
- Consider the following to prepare for each secondary market disclosure and year end audit:
 - Evaluate the timing of revenue recognition regarding DSRIP reimbursement and prepare analysis to support accounting and reporting for each quarter.
 - *Management analyzed DSRIP at year end and we recommend that management continue to evaluate this on a quarterly basis.*
 - Include future commitments disclosure regarding capital projects that will be funded by bond proceeds, Higher Ed Grant or operating funds
 - *This disclosure was not included within the Q3 SDMD*

Results (continued)

New Observations / Recommendations

- Patient accounts receivable, net increased \$6.8M or 9% from June 30, 2017 to March 31, 2018. We recommend management continue to monitor the receivable balance and evaluate for exposure.
- We recommend that management evaluate the impact of GASB 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions* and GASB 85, *Ominbus* . These standards are effective 6/30/18.
- We recommend that management expand disclosures with regards to the related parties of Rutgers University / State of New Jersey.
- We do not have any other new observations or recommendations as a result of our procedures performed over Q3 secondary market disclosure.



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