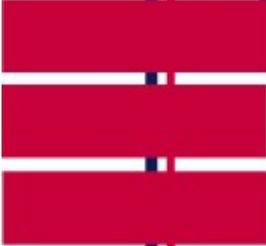


INOVA HEALTH SYSTEM



**Audited Consolidated Financial Statements and
Other Supplementary Information Relating to the
IHS Obligated Group, and Management's
Discussion and Analysis of Results of Operations
and Financial Position**

**Fiscal Year Ended
December 31, 2019**

Inova Health System
Management’s Discussion and Analysis of Results of Operations and Financial Position
As of and for the Year Ended December 31, 2019

Introduction

Inova Health System (“IHS”) is an integrated, not-for-profit health care delivery system that owns, operates and manages clinical, educational, research, and hospital facilities located in northern Virginia, serving northern Virginia, the Washington, D.C. metropolitan area, and contiguous counties in Virginia and Maryland. The principal line of business for IHS is the delivery of acute care hospital services at locations in northern Virginia. IHS also operates an integrated network of health services including ambulatory care, home health care, senior services, assisted living, and other health related services. IHS maintains a group of primary care and specialty physicians operating as the Inova Medical Group as well as a clinically integrated physician network known as Signature Partners and Innovation Health (“Innovation”), a joint venture with Aetna offering commercial health insurance plans.

The following discussion and analysis provides information that IHS management believes is relevant to an assessment and understanding of IHS’ results of operations and financial position. This analysis should be read in conjunction with IHS’ financial statements for the years ended December 31, 2019 and 2018. The discussion and analysis focuses on IHS as a whole, which management believes provides a fair description and analysis, in all material respects, of the Obligated Group’s results of operations and financial condition, insofar as the Obligated Group represents approximately 94.1% of total operating revenues and nearly 100% of unrestricted net assets of IHS as of and for the year ended December 31, 2019.

Results of Operations as of and for the year ended December 31, 2019 and 2018

Overall, IHS reported strong operating results achieving Operating and Cash Flow margins of 5.8% and 13.9%, respectively. Both profitability indicators slightly exceeded prior year performance.

Operating Revenues. Total operating revenues for IHS for the year ended December 31, 2019 were \$3.8 billion, a 10.6% increase from prior year. Net patient service revenue increased 11.5% to \$3.6 billion primarily due to significant increases in patient activity across most service lines compared with prior year, including:

	2019	2018	% Change
Admissions	99,507	95,444	4.3%
Inpatient Surgeries	23,407	22,177	5.5%
Outpatient Surgeries	46,535	43,716	6.4%
Emergency Visits	442,079	423,740	4.3%
Urgent Care Visits	187,831	171,687	9.4%

Operating Expenses. Total operating expenses for the year ended December 31, 2019 were \$3.5 billion, an increase of 10.5% as compared to prior year. Salaries and benefits increased \$141 million, or 8.3%, primarily due to merit and market based pay adjustments, as well as increased staffing costs associated with increased volumes. Other operating expenses increased \$168 million, or 13.6%, primarily due to increases in medical supplies and other costs associated with increased surgical volumes and other patient activity, as well as information technology (“IT”) costs related to the implementation of Oracle Enterprise Resource Planning (“ERP”) software and maintenance and support for various other IT projects.

Operating Income was \$219.7 million, or 5.8% of total operating revenues, for the year ended December 31, 2019, as compared to \$196.2 million, or 5.8% of total operating revenues, in 2018.

Investment Income and Other, net. Due to improved market returns, investment income was \$884 million, resulting in a net margin of 23.4% for the year. This compares favorably to investment income of \$(344.2) million and a net margin of -5.1% for 2018.

Financial Position as of December 31, 2019

Current Assets and Liquidity. IHS’ balance sheet remains strong, with significant unrestricted cash and investments at December 31, 2019 of \$5.9 billion, of which \$3.1 billion represents investments that can be liquidated within 3 days. Operating cash flow remained strong at \$445.8 million in 2019 compared to \$449.7 million in 2018.

Investments. The following table summarizes the asset allocation for the Strategic Fund and the Capital Fund, which together comprised the Board designated funds as of December 31, 2019 (dollars in thousands):

	<u>Amount</u>	<u>%</u>
<u>Strategic Fund</u>		
Cash and cash equivalent	\$ 89,721	1.6%
Fixed income	909,464	16.6%
Public equity	3,087,297	56.4%
Growth hedge fund	322,063	5.9%
Private investments	310,066	5.7%
Diversifiers	577,320	10.5%
	<u>5,295,931</u>	<u>96.7%</u>
<u>Capital Fund</u>		
	<u>178,052</u>	<u>3.3%</u>
Total	<u>5,473,983</u>	<u>100.0%</u>

Fixed income securities are primarily investment-grade U.S. bonds with maturities ranging from 1 year to 30 years. Public equity securities are typically exchange traded U.S. and non-U.S. stocks. Growth hedge funds and diversifiers include strategies with moderate to low correlation with more traditional equity and fixed income sectors. Private investments include early stage venture capital and buyout funds and real assets.

IHS maintains a separate portfolio comprised of short duration, high quality bonds (Capital Fund). This fund was established to ensure that IHS would have sufficient liquidity to complete critical construction projects in the event of a major financial market disruption.

Property, Plant, and Equipment. Capital expenditures were \$374 million for the year ended December 31, 2019, which included \$205 million of major hospital expansion and renovation projects at the Inova Fairfax and Loudoun Hospital's and the ICPH campus including \$38 million for the new Inova Schar Cancer Institute. The remainder of capital expenditures related to information technology projects, and routine capital replacement.

All planned capital expenditures are regularly evaluated based upon business need, economic conditions and IHS' financial position and will be financed through a combination of operating cash flow, donations, tax-exempt borrowing and cash reserves if necessary.

Debt Structure and Liability Management. At December 31, 2019, total long-term debt outstanding, including financing obligations and the commercial paper ("CP") program discussed below, was approximately \$1.9 billion, or 22.5% of capitalization. IHS' capital structure is diversified to mitigate interest rate risk by utilizing different modes and durations of long-term debt as well as interest rate swaps.

As of December 31, 2019, 70% of IHS underlying long-term debt is in some form of fixed rate. Inova also holds two fixed-payer swap contracts and one variable-payor swap contract with a combined notional amount of \$219 million. As of December 31, 2019, the swaps had a combined fair market value of (\$3.0) million. IHS' effective fixed rate debt percentage was approximately 77% as of December 31, 2019.

IHS maintains a self-liquidity taxable CP program with \$100.0 million outstanding of short term debt having maturity dates from 1 to 270 days. The outstanding CP is included in *Notes payable and other liabilities* in the current liabilities section of the accompanying Consolidated Balance Sheets.

Other- Subsequent events

IHS is aware of certain additional risks regarding the spread of COVID-19, a strain of coronavirus. On March 11, 2020, the World Health Organization declared COVID-19 a pandemic, and on March 13, 2020, President Trump declared a national emergency. The federal government and a large number of state governments, including Virginia, have imposed strict measures to curtail certain aspects of public life in an effort to contain the virus as U.S. cases have risen sharply in March 2020.

Although IHS has activated plans to address the COVID-19 threat and is operating pursuant to infectious disease protocols and its emergency preparedness plan, the potential impact of a pandemic, epidemic or outbreak of an infectious disease with respect to the IHS service area or facilities is difficult to predict and could adversely impact the business, financial condition or results of operations, and, accordingly, may materially adversely impact the financial condition of IHS.

In light of the foregoing, as of March 20, 2020, IHS drew on its existing lines of credit (\$237.5 million) to preserve flexibility in managing operational challenges and responding to the volatility in the financial markets with respect to IHS's outstanding debt.

Please see Note 2 and Note 10 to the Consolidated Financial Statements

Adoption of New Lease and Goodwill Standard

On January 1, 2019, IHS adopted Accounting Standards Update ("ASU") No. 2016-02, *Leases (Topic 842)*, using the modified retrospective approach. This ASU requires the rights and obligations arising from the lease contracts, including existing and new arrangements, to be recognized as assets and liabilities on the accompanying Consolidated Balance Sheets. The ASU also requires disclosures to help financial statement users better understand the amount, timing, and uncertainty of cash flows arising from leases. The adoption of the ASU resulted in the recording of additional net lease assets and lease liabilities of \$157 million on the accompanying Consolidated Balance Sheets as of January 1, 2018. The standard did not materially impact our accompanying Consolidated Statements of Operations and Changes in Net Assets, Statements of Cash Flows for the year ended December 31, 2018. See Note 12.

Effective January 1, 2019, the FASB issued ASU 2019-06, *Intangibles – Goodwill and Other (Topic 350)*, *Business Combinations (Topic 805)*, and *Not-for-Profit Entities (Topic 958): Extending the Private Company Accounting Alternatives on Goodwill and Certain Identifiable Intangible Assets to Not-for-Profit Entities*. This ASU, upon election of the accounting alternative method, provides that goodwill and certain indefinite-lived intangible assets be amortized on a straight-line basis. Additionally, under this ASU, impairment testing is only required upon the occurrence of a triggering event and the company has the option to test for impairment at the entity level. The ASU was early adopted effective January 1, 2019. The adoption of ASU did not have a material impact on the accompanying consolidated financial statements.

Other Financial Information

The following are selected financial indicators for IHS as of and for the years ended December 31, 2019 and 2018:

	<u>2019</u>	<u>2018</u>
Operating Margin ¹	5.8%	5.8%
Operating Cash Flow Margin ²	13.9%	13.8%
Net Margin ³	23.4%	-5.1%
Net Days in Accounts Receivable ⁴	34.5	35.2
Days in Unrestricted Cash ⁵	651.3	600.1
Unrestricted Cash to Debt ⁶	3.0	2.5
Debt Service Coverage Ratio ⁷	13.0x	2.6x

1 Operating income divided by operating revenue

2 Operating income plus interest expense, plus depreciation and amortization expense divided by total operating revenue

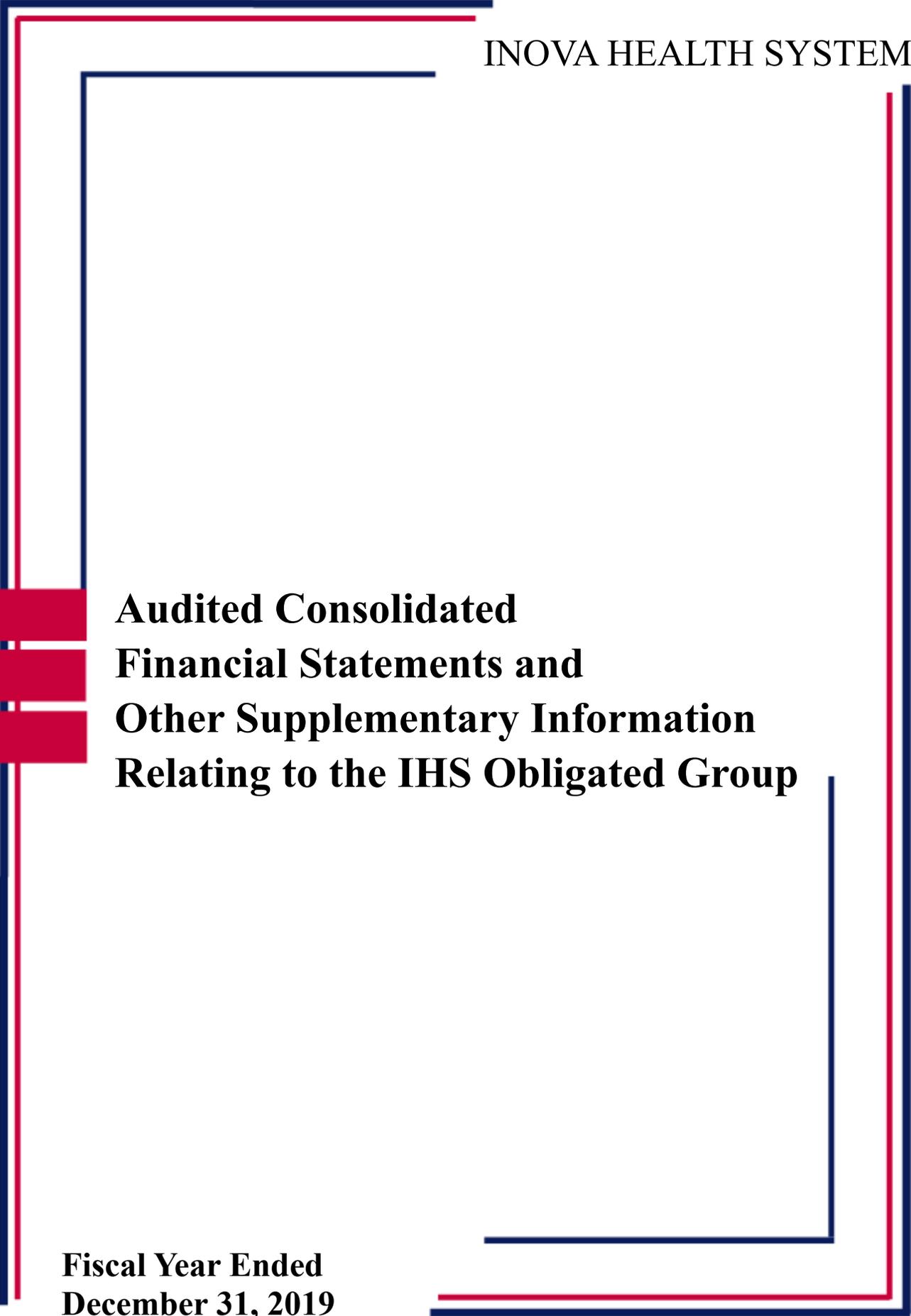
3 Excess revenues over expenses divided by total operating revenue plus investment income and other, net

4 Net Patient Receivables divided by three-month average daily net patient service revenue

5 Cash and short-term investments plus unrestricted cash reserves plus unrestricted long-term investments divided by average daily operating expenses excluding depreciation and amortization expense

6 Cash and short-term investments plus unrestricted cash reserves plus unrestricted long-term investments divided by long term debt plus financing obligation plus commercial paper borrowings

7 Income Available for Debt Service divided by long-term debt service requirement



INOVA HEALTH SYSTEM



**Audited Consolidated
Financial Statements and
Other Supplementary Information
Relating to the IHS Obligated Group**

**Fiscal Year Ended
December 31, 2019**

Inova Health System
Audited Consolidated Financial Statements
And Other Supplementary Information
Relating to IHS Obligated Group
December 31, 2019 and 2018

Audited Consolidated Financial Statements

Report of Independent Auditors.....	1
Consolidated Balance Sheets	2
Consolidated Statements of Operations and Changes in Net Assets	3-4
Consolidated Statements of Cash Flows.....	5
Notes to Consolidated Financial Statements.....	6-30

Other Supplementary Information

Report of Independent Auditors on Other Supplementary Information	31
Consolidated Balance Sheets	32
Consolidated Statements of Operations	33
Consolidated Statements of Cash Flows.....	34



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Report of Independent Auditors

The Board of Trustees
Inova Health System

We have audited the accompanying consolidated financial statements of Inova Health System (IHS), which comprise the consolidated balance sheets as of December 31, 2019 and 2018, and the related consolidated statements of operations and 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 IHS at December 31, 2019 and 2018, and the consolidated results of its operations and changes in net assets, and its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

March 20, 2020

Inova Health System
Consolidated Balance Sheets
December 31, 2019 and 2018
(in thousands)

	2019	2018
		(as adjusted)*
ASSETS		
Current Assets		
Cash and cash equivalents	\$ 404,350	\$ 333,100
Assets whose use is limited, current	198,565	198,955
Patient accounts receivable, net	363,704	321,920
Other current assets	162,719	136,930
Total Current Assets	1,129,338	990,905
Property, Equipment and Leasehold Interests, net (Note 5)	2,495,620	2,379,913
Assets Whose Use Is Limited (Notes 2, 6, 7, 14)		
Held by bond trustee	42,888	135,679
By board for plant replacement and expansion	5,295,931	4,400,115
By board for construction projects	178,052	169,313
By donor	157,693	135,341
For professional liability	92,826	80,422
For health plan liability	552	534
	5,767,942	4,921,404
Less amounts required to meet current obligations	(198,565)	(198,955)
Total Assets Whose Use Is Limited, non-current	5,569,377	4,722,449
Other Assets		
Investments in and receivables from affiliates (Note 8)	70,436	63,053
Goodwill and other intangible assets, net (Note 9)	37,379	42,233
Long-term right of use asset (Note 12)	116,644	131,627
Long-term investments	50,479	49,766
Interest rate swap (Note 11)	-	6,522
Other long-term assets	80,001	80,502
Total Other Assets	354,939	373,703
TOTAL ASSETS	\$ 9,549,274	\$ 8,466,970
LIABILITIES AND NET ASSETS		
Current Liabilities		
Accounts payable and other accrued expenses	\$ 446,503	\$ 406,078
Third-party settlements	44,621	46,657
Notes payable and other liabilities	112,327	112,849
Financing obligation (Note 13)	183,167	-
Current portion of long-term debt (Note 10)	228,861	228,429
Current lease liability (Note 12)	29,707	34,562
Total Current Liabilities	1,045,186	828,575
Non-current Liabilities		
Long-term debt, less current portion (Note 10)	1,422,080	1,463,060
Financing obligation (Note 13)	-	184,461
Long-term lease liability (Note 12)	101,303	112,345
Interest rate swap (Note 11)	2,977	-
Other non-current obligations	57,609	69,146
Total Non-current Liabilities	1,583,969	1,829,012
Net Assets		
Without donor restrictions	6,684,613	5,597,522
With donor restrictions	214,248	191,237
Total Net Assets Attributable to IHS	6,898,861	5,788,759
Non-controlling interest	21,258	20,624
Total Net Assets	6,920,119	5,809,383
TOTAL LIABILITIES AND NET ASSETS	\$ 9,549,274	\$ 8,466,970

*Refer to Note 2 regarding the adoption of the new lease accounting standard, including impacts on previously reported results.

See notes to the consolidated financial statements.

Inova Health System
Consolidated Statements of Operations and Changes in Net Assets
For the Years Ended December 31, 2019 and 2018
(in thousands)

	2019	2018
Operating Revenues		
Net patient service revenue	\$ 3,624,779	\$ 3,249,667
Other operating revenue	139,094	153,168
Total Operating Revenues	3,763,873	3,402,835
Operating Expenses		
Salaries and benefits	1,834,466	1,693,913
Other operating expenses	1,406,478	1,238,001
Depreciation and amortization	249,874	224,632
Interest	53,342	50,135
Total Operating Expenses	3,544,160	3,206,681
Operating Income before Gain on Disposal of Business Line	219,713	196,154
Gain on disposal of business line	–	4,714
Operating Income	219,713	200,868
Investment income (loss) and other, net	883,886	(344,242)
Excess of Revenues Over Expenses (Expenses over Revenues)	1,103,599	(143,374)
Less: Non-controlling interest	(15,916)	(13,841)
Excess of Revenues Over Expenses (Expenses over Revenue), Attributable to IHS	1,087,683	(157,215)

Continued on page 4.

See notes to the consolidated financial statements.

Inova Health System
Consolidated Statements of Operations and Changes in Net Assets (continued)
For the Years Ended December 31, 2019 and 2018
(in thousands)

	<u>Without Donor Restrictions</u>	<u>With Donor Restrictions</u>	<u>Noncontrolling Interest</u>	<u>Total</u>
Balance at December 31, 2017	\$ 5,744,855	\$ 160,448	\$ 19,422	\$ 5,924,725
Excess of expenses over revenues (from page 3)	(157,215)	–	13,841	(143,374)
Unrealized gain (loss) on investments, net	804	(1,583)	–	(779)
Sale of non-controlling position	8,624	–	–	8,624
Gifts and bequests	–	51,008	–	51,008
Restricted investment income	–	(225)	–	(225)
Net assets released from restriction	–	(18,617)	–	(18,617)
Other changes in non-controlling equity interest	(784)	–	(12,639)	(13,423)
Other	1,238	206	–	1,444
Change in Net Assets	<u>(147,333)</u>	<u>30,789</u>	<u>1,202</u>	<u>(115,342)</u>
Balance at December 31, 2018 (as adjusted)*	5,597,522	191,237	20,624	5,809,383
Excess of revenues over expenses (from page 3)	1,087,683	–	15,916	1,103,599
Unrealized (loss) gain on investments, net	(272)	1,574	–	1,302
Gifts and bequests	–	37,037	–	37,037
Restricted investment income	–	2,669	–	2,669
Net assets released from restriction	–	(18,620)	–	(18,620)
Other changes in non-controlling equity interest	(156)	–	(15,282)	(15,438)
Other	(164)	351	–	187
Change in Net Assets	<u>1,087,091</u>	<u>23,011</u>	<u>634</u>	<u>1,110,736</u>
Balance at December 31, 2019	<u>\$ 6,684,613</u>	<u>\$ 214,248</u>	<u>\$ 21,258</u>	<u>\$ 6,920,119</u>

*Refer to Note 2 regarding the adoption of the new lease accounting standard, including impacts on previously reported results.

See notes to the consolidated financial statements.

Inova Health System
Consolidated Statements of Cash Flows
For the Years Ended December 31, 2019 and 2018
(in thousands)

	2019	2018
		(as adjusted)*
Operating Activities		
Change in net assets	\$ 1,110,736	\$ (115,342)
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation and amortization	249,874	224,632
Net realized and unrealized (gains) losses on investments	(836,812)	411,132
Change in fair value of interest rate swaps	9,499	(4,849)
Equity investment losses (gains), net	3,706	(1,321)
Gain on sale of long-lived assets	–	(2,253)
(Increase) decrease in accounts receivable and third-party settlements, net	(52,961)	10,135
(Increase) decrease in other current assets	(20,661)	25,784
Increase (decrease) in accounts payable and other current liabilities	53,535	(18,504)
Decrease in other non-current obligations	(7,608)	(2,606)
Restricted contributions and investment income	(39,706)	(51,035)
Other	(23,817)	(26,098)
Net Cash Provided by Operating Activities	445,785	449,675
Investing Activities		
Capital expenditures	(373,996)	(437,710)
Proceeds from sale of long-lived assets	–	20,242
Investments in and advances to joint ventures and affiliates	(11,089)	(10,205)
Purchases of investments	(2,231,188)	(1,124,176)
Proceeds from sale of investments	2,156,123	1,087,557
Net Cash Used in Investing Activities	(460,150)	(464,292)
Financing Activities		
Principal payments on long-term debt	(34,128)	(43,178)
Proceeds from issuance of long-term debt	–	484,977
Refunding of long-term debt	–	(220,050)
Restricted contributions and investment income	39,424	30,353
Other	(6,860)	(2,724)
Net Cash (Used in) Provided by Financing Activities	(1,564)	249,378
Net (Decrease) Increase in Cash, Cash Equivalents and Restricted Cash	(15,929)	234,761
Cash, Cash Equivalents and Restricted Cash at Beginning of Year	487,261	252,500
CASH, CASH EQUIVALENTS AND RESTRICTED CASH AT END OF YEAR	471,332	487,261
Less: Restricted cash included in assets whose use is limited (Note 2)	66,982	154,161
CASH AND CASH EQUIVALENTS AT END OF YEAR	\$ 404,350	\$ 333,100

*Refer to Note 2 regarding the adoption of the new lease accounting standard, including impacts on previously reported results.

Inova Health System
Notes to Consolidated Financial Statements
December 31, 2019 and 2018

1. Nature of Operations

Organization: Inova Health System (“IHS”) is an integrated, not-for-profit health care delivery system that owns, operates and manages clinical, educational, research and hospital facilities located in Northern Virginia, serving Northern Virginia, the Washington, D.C. metropolitan area and contiguous counties in Virginia and Maryland. The principal line of business for IHS is the delivery of acute care hospital services at five hospitals located in Northern Virginia. IHS also operates an integrated network of health services including a medical group, ambulatory care, home health care, senior services, assisted living and other health related services.

2. Summary of Significant Accounting Policies

Basis of Presentation: The financial statements have been prepared in accordance with accounting principles generally accepted in the United States (“GAAP”). The preparation of financial statements requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

Certain reclassifications have been made to the 2018 consolidated financial statements to conform with classifications used in 2019. The reclassifications had no significant effect on total revenue or total excess revenue over expenses (expenses over revenue) previously reported.

Principles of Consolidation: The IHS accompanying consolidated financial statements include the accounts of the Inova Health System Foundation (the “Foundation”); Inova Health Care Services (“IHCS”); Loudoun Hospital Center (“LHC”); Inova Holdings, Inc. (“IHI”); and their majority-owned subsidiaries and controlled affiliates. All material intercompany accounts and transactions have been eliminated in consolidation.

The Foundation is a tax-exempt, non-stock corporation, which controls its affiliated corporations through its authority to appoint the governing boards of the tax-exempt, non-stock affiliates or its stock ownership. The Foundation also supports and maintains the programs, services, and facilities of IHS’ health care delivery system in part through the solicitation, receipt, administration, and distribution of philanthropic gifts on behalf of its tax-exempt affiliates. Inova Health Plan, LLC (“IHP”), a former wholly-owned subsidiary of the Foundation previously known as INTotal, was a Medicaid HMO licensed and authorized to do business in Virginia.

IHCS is a tax-exempt, non-stock corporation that serves the health care needs of the community by establishing, maintaining and operating hospital and health care facilities, programs, and other shared and integrated health care delivery arrangements. IHCS operates the following facilities, among others: Inova Fairfax Hospital (“Fairfax”); Inova Mount Vernon Hospital (“Mount Vernon”), Inova Fair Oaks Hospital (“Fair Oaks”) and Inova Alexandria Hospital (“Alexandria”). IHCS also provides and manages the clinical, non-hospital facilities and programs whose services include senior services, assisted living facilities, addiction treatment services for adults and adolescents, outpatient rehabilitation services, urgent care and other outpatient health care services. IHCS also maintains a group of primary care and specialty physicians operating as the Inova Medical Group.

LHC is a tax-exempt, non-stock corporation that serves the health care needs of Loudoun County, Virginia, and surrounding areas. In addition to Inova Loudoun Hospital (“Loudoun”), LHC operates Loudoun Nursing and Rehabilitation Center, Loudoun Healthcare Foundation and other health care and related facilities. Effective December 31, 2019, LHC merged into IHCS. In addition, Loudoun Healthcare Foundation and Alexandria Healthcare Foundation merged into the Inova Health System Foundation.

Inova Health System
Notes to Consolidated Financial Statements (continued)
December 31, 2019 and 2018

2. Summary of Significant Accounting Policies (continued)

IHI is a wholly owned subsidiary of the Foundation and is the parent holding company for various taxable entities within IHS including Technical Dynamics Inc., a biomedical equipment maintenance and engineering company. IHI and its subsidiaries operate facilities providing a variety of health care and support services to patients and to affiliated health care providers.

Cash and Cash Equivalents: IHS classifies as cash equivalents all highly liquid financial instruments with a maturity of three months or less when purchased, excluding those held in short-term investments and assets limited as to use. Cash equivalents are valued at cost, which approximates fair value.

Patient Accounts Receivable: Patient accounts receivable include charges for amounts due from all patients less price concessions relating to allowances for the excess of established charges over the payments to be received on behalf of patients covered by Medicare, Medicaid and other insurers. The provision for price concessions is based upon management's assessment of historical and expected net collections considering historical business and economic conditions, trends in health care coverage, and other collection indicators. Periodically throughout the year, management assesses the adequacy of the price concessions based upon historical experience of self-pay accounts receivable, including those balances after insurance payments and not covered by insurance. The results of this review are then used to make any modifications to the provision for price concessions. There have been no significant changes in the current year to the underlying assumptions used by IHS to estimate the allowance for price concessions. Patient accounts receivable are written off after collection efforts have been followed in accordance with IHS policies.

All operating entities of IHS treat emergency patients and provide medically necessary treatment to patients regardless of their ability to pay. A patient is classified as a charity patient based upon established IHS' policies that consider patient income levels as well as other factors including credit histories and demographic information. Since IHS does not pursue collection of amounts that qualify as charity care, these amounts are deducted from gross revenue.

Assets Whose Use Is Limited: Assets whose use is limited include board-designated funds for plant replacement and expansion and construction projects, funds restricted by donors for charitable purposes, funds restricted to cover self-insurance liabilities, and trustee-held assets restricted for the retirement of long-term liabilities. The related restricted cash and cash equivalents included in funds by donor, for professional and health liabilities, and held by bond trustee are included the accompanying Consolidated Statements of Cash Flows for the years ended December 31, 2019 and 2018.

Investments in equity securities with readily determinable fair values and all investments in debt securities held by IHS' custodian are designated as trading securities. Investment income (including realized gains and losses, unrealized gains and losses, interest, and dividends) is included in excess of revenues over expenses (expenses over revenues) unless such earnings are subject to donor-imposed restrictions. Investment income restricted by donor stipulations is reported as an increase in net assets with donor restrictions. Unrealized gains and losses on investments classified as other-than-trading are reported as a change in net assets without donor restrictions and, in accordance with relevant accounting literature, are excluded from excess of revenues over expenses (expenses over revenues). IHS also holds investments in limited partnerships as a conduit for investments that are not actively traded. These investments are summarized as alternative investments. Alternative investments are accounted for under the equity method of accounting using the net asset value ("NAV") practical expedient. Investments designated as other-than-trading are periodically reviewed for impairment conditions, including the magnitude and duration of the decline that indicate the occurrence of an other-than-temporary decline. If such conditions exist, the investment's cost is then written down to its current market value. IHS did not identify the occurrence of other-than-temporary declines in fair value for the years ended December 31, 2019 or 2018.

Inova Health System
Notes to Consolidated Financial Statements (continued)
December 31, 2019 and 2018

2. Summary of Significant Accounting Policies (continued)

Investment securities and limited partnerships, in general, are exposed to various risks, such as interest rate, credit, and overall market volatility risks. Due to the level of risks associated with certain investment securities and limited partnerships, it is reasonably possible that changes in the value of the investments could occur in the short-term and that changes could materially affect the amounts reported in the IHS' consolidated financial statements.

Fair Value Measurements: IHS evaluates assets and liabilities subject to fair value measurements on a recurring basis to determine the appropriate level in which to classify them for each reporting period. See Note 7.

Property, Equipment and Leasehold Interests: Property and equipment acquisitions are recorded at cost. Depreciation is provided over the estimated useful life of each class of depreciable assets, and is computed using the straight-line method. The general range of useful lives is five to twenty years for land improvements, ten to thirty years for buildings, fixed equipment, and leasehold improvements, and five to ten years for major movable equipment. Software and other IT equipment are included in major movable equipment with useful lives of three to five years. Equipment under finance leases obligations is amortized using the straight-line method over the shorter period of the lease term or the estimated useful life of the equipment. Such amortization is included in depreciation and amortization in the accompanying Consolidated Statements of Operations and Changes in Net Assets. Interest cost incurred on borrowed funds during the period of construction of capital assets is capitalized as a component of the cost of acquiring those assets. Repairs and maintenance are expensed as incurred.

Donated assets are recorded at their fair value at the date of donation. Gifts of long-lived assets such as land, buildings, or equipment are reported as unrestricted support unless explicit donor stipulations specify how the donated assets must be used. Gifts of long-lived assets with explicit restrictions that specify how the assets are to be used and gifts of cash or other assets that must be used to acquire long-lived assets are reported as restricted support.

Net Assets: Net assets, revenues, gains, and losses are classified based on the existence or absence of donor or grantor imposed restrictions. Accordingly, net assets and changes therein are classified and reported as follows:

Net Assets without Donor Restrictions: Net assets available for use in general operations and not subject to donor restrictions. The governing board has designated, from net assets without donor restrictions, net assets for an operating reserve and board-designated funds.

Net Assets with Donor Restrictions: Net assets with donor restrictions are those whose use by IHS has been limited by donors to a specific time period or purpose, or in perpetuity. Annual changes in fair value are reported as increases or decreases in net assets with donor restrictions.

Donor-restricted Gifts: Unconditional promises to give cash and other assets are reported at fair value at the date the promise is received. Contributions received are reported as net assets with donor restrictions if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, net assets with donor restrictions are reclassified as assets without donor restrictions and reported in the accompanying Consolidated Statements of Operations and Changes in Net Assets as net assets released from restriction. Donor-restricted contributions whose restrictions are met within the same year as received and contributions received where no restrictions were stipulated are reflected as contributions without donor restrictions and reported in the accompanying consolidated financial statements as other operating revenue.

Inova Health System
Notes to Consolidated Financial Statements (continued)
December 31, 2019 and 2018

2. Summary of Significant Accounting Policies (continued)

Excess of Revenues over Expenses (Expenses over Revenues): The accompanying Consolidated Statements of Operations and Changes in Net Assets include the excess of revenues over expenses (expenses over revenues) as the performance indicator. Changes in unrestricted net assets that are excluded from the excess of revenues over expenses (expenses over revenues), consistent with industry practice, include unrealized gains and losses on other-than-trading assets limited as to use and investments to the extent losses are deemed temporary, contributions of long-lived assets (including assets acquired using contributions, which by donor restriction were to be used for the purposes of acquiring such assets).

Investments in and Receivables from Affiliates: IHS makes investments in corporations and other forms of businesses. Investments where less than 50% of the voting common stock is owned by IHS as well as certain partnership and limited liability company investments in which IHS does not have the ability to exercise significant influence are accounted for using the equity method. See Note 8. Joint ventures where IHS has greater than 50% ownership or control or more are included in the accompanying consolidated financial statements in which the proportionate share owned by third parties is included within non-controlling interest. All significant intercompany transactions have been eliminated.

Goodwill and Other Intangible Assets: Financial Accounting Standards Board (“FASB”) guidance requires business combinations to be accounted for using the acquisition method of accounting and it also specifies the types of acquired intangible assets that are required to be recognized and reported separately from goodwill. Goodwill represents the excess of cost of acquisition over the fair value of net assets acquired. Other intangible assets primarily represent the values assigned to subscriber bases, provider and hospital networks, and trademarks. With the adoption of Accounting Standards Update (“ASU”) 2019-06 effective January 1, 2019, IHS elected the accounting alternative which allows goodwill and other intangible assets with indefinite lives to be amortized on a straight-line basis over 10 years, or less if management demonstrates that another useful life is more appropriate, and tested for impairment upon the occurrence of a triggering event at the entity level. See Note 9.

Interest Rate Swap Agreements: IHS has entered into interest rate swap agreements to manage the net exposure to interest rate changes related to its borrowings and to manage its overall borrowing costs. For designated cash flow hedges, the change in its fair value is recorded as a change in other unrestricted net assets. For interest rate swaps not designated or qualifying as hedges, changes in fair value are recorded in investment income (loss) and other, net. See Note 11.

Long-term Investments: IHS maintains a strategic portfolio of investments in various funds and other unaffiliated companies. IHS’ ownership stake ranges from 0.8% to 12.7% and IHS does not have the ability to exert significant influence over the investees. These investments are measured at fair value with any changes recognized within investment income (loss) and other, net. For the equity investments that do not have a readily determinable fair value using the NAV practical expedient, IHS measures those investments using the measurement alternative. The measurement alternative measures those investments at cost, less any impairment, plus or minus changes resulting from observable price changes in orderly transactions for the identical or a similar investment of the same issuer.

Income Taxes: The Foundation, IHCS, and LHC are not-for-profit corporations and have been determined to be exempt from Federal income tax under the provisions of section 501(c)(3) of the Internal Revenue Code. Therefore, these entities will not incur any liability for federal income tax, except for possible unrelated business income. IHI and its subsidiaries are taxable organizations. Deferred income taxes are provided for all significant timing differences between revenues and expenses reported for financial statement and for tax purposes. Management annually reviews its tax positions and has determined that there are no material uncertain tax positions that require recognition in the consolidated financial statements. Accounting principles generally accepted in the United States require management

Inova Health System
Notes to Consolidated Financial Statements (continued)
December 31, 2019 and 2018

2. Summary of Significant Accounting Policies (continued)

to evaluate uncertain tax positions taken by IHS. The financial statement effects of a tax position are recognized when the position is more likely than not, based on the technical merits, to be sustained upon examination by the Internal Revenue Service. Management has concluded that as of December 31, 2019 and 2018, there are no uncertain positions taken or expected to be taken. IHS has recognized no interest or penalties related to uncertain tax positions. IHS is subject to routine audits by taxing jurisdictions; however, there are currently no audits for any tax periods in progress. Management believes that IHS is no longer subject to income tax examinations for years prior to 2016.

The Tax Cuts and Jobs Act (the Act) was enacted on December 22, 2017. The Act reduces the US federal corporate tax rate from 35% to 21%, requires companies to pay a one-time transition tax on earnings of certain foreign subsidiaries that was previously tax deferred and creates new taxes on certain foreign sourced earnings. For tax-exempt entities, the Act also requires organizations to pay an excise tax on remuneration above certain thresholds that is paid to executives by the organization, report income or loss from unrelated business activities on an activity-by-activity basis, and repeals tax-exempt status of advanced refunding bond issuances among other provisions. At December 31, 2019, IHS has made a reasonable estimate of the tax effects of the enactment of the Act. Certain regulatory guidance provides for a measurement period of up to one year during which the accounting for the tax effects of the Act may be completed. IHS may record further adjustments in future periods upon obtaining, preparing, or analyzing additional information about facts and circumstances that existed as of the date of enactment that would have affected the income tax effects initially reported. IHS will continue to revise and refine the calculations as additional IRS guidance is issued.

Leases: Effective January 1, 2019, IHS adopted ASU 2016-02, *Leases (Topic 842)*, using the modified retrospective approach. For the impact of adoption and other required disclosures, see Note 12. IHS enters into lease agreements for equipment, office space and certain facilities in conducting its normal business operations. Operating leases are included in long-term right-of-use assets, current lease liability and long-term lease liability in IHS's accompanying Consolidated Balance Sheets.

Right-of-use assets represent IHS's right to use an underlying asset for the lease term and lease liabilities represent its obligation to make lease payments arising from the lease. At the inception of any contract, IHS evaluates the agreement to determine whether the contract contains a lease. If the contract contains a lease, IHS then evaluates the term and whether the lease is an operating or finance lease. Most leases include one or more options to renew or may have a termination option. IHS determines whether these options are reasonably certain to be exercised at the inception of the lease. The depreciable life of right-of-use assets and leasehold improvements are limited by the expected lease term, unless there is a transfer of title or purchase option that is reasonably certain to be exercised at the inception of the lease. The lease expense is recognized on a straight-line basis in the accompanying Consolidated Statements of Operations and Changes in Net Assets over the terms of the respective leases. Leases with an initial term of 12 months or less are not recorded on the accompanying Consolidated Balance Sheets.

Topic 842 includes an accounting policy election for non-public business entities to use the risk-free rate for the measurement of lease liabilities. IHS elected to utilize the risk-free rate for the measurement of lease liabilities for initial transition and going forward. This rate will be applied to all leases using a period comparable to the lease.

Non-controlling Interest: The non-controlling interest in a subsidiary is presented within net assets in the IHS's accompanying Consolidated Balance Sheet and Consolidated Statements of Operations and Changes in Net Assets and represents the proportionate share owned by third parties. IHS presents the unrestricted non-controlling interest and the amount of consolidated changes in net assets in the accompanying Consolidated Statements of Operations and Changes in Net Assets. The carrying amount of the non-controlling interest is adjusted based on an allocation of subsidiary earnings based on ownership interest.

Inova Health System
Notes to Consolidated Financial Statements (continued)
December 31, 2019 and 2018

2. Summary of Significant Accounting Policies (continued)

Subsequent Events: IHS has evaluated subsequent events that have occurred for recognition and disclosure through March 20, 2020, the date the accompanying consolidated financial statements were available for issuance.

Risk Factors: IHS' ability to maintain and/or increase future revenues or income could be adversely affected by: (i) the pressure to contain costs and assume risks that may result from payors promoting alternative methods for health care delivery or payment of services, such as discounted fee for service networks, valued-based payments, and capitated fee arrangements; (ii) increased competition from other hospital facilities and integrated health care delivery systems in IHS' service areas; (iii) new statutory, legal or regulatory requirements, or structural, operational or payment changes to the health care industry, resulting from changes of the Patient Protection and Affordable Care Act and other similar health care reform measures; (iv) changes in revenue mix, or delays in receiving payments from third party payors, including any payments from the State of Virginia that may result if there were delays in appropriations and state budget deficits; (v) proposed and/or future changes in the laws, rules, regulations and policies relating to the definition, activities, and/or taxation of non-profit tax-exempt entities; (vi) future legislation, regulation or other actions by federal, state and local governments and their agencies which may impose requirements or continue the trend toward more restrictive limitations on reimbursement for health care services; (vii) future legislation or adverse trends affecting the costs related to professional liability coverage; (viii) the future of Virginia's Certificate of Need program, where future deregulation could result in the entrance of new competitors, or future additional regulation may eliminate IHS' ability to expand new services; (ix) changes in general and local economic conditions that could influence patients' ability to pay for services or the adequacy of patients' health insurance coverage; (x) a potential shortage of physicians, qualified nurses and other skilled health care professionals in the local employment market; and (xi) changes in general and local economic conditions that could cause volatility in investments, capital and debt markets and may impose limitations to timely access to debt markets.

IHS is aware of certain additional risks regarding the spread of COVID-19, a strain of coronavirus. On March 11, 2020, the World Health Organization declared COVID-19 a pandemic, and on March 13, 2020, President Trump declared a national emergency. The federal government and a large number of state governments, including Virginia, have imposed strict measures to curtail certain aspects of public life in an effort to contain the virus as U.S. cases have risen sharply in March 2020.

An outbreak of an infectious disease, including the growth in the magnitude or severity of COVID-19 cases in IHS's service area, could result in an abnormally high demand for health care services, potentially inundating hospitals with patients in need of intensive care services, and the treatment of a highly contagious disease at one of the IHS facilities could also result in a temporary shutdown of facilities or diversion of patients or staffing shortages. Additionally, certain elective procedures may be deferred, resulting in reduced patient volumes and operating revenues. Further, the changing global economic conditions or potential global health concerns such as the COVID-19 may also affect IHS's partners, suppliers, distributors and payors, potentially disrupting or delaying IHS's supply chain and delaying reimbursement by governmental or private payors. It is not possible to predict the costs associated with responding to an infectious disease outbreak by IHS or preparation for such treatment.

In addition to the direct impact to the health care industry, financial markets in the United States and globally have recently seen significant declines attributed to COVID-19 concerns. The continued spread of COVID-19 or any other similar outbreaks in the future may materially adversely impact the IHS's financial condition, liquidity and results of operations, as well as national and local economies.

Inova Health System
Notes to Consolidated Financial Statements (continued)
December 31, 2019 and 2018

2. Summary of Significant Accounting Policies (continued)

Although IHS has activated plans to address the COVID-19 threat and is operating pursuant to infectious disease protocols and its emergency preparedness plan, the potential impact of a pandemic, epidemic or outbreak of an infectious disease with respect to the IHS service area or facilities is difficult to predict and could adversely impact the business, financial condition or results of operations, and, accordingly, may materially adversely impact the financial condition of IHS.

Recent Accounting Pronouncements: Effective January 1, 2019, IHS adopted FASB Accounting Standards Update (ASU) 2016-02, *Leases (Topic 842)*, using the modified retrospective approach and elected an application date equal to the later of (1) the beginning of the earliest comparative period presented in the financial statements and (2) the commencement date of the lease. The modified retrospective approach provides a method of recording existing leases at adoption and in comparative periods that approximates the results of a full retrospective approach. This ASU requires the rights and obligations arising from the lease contracts, including existing and new arrangements, to be recognized as assets and liabilities on the accompanying Consolidated Balance Sheets. The ASU also requires disclosures to help financial statement users better understand the amount, timing, and uncertainty of cash flows arising from leases.

IHS elected the package of practical expedients permitted under the transition guidance within the new standard, which among other things, eliminates the requirement to reassess 1) whether any expired or existing contracts that commenced before the effective date are, or contain, leases, 2) the lease classification for any expired or existing leases, and 3) initial direct costs for any existing leases. IHS also elected the practical expedient which allows Inova to treat the lease and non-lease components of a contract as a single component and account for as a lease. This election will only be applied to supply chain and information technology contracts and not for real estate contracts.

The adoption of the ASU resulted in the recording of additional net lease assets and lease liabilities of \$157 million on the accompanying Consolidated Balance Sheets as of January 1, 2018. The standard did not materially impact our accompanying Consolidated Statements of Operations and Changes in Net Assets, Statements of Cash Flows for the year ended December 31, 2018. See Note 12.

Effective January 1, 2019, IHS adopted FASB issued ASU 2018-15, *Intangibles – Goodwill and Other, Internal-Use Software (Subtopic 350-40), Customer’s Accounting for Implementation Cost Incurred in a Cloud Computing Arrangement That Is a Service Contract*. This ASU aligns the requirements for capitalizing cost incurred in a hosting arrangement that is a service contract with the requirements for capitalizing implementation costs incurred to develop or obtain internal use software. In February 2019, IHS entered into a cloud services agreement which included a subscription package for Oracle Software as a Service (SaaS) Cloud Services for a ten-year fixed noncancelable term with the option to renew for the subsequent five years. As a result of implementation of ASU, IHS recorded \$20.3 million in capitalized implementation costs as part of other long-term assets as of December 31, 2019.

Effective January 1, 2019, IHS adopted FASB issued ASU 2016-18, *Statement of Cash Flows (Topic 230): 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. Refer to Note 2 on assets whose use is limited.

Inova Health System
Notes to Consolidated Financial Statements (continued)
December 31, 2019 and 2018

2. Summary of Significant Accounting Policies (continued)

Effective January 1, 2019, IHS adopted FASB ASU 2018-08, *Not-for-Profit Entities – Clarifying the Scope and Accounting Guidance for Contributions Received and Contributions Made (Topic 958)*, using a modified retrospective approach. This ASU provides a more robust framework to determine when a transaction should be accounted for as a contribution or as an exchange transaction and provides additional guidance about how to determine whether a contribution is conditional. The adoption of ASU did not have a material impact on the consolidated financial statements.

Effective January 1, 2019, the FASB issued ASU 2019-06, *Intangibles – Goodwill and Other (Topic 350), Business Combinations (Topic 805), and Not-for-Profit Entities (Topic 958): Extending the Private Company Accounting Alternatives on Goodwill and Certain Identifiable Intangible Assets to Not-for-Profit Entities*. This ASU, upon election of the accounting alternative method, provides that goodwill and certain indefinite-lived intangible assets be amortized on a straight-line basis. Additionally, under this ASU, impairment testing is only required upon the occurrence of a triggering event and the company has the option to test for impairment at the entity level. The provisions of ASU 2018-15 are effective for IHS for annual periods beginning after December 15, 2020, and interim periods thereafter. Early adoption is permitted. The ASU was early adopted effective January 1, 2019. The adoption of ASU did not have a material impact on the consolidated financial statements.

In January 2016, the FASB issued ASU 2016-01, *Recognition and Measurement of Financial Assets and Financial Liabilities (Subtopic 825-10)*. This update requires: 1) certain equity investments to be measured at fair value, 2) simplifies the impairment assessment of equity investments, 3) eliminates certain disclosures, 4) requires management to evaluate the need for a valuation allowance on certain deferred tax assets and, 5) requires separate presentation of certain amounts in the financial statements. The ASU was adopted effective January 1, 2019. The adoption of ASU did not have a material impact on the consolidated financial statements.

New Accounting Standards Not Yet Adopted: In June 2016, the FASB issued ASU 2016-13, *Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*. ASU 2016-13 requires financial assets measured at amortized cost to be presented at the net amount expected to be collected. The measurement of expected credit losses is based on relevant information about past events, including historical experience, current conditions, and reasonable and supportable forecasts that affect the collectibility of the reported amounts. An entity must use judgment in determining the relevant information and estimation methods that are appropriate in its circumstances. ASU 2016-13 is effective for annual reporting periods beginning after December 15, 2022, including interim periods within those fiscal years, and a modified retrospective approach is required, with a cumulative-effect adjustment to net assets as of the beginning of the first reporting period in which the guidance is effective. Management is currently evaluating the impact of adopting this new accounting guidance.

In March 2017, the FASB issued ASU 2017-08, *Receivables – Nonrefundable Fees and Other Costs: Premium Amortization on Purchased Callable Debt Securities (Subtopic 310-20)*. The amendments to this updated shorten the amortization period for certain callable debt securities held at a premium. Specifically, the amendments require the premium to be amortized to the earliest call date. The amendments do not require an accounting change for securities held at a discount; the discount continues to be amortized to maturity. The amendments in this update are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. Management is currently evaluating the impact that the adoption of ASU 2017-08 will have on its consolidated financial statements.

In August 2018, the FASB issued ASU 2018-13, *Fair Value Measurements (Topic 820)*. This ASU improves the effectiveness of the notes to the financial statements through changes in disclosure requirements for fair value measurement. The ASU is effective January 1, 2020 and will be applied using a retrospective approach. IHS is currently assessing the impact of the ASU on the consolidated financial statements.

Inova Health System
Notes to Consolidated Financial Statements (continued)
December 31, 2019 and 2018

3. Net Patient Service Revenue

IHS adopted the new standard ASU 2014-09, *Revenue from Contracts with Customers (Topic 606)*, effective January 1, 2018, using the full retrospective method. The most significant change from the adoption of the new standard relates to IHS' estimation for the allowance for doubtful accounts. Under the previous standards, IHS' estimate for amounts not expected to be collected based upon historical experience, were reflected as provision for bad debts and deducted from net patient service revenue to arrive at net patient service revenue less provision for bad debts. Under the new standard, those amounts will continue to be recognized as a reduction to net patient service revenue, however, not reflected separately as provision for bad debts, and accordingly the caption net patient service revenue less provision for bad debts will no longer be presented on the accompanying Consolidated Statements of Operations and Changes in Net Assets. Subsequent changes in the estimate of collectability due to a change in the financial status of a payor, for example a bankruptcy, will be recognized as bad debt expense in operating expenses.

Accordingly, the net patient service revenue is presented for the year ended 2019 and 2018. IHS's revenues generally relate to contracts with patients in which our performance obligations are to provide health care services to the patients. Revenues are recorded during the period the obligations to provide health care services are satisfied. Performance obligations for inpatient services are generally satisfied over periods that average approximately five days, and revenues are recognized based on charges incurred in relation to total expected charges. Performance obligations for outpatient services are generally satisfied over a period of less than one day. The contractual relationship with patients, in most cases, also involve a third-party payor (Medicare, Medicaid, managed care health plans and commercial insurance companies, including plans offered through the health insurance exchanges) and the transaction prices for services provided are dependent upon the terms provided by (Medicare and Medicaid) or negotiated with (managed care health plans and commercial insurance companies) the third-party payors. The payment arrangements with third-party payors for services provided patients typically specify payments at amounts less than IHS's standard charges. Medicare generally pays for inpatient and outpatient services at prospectively determined rates based on clinical, diagnostic and other factors. Services provided to patients having Medicaid coverage are generally paid at prospectively determined rates per discharge, per identified service or per covered member. Agreements with commercial insurance carriers, managed care and preferred provider organizations generally provide for payments based on predetermined rates per diagnosis, per diem rates or discounted fee-for-service rates. Management continually reviews the contractual estimation process to incorporate updates to laws and regulations and the frequent changes in managed care contractual terms resulting from contract renegotiations and renewals.

IHS' net patient service revenues are based upon the estimated amounts that management expects to be entitled to receive from patients and third-party payors. Estimates of contractual allowances under managed care and commercial insurance plans are based upon the payment terms specified in the related contractual agreements and are recognized as explicit price concessions. Revenues related to uninsured patients and uninsured copayment and deductible amounts for patients who have health care coverage may have discounts applied (uninsured discounts and contractual discounts). Management also records estimated implicit price concessions (based primarily on historical collection experience) related to uninsured accounts to record self-pay revenues at the estimated amounts that it expects to collect.

IHS has elected the practical expedient allowed under FASB ASC 606-10-32-18 and does not adjust the promised amount of consideration from patients and third-party payors for the effects of a significant financing component due to IHS' expectation that the period between the time the service is provided to a patient and the time that the patient or third-party payor pays for that service will be one year or less. However, IHS does, in certain circumstances, enter into payment agreements with patients that allow payments in excess of one year. For those cases, the financing component is not deemed to be significant to the contract.

Inova Health System
Notes to Consolidated Financial Statements (continued)
December 31, 2019 and 2018

3. Net Patient Service Revenue (continued)

	2019		2018	
Medicare	\$ 648,110	17.2%	\$ 625,279	18.4%
Medicaid	234,073	6.2%	135,108	4.0%
Commercial and other	2,742,596	72.9%	2,489,280	73.1%
Net Patient Service Revenue	3,624,779	96.3%	3,249,667	95.5%
Other operating revenue	139,094	3.7%	153,168	4.5%
Total Operating Revenue	\$ 3,763,873	100.0%	\$ 3,402,835	100.0%

Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. Settlements with third-party payors for retroactive adjustments due to audits, reviews, or investigations are considered variable consideration and are included in the determination of the estimated transaction price for providing patient care. These settlements are estimated based on the terms of the payment agreements with the payor, correspondence from the payor and IHS' historical settlement activity, including an assessment to ensure it is probable a significant reversal in the amount of cumulative revenue recognized will not occur when the uncertainty associated with the retroactive adjustment is subsequently resolved. Estimated settlements are adjusted in future periods as adjustments become known, or as years are settled or are no longer subject to such audits, reviews and investigations. Adjustments arising from a change in the transactions price were not significant in 2019 and 2018.

The collection of outstanding receivables for Medicare, Medicaid, other third-party payors and patients is IHS' primary source of cash and is critical to its operating performance. IHS' practice is to assign a patient to the primary payor and not reflect other uninsured balances as self-pay. Therefore, the payors listed above contain patient responsibility components such as deductibles and copayments. The primary collection risks relate to uninsured patient accounts, including patient accounts for which the primary insurance carrier has paid the amounts covered by the applicable agreement, but patient responsibility amounts remain outstanding. Implicit price concessions relate primarily to amounts due directly from patients. Estimated price concessions are recorded for all uninsured accounts, regardless of the aging of those accounts. Accounts are written off when all reasonable internal and external collection efforts have been performed.

The estimates for implicit price concessions are based upon management's assessment of historical write-offs and expected net collections, business and economic conditions, trends in federal, state and private employer health care coverage and other collection indicators. Management relies on the results of detailed reviews of historical write-offs and collections at facilities that represent a majority of IHS' revenues and patient accounts receivable (the "hindsight analysis") as a primary source of information in estimating the collectability of patient accounts receivable. Management performs a hindsight analysis monthly, utilizing rolling twelve-month patient accounts receivable collection and write-off data. Management believes monthly updates to the estimated implicit price concession amounts at each of IHS' healthcare facilities provide reasonable estimates of its revenues and valuations of its patient accounts receivable. These routine, monthly changes in estimates have not resulted in material adjustments to the valuations of patient accounts receivable or period-to-period comparisons of the results of operations. For the years ended December 31, 2019 and 2018, estimated implicit price concessions of \$178.8 million and \$182.3 million, respectively, had been recorded as reductions to IHS' revenues and patient accounts receivable balances to enable management to record IHS' revenues and patient accounts receivable at the estimated amounts that they expect to collect.

Inova Health System
Notes to Consolidated Financial Statements (continued)
December 31, 2019 and 2018

4. Charity Care and Other Community Benefits

IHS provides healthcare services to patients who meet certain criteria under its charity care policy without charge (or at amounts less than the established rates). Since IHS does not pursue collection of amounts that qualify as charity care, such amounts are not reported as net patient service revenue. The amounts reported as charity care represent the cost of rendering such services typically based on the cost to charge ratio for each facility. Various government programs provide for the indigent, including Medicaid recipients. These programs provide a percentage of reimbursement for qualifying patients; however, payment is typically below the cost of those services.

In addition to charity and uncompensated care, IHS provides benefits to the broader community. These services include free health screenings, educational services, prevention services, and support programs. In addition, IHS incurs significant unreimbursed costs in providing medical education and performing medical research. The cost is estimated by utilizing a ratio of cost to gross charges applied to the gross uncompensated charges associated with providing charity care.

IHS' estimated costs of providing services to the poor and broader community for the years ended December 31, 2019 and 2018 are as follows (in thousands):

	2019	2018
Charity care	\$ 108,307	\$ 129,984
Unpaid cost of state programs to financially disadvantaged persons	221,073	144,908
Community health programs	28,646	24,776
Medical education and research	30,254	23,777
Total community benefits, at cost	\$ 388,280	\$ 323,445

5. Property, Equipment and Leasehold Interests

The components of property, equipment and leasehold interests, including capital lease assets, at cost, and the related accumulated depreciation were as follows at December 31, 2019 and 2018 (in thousands):

	2019	2018
Land and land improvements	\$ 222,087	\$ 222,032
Buildings, fixed equipment and leasehold improvements	3,009,507	2,703,086
Major movable equipment	1,730,598	1,635,487
	4,962,192	4,560,605
Less: Accumulated depreciation and amortization	(2,854,075)	(2,671,251)
	2,108,117	1,889,354
Construction-in-progress	387,503	490,559
Total	\$ 2,495,620	\$ 2,379,913

Inova Health System
Notes to Consolidated Financial Statements (continued)
December 31, 2019 and 2018

6. Investments

IHS' investments as of December 31, 2019 and 2018 are as follows (in thousands):

	2019	2018
Cash and cash equivalents	\$ 256,022	\$ 523,096
Equity securities	754,097	833,740
Debt securities	1,099,717	828,039
Alternative investments	3,658,106	2,736,529
Total	\$ 5,767,942	\$ 4,921,404

Income from alternative investments is recorded in investment income and other, net on the accompanying Consolidated Statements of Operations and Changes in Net Assets. IHS invests in an array of alternative investments, primarily public, hedge, fund of funds and real asset funds, distressed debt and private equity. A substantial portion of the underlying securities held by these funds are in actively traded marketable securities. The hedge funds may invest in multiple strategies, including long and short equity, other non-directional, distressed securities, and various forms of arbitrage. The real asset funds invest primarily in commercial and residential real estate as well as the securities of natural resource companies. The distressed debt funds invest in loans of companies whose credit rating is considered below investment grade. The private equity funds invest primarily in domestic companies. For public equity and bond funds and hedge funds, the redemption frequency ranges from daily to every three years with redemption notice periods from 1 to 150 days. For real assets, distressed debt and private equity, IHS' liquidity is at the fund managers' discretion and may apply to all or portions of a particular invested amount. Total unfunded commitments to alternative investment funds are \$699.1 million and \$399.0 million as of December 31, 2019 and 2018, respectively.

Investments are carried at estimated fair value, unless recorded on the equity method of accounting using the net asset value ("NAV") practical expedient. Realized gains and losses from sales of investments are reflected in income for the period in which they occur. The average cost of the investment sold is used to determine the realized gain or loss. Interest and dividend income is reported net of investment-related expenses.

7. Fair Value Measurements

Fair value is the price that would be received to sell an asset or paid to transfer a liability, or the exit price, in an orderly transaction between market participants at the measurement date. ASC Topic 820, *Fair Value Measurement*, establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy distinguishes between market participant assumptions based on independent sources (observable inputs classified within Levels 1 and 2) and the reporting entity's own notions about market participant assumptions (unobservable inputs classified within Level 3). Transfers into and out of all levels of the fair value hierarchy are reflected at end-of-period fair value. The fair value levels are as follows:

- Level 1 inputs utilize unadjusted quoted prices in active markets for identical assets or liabilities that IHS has the ability to access at the measurement date.
- Level 2 inputs are other observable inputs for the assets or liabilities, either directly or indirectly. These may include quoted prices for similar assets and liabilities in active markets, interest rates, foreign exchange rates and yield curves that are observable at commonly quoted intervals.

Inova Health System
Notes to Consolidated Financial Statements (continued)
December 31, 2019 and 2018

7. Fair Value Measurements (continued)

- Level 3 inputs are unobservable inputs for the assets or liabilities, which are typically based on an entity's own assumptions, as there is little, if any, related market activity.

Fair value level assignment for assets and liabilities is based on the lowest level input that is significant to the fair value measurement in its entirety. IHS' assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment, and considers factors specific to the assets and liabilities.

Alternative investments represent funds included on the balance sheet that are reported using the net asset value ("NAV") practical expedient as prescribed by ASU 2015-07, *Disclosures for Investments in Certain Entities that Calculate Net Asset Value per Share*. These amounts are not required to be categorized in the fair value hierarchy. The fair value of these investments is based on the net asset value information provided by the general partner. Fair value is based on the proportionate share of the NAV based on the most recent partner's capital statements received from the general partners. This valuation methodology is consistent with the equity method.

The following tables present IHS' assets and liabilities measured at fair value on a recurring basis as of December 31, 2019 and 2018, respectively. Certain assets such as open purchases and sales do not have fair values classified within a level in the valuation hierarchy. Alternative investments are excluded from fair value tables below (in thousands).

	December 31,			
	2019	Level 1	Level 2	Level 3
Assets:				
Cash and cash equivalents	\$ 256,022	\$ 248,043	\$ 7,979	\$ –
U.S. government and agency securities	615,631	–	615,631	–
Corporate and other bonds				
– Asset-backed securities	235,548	–	235,548	–
– Corporate and other bonds	220,257	–	220,257	–
– Other government securities	28,281	–	28,281	–
Equity securities				
– Domestic	90,925	90,925	–	–
– International	230,892	230,892	–	–
Mutual fund / ETF				
– Equity	373,303	373,303	–	–
– Fixed income and other	58,977	58,977	–	–
Total assets	\$ 2,109,836	\$ 1,002,140	\$ 1,107,696	\$ –
Liabilities:				
Interest rate swap liability	\$ (2,977)	\$ –	\$ (2,977)	\$ –
Total liabilities	\$ (2,977)	\$ –	\$ (2,977)	\$ –

Inova Health System
Notes to Consolidated Financial Statements (continued)
December 31, 2019 and 2018

7. Fair Value Measurements (continued)

	December 31,			
	2018	Level 1	Level 2	Level 3
Assets:				
Cash and cash equivalents	\$ 523,096	\$ 498,477	\$ 24,619	\$ –
U.S. government and agency securities	322,714	–	322,714	–
Corporate and other bonds				
– Asset-backed securities	208,601	–	208,601	–
– Corporate and other bonds	256,869	–	256,869	–
– Other government securities	39,855	–	39,855	–
Equity securities				
– Domestic	259,700	259,700	–	–
– International	223,066	216,418	6,648	–
Mutual fund / ETF				
– Equity	310,815	310,815	–	–
– Fixed income and other	40,159	40,159	–	–
Subtotal	2,184,875	1,325,569	859,306	–
Interest rate swap asset	6,522	–	6,522	–
Total assets	\$ 2,191,397	\$ 1,325,569	\$ 865,828	\$ –

The fair value of IHS' securities is determined by management using third-party service providers utilizing various methods dependent upon the specific type of investment. Where quoted prices are available in an active market, securities are classified within Level 1 of the valuation hierarchy. Where significant inputs, including benchmark yields, broker-dealer quotes, issuer spreads, bids, offers, the LIBOR curve and measures of volatility, are used by these third-party dealers or independent pricing services to determine fair values, the securities are classified within Level 2.

Assets utilizing Level 1 inputs include: cash and cash equivalents, exchange-traded equity securities, equity and fixed income mutual funds and exchange-traded funds.

Assets and liabilities utilizing Level 2 inputs include: U.S. government and agency securities, corporate, and municipal bonds, certain mortgage-backed securities, asset-backed securities, and foreign government issued securities. IHS entered into interest rate swap agreements in conjunction with the issuance of variable rate bonds. The swap contracts are valued using models based on readily observable market parameters for all substantial terms of the contract. See Note 12 for additional information.

Inova Health System
Notes to Consolidated Financial Statements (continued)
December 31, 2019 and 2018

8. Investments in and Receivables from Affiliates

IHS makes strategic investments in corporations and other forms of businesses. IHS accounts for investments with less than 50% ownership under the equity method of accounting and includes IHS' net equity interest in investments in and receivables from affiliates in the accompanying Consolidated Balance Sheets.

IHS invested in a joint venture with Aetna that established Innovation Health ("IHealth"), a licensed health plan serving Northern Virginia. IHealth commenced operations in July 2013. IHealth provides employers and consumers access to more affordable, coordinated and integrated health care in the region. IHS holds a 50% interest in IHealth.

IHS' ownership in significant nonconsolidated entities and the amounts included in IHS' consolidated financial statements as of December 31, 2019 and 2018 are as follows (in thousands):

	Carrying Value		Equity Method Income (Losses)	
	2019	2018	2019	2018
IHealth	\$ 53,427	\$ 46,318	\$ 7,108	\$ 9,276
Other investment accounted for under equity method	17,009	16,735	(10,814)	(7,955)
Total investments in affiliates	<u>\$ 70,436</u>	<u>\$ 63,053</u>	<u>\$ (3,706)</u>	<u>\$ 1,321</u>

The summarized financial positions and results of operations for investments in affiliates accounted for under the equity method as of and for the years ended December 31, 2019 and 2018 are as follows (in thousands) (unaudited):

	2019	2018
Total assets	\$ 228,855	\$ 210,173
Total liabilities	70,701	73,301
Net assets	158,154	136,873
Total revenues, net	394,324	393,038
Excess of (expenses over revenue) revenue over expenses (excluding minority interest)	(2,419)	6,615

Inova Health System
Notes to Consolidated Financial Statements (continued)
December 31, 2019 and 2018

9. Goodwill and Other Intangible Assets

A summary of goodwill and other intangible assets at December 31, 2019 and 2018 is as follows (in thousands):

	<u>2019</u>	<u>2018</u>
Intangible assets	\$ 8,866	\$ 8,827
Accumulated amortization	(4,980)	(3,897)
Total intangibles, net	<u>3,886</u>	<u>4,930</u>
Goodwill	37,303	37,303
Accumulated amortization	(3,810)	—
Total goodwill, net	<u>33,493</u>	<u>37,303</u>
Total goodwill and intangibles	<u>\$ 37,379</u>	<u>\$ 42,233</u>

Amortization expense of goodwill and intangible assets was \$4.8 million and \$1.3 million, for the years ended December 31, 2019 and 2018, respectively.

As a result of the ASU 2019-06, effective January 1, 2019, management, instead of testing goodwill for impairment on an annual basis, will amortize goodwill on a straight-line basis, test for impairment upon a triggering event, and have the option to elect to test for impairment at the entity level.

Upon the occurrence of a triggering event, management assesses qualitative factors to determine whether it is more likely than not that the fair value of the reporting unit is less than its carrying amount, including goodwill. If management determines that it is more likely than not that the fair value of the reporting unit is less than its carrying amount, management will determine the fair value of the reporting unit and compare the fair value of the reporting unit with its carrying amount. Goodwill impairment is recognized if the carrying amount of the reporting unit exceeds its fair value and the loss recorded shall not exceed the reporting unit's carrying amount of goodwill. There were no impairment losses recognized in 2019 and 2018.

Inova Health System
Notes to Consolidated Financial Statements (continued)
December 31, 2019 and 2018

10. Long-Term Debt

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

	<u>2019</u>	<u>2018</u>
Long-term Debt of the IHS Obligated Group		
1993A Hospital Revenue Refunding Bonds; maturing 8/15/23; semi-annual interest at a fixed rate of 2.75% to 5.25%	31,550	38,505
2005A Health Care Revenue Bonds; maturing 5/15/35; monthly interest at a variable rate and maximum of 12.0%	109,730	109,730
2010A-2 Health Care Revenue Bonds; maturing 5/15/39; monthly interest at a variable rate and maximum of 12.0%	95,000	95,000
2012A Health Care Revenue Bonds; maturing 5/15/42; semi-annual interest at a fixed rate of 2.25% to 5.0%	261,925	265,325
2012A Health Care Revenue Bonds; maturing 5/15/42; semi-annual interest at a fixed rate of 3.0% to 5.0%	60,000	60,000
2012D Health Care Revenue Bonds; maturing 5/15/29; semi-annual interest at a fixed rate of 3.0% to 5.0%	70,395	70,395
2013 Health Care Revenue Bonds; maturing 12/1/23; monthly interest at a fixed rate of 2.15%	53,930	66,510
2014A Health Care Revenue Bonds; maturing 5/15/44; semi-annual interest at a fixed rate of 2.5% to 5.0%	200,000	200,000
2016A Health Care Revenue Bonds; maturing 5/15/31; semi-annual interest at a fixed rate of 5.0%	111,880	111,880
2016B Health Care Revenue Bonds; maturing 5/15/26; semi-annual interest at a fixed rate of 5.0%	31,295	31,295
2016C Health Care Revenue Bonds; maturing 5/15/42; monthly interest at a variable rate and maximum of 12%	98,565	98,955
2018A Health Care Revenue Bonds; maturing 5/15/2048; semi-annual interest at a fixed rate of 3.0% to 5.0%	200,040	206,860
2018B Health Care Revenue Bonds; maturing 5/15/2057; semi-annual interest at a fixed rate of 5.0%	150,000	150,000
2018C Health Care Revenue Bonds; maturing 5/15/2033; monthly interest at a variable rate and maximum of 12.0%	100,000	100,000
Total Long-term Debt of the IHS Obligated Group	<u>1,574,310</u>	<u>1,604,455</u>
Less: Current Portion of Long-term Debt	(227,905)	(227,210)
Net Original Issue Premium	80,990	88,230
Net Deferred Financing Costs	(8,150)	(8,698)
Net Long-term Debt of the IHS Obligated Group	<u>\$ 1,419,245</u>	<u>\$ 1,456,777</u>
Total Long-term Debt of Non-Obligated IHS Affiliates	\$ 3,791	\$ 7,502
Less: Current Portion of Long-term Debt	(956)	(1,219)
Net Long-term Debt of Non-Obligated IHS Affiliates	<u>\$ 2,835</u>	<u>\$ 6,283</u>

The long-term debt of non-obligated IHS affiliates represents a construction loan of \$3.6 million and line of credit of \$0.2 million. The construction loan has a maturity date of July 15, 2024 and a fixed interest rate of 2.75%. The line of credit has a maturity date of January 8, 2022 and a variable interest rate, which was 4.25% as of December 31, 2019.

Inova Health System
Notes to Consolidated Financial Statements (continued)
December 31, 2019 and 2018

10. Long-Term Debt (continued)

The preponderance of IHS' debt is tax-exempt revenue bonds issued under a Master Trust Indenture, which defines the obligated subsidiaries and affiliates under the bonds. The Members of the IHS Obligated Group consist of the Foundation, IHCS and LHC. The financial statements presented for the Obligated Group include only their accounts, which includes their investment interest in controlled, affiliated entities, but does not include in the revenues, expenses, assets or liabilities of the Obligated Group the revenues, expenses, assets or liabilities of any of those controlled, affiliated entities.

On July 31, 2018, the Industrial Development Authority issued \$206.9 million of Series 2018A bonds for the benefit of the Obligated Group. The 2018A bonds are comprised of fixed rate term and coupon bonds with principal payments starting in the year 2019. Interest is payable semiannually on May 15 and November 15 of each year, commencing on November 15, 2018. The premium received was \$12.1 million. The total proceeds from the offering were \$219.0 million.

On July 31, 2018, the Industrial Development Authority issued \$150.0 million of Series 2018B bonds for the benefit of the Obligated Group. The 2018B bonds are comprised of coupon bonds with principal payments starting in May 2033. Interest is payable semiannually on May 15 and Nov 15 of each year, commencing November 15, 2018. The premium received was \$16.0 million. The total proceeds from the offering were \$166.0 million.

On July 31, 2018, the Industrial Development Authority issued \$100.0 million of Series 2018C bonds for the benefit of the Obligated Group. The 2018C bonds are comprised of self-liquidity variable rate demand bonds. Interest is payable on the first day of each month, commencing on September 1, 2018.

Approximately \$264.9 million of the proceeds of the 2018A, B, and C bonds will be used to finance various capital projects, and the remaining proceeds refunded all or a portion of Series 2017, Series 2005C and Series 2000A bonds.

IHS Obligated Group debts are secured by an interest in all funds held by the Bond Trustee for purposes of debt service, construction and equipment acquisition. Each Member of the IHS Obligated Group covenants that it will not pledge or grant a security interest in (except as may be otherwise provided in the Master Trust Indenture) any of its property. The Master Trust Indenture for the IHS Obligated Group requires that certain minimum financial ratios be met. IHS is in compliance with the financial ratio requirements.

The interest rate on the variable rate bonds ranged between 1.05% and 2.50% in 2019 and 0.80% and 2.36% in 2018. The variable rate bonds include an optional tender feature that allows the bond holder to tender the bonds on a weekly interest payment date.

The tender feature of the 2016C and 2018C Bonds and certain variable rate bonds requires IHS to maintain current assets of \$199.0 million as of December 31, 2019 and 2018, respectively, to provide for redemption of the tendered bonds. These assets are included in the current portion of assets whose use is limited.

Costs incurred in the issuance or conversion of long-term debt are deferred and amortized over the life of the related debt using the principal balance outstanding method.

Inova Health System
Notes to Consolidated Financial Statements (continued)
December 31, 2019 and 2018

10. Long-Term Debt (continued)

Certain bonds are subject to mandatory sinking fund redemption and to earlier redemption under certain circumstances as defined in the respective bond indenture agreements. Maturities of long-term debt for the five years succeeding December 31, 2019 are as follows (in thousands):

	2020	2021	2022	2023	2024	Thereafter	Total
Scheduled maturities	\$ 30,296	\$ 32,758	\$ 93,969	\$ 35,112	\$ 17,971	\$ 1,169,430	\$ 1,379,536
Bonds under remarketing agreement and subject to mandatory tender	198,565	—	—	—	—	—	198,565
Total	<u>\$ 228,861</u>	<u>\$ 32,758</u>	<u>\$ 93,969</u>	<u>\$ 35,112</u>	<u>\$ 17,971</u>	<u>\$ 1,169,430</u>	<u>\$ 1,578,101</u>

IHS issued \$100.0 million of taxable commercial paper (“CP”) under a program authorized for borrowings up to \$100.0 million with maturity dates from one to 270 days. Proceeds from this issuance were used for a variety of working capital requirements. IHS maintains a self-liquidity program that would be used to repurchase any CP that is not remarketed. All outstanding CP is included in notes payable and other liabilities in the current liabilities section of the accompanying Consolidated Balance Sheets. As of December 31, 2019 and 2018, the amount of CP outstanding was \$100.0 million.

Total interest paid was \$72.1 million and \$62.3 million for the years ended December 31, 2019 and 2018, respectively.

As of December 31, 2019 and 2018, IHS maintains unsecured lines of credit with three large commercial banks with a combined available principal amount of \$237.5 million, including a \$100 million line of credit that is scheduled to expire on June 30, 2020, which management intends to renew. There were no amounts outstanding on these credit lines as of December 31, 2019 or 2018, respectively; however, IHS drew down the entire outstanding amount as of March 20, 2020.

11. Derivative Financial Instruments

IHS entered into interest rate swap agreements in order to hedge the variability of cash flows related to changes in market interest rates on underlying variable rate debt. Below is a summary of the interest rate swap agreements as of December 31, 2019 and 2018, respectively (in thousands):

Counter Party	Notional Amount	Maturity Date	Type	Payer Rate	Receiver Rate	Fair Value	Collateral Threshold	Collateral Posted
As of December 31, 2019								
Merrill Lynch Capital Services, Inc.	\$ 50,000	5/15/2034	Fixed Payer	1.65%	67% of one-month USD LIBOR	\$ (6)	\$ 30,000	\$ —
Citibank, N.A.	100,000	1/15/2034	Variable Payer	67% of USD-LIBOR-BBA	67% of the USD-ISDA-Swap Rate minus 0.387%	(1,212)	45,000	—
JPMorgan Chase Bank, N.A.	69,495	5/15/2034	Fixed Payer	1.45%	67% of one-month USD LIBOR	(1,759)	25,000	—
Total	<u>\$ 219,495</u>					<u>\$ (2,977)</u>	<u>\$ 100,000</u>	<u>\$ —</u>
As of December 31, 2018								
Merrill Lynch Capital Services, Inc.	\$ 50,000	5/15/2034	Fixed Payer	1.65%	67% of one-month USD LIBOR	\$ 3,186	\$ 30,000	\$ —
JPMorgan Chase Bank, N.A.	69,495	5/15/2034	Fixed Payer	1.45%	67% of one-month USD LIBOR	3,336	25,000	—
Total	<u>\$ 119,495</u>					<u>\$ 6,522</u>	<u>\$ 55,000</u>	<u>\$ —</u>

Inova Health System
Notes to Consolidated Financial Statements (continued)
December 31, 2019 and 2018

12. Leases

IHS' leases equipment, office space and certain facilities. Included in the other operating expenses of the accompanying Consolidated Statements of Operations and Changes in Net Assets are lease expenses of approximately \$50.0 million and \$51.2 million in 2019 and 2018, respectively. This lease expense was offset by \$1.3 million in sublease income in both 2019 and 2018, which was included in investment income (loss) and other, net of the accompanying Consolidated Statements of Operations and Changes in Net Assets. The following table summarizes the components of our lease expense for the years ended December 31, 2019 and 2018 (in thousands):

	<u>2019</u>	<u>2018</u>
Finance lease cost		
Amortization	\$ 903	\$ 754
Interest	105	90
Total finance lease cost	<u>1,008</u>	<u>844</u>
Operating lease cost	38,236	40,362
Short-term lease cost	6,442	5,368
Variable lease cost	4,331	4,678
Total lease cost before sublease income	<u>50,017</u>	<u>51,252</u>
Less: Sublease income	<u>(1,324)</u>	<u>(1,311)</u>
Total lease cost, net of sublease income	<u>\$ 48,693</u>	<u>\$ 49,941</u>

IHS recognized \$116.6 million and \$131.6 million in right of use assets on the accompanying Consolidated Balance Sheets as of December 31, 2019 and December 31, 2018, respectively, all of which were associated operating leases and classified as noncurrent. The following table summarizes the components of operating and finance lease liabilities classified as current and noncurrent on the accompanying Consolidated Balance Sheets as of December 31, 2019 and 2018 (in thousands):

	<u>Operating Leases</u>	<u>Finance Leases</u>	<u>Total</u>
December 31, 2019			
Current	\$ 28,845	\$ 862	\$ 29,707
Long-term	100,271	1,032	101,303
Total lease liabilities	<u>\$ 129,116</u>	<u>\$ 1,894</u>	<u>\$ 131,010</u>
December 31, 2018			
Current	\$ 32,993	\$ 1,569	\$ 34,562
Long-term	110,114	2,231	112,345
Total lease liabilities	<u>\$ 143,107</u>	<u>\$ 3,800</u>	<u>\$ 146,907</u>

Inova Health System
Notes to Consolidated Financial Statements (continued)
December 31, 2019 and 2018

12. Leases (continued)

The following table summarizes cash flows from operating and finance leases for the years ended December 31, 2019 and 2018 (in thousands):

	<u>2019</u>	<u>2018</u>
Cash paid for amounts included in the measurement of lease liabilities		
Operating cash flows paid for operating leases	\$ 37,618	\$ 39,179
Operating cash flows paid for interest portion of finance leases	\$ 97	\$ 115
Financing cash flows paid for principal portion of finance leases	\$ 2,085	\$ 1,833
Right-of-use assets obtained in exchange for lease obligations		
Operating leases	\$ 16,755	\$ 7,769
Finance leases	\$ 284	\$ 2,474

The weighted-average discount rates and our weighted remaining lease terms as of December 31, 2019 and 2018 (in thousands):

	<u>2019</u>	<u>2018</u>
Weighted-average discount rate:		
Operating leases	2.48%	2.48%
Finance leases	3.41%	3.46%
Weighted-average lease term:		
Operating leases	5.37	5.81
Finance leases	2.40	2.44

The following table summarizes the maturity of operating and finance lease liabilities as of December 31, 2019 (in thousands):

	<u>Operating Leases</u>	<u>Finance Leases</u>
2020	\$ 31,659	\$ 911
2021	26,234	639
2022	22,925	349
2023	20,839	72
2024	14,311	-
Thereafter	22,181	-
Total lease payments	138,149	1,971
Less: Imputed interest	(9,033)	(77)
Total lease liabilities	<u>\$ 129,116</u>	<u>\$ 1,894</u>

Inova Health System
Notes to Consolidated Financial Statements (continued)
December 31, 2019 and 2018

13. Financing Obligation

On February 5, 2015, IHS entered into a 99-year lease agreement for rights to 117 acres of land and 1.2 million square feet of office space. This large corporate campus is adjacent to its flagship hospital in Fairfax, Virginia. Inova took possession of the site on October 1, 2015. The lease agreement provides the lessor with a put option to sell the property to IHS upon 90 days written notice for \$180.0 million at any time during the first 5 years of the lease. Starting in year 6, the lease payments decline by 50% assuming IHS makes certain capital investments on the site and the lessor becomes responsible for the property taxes. IHS believes that the lessor will exercise the put option on or before October 1, 2020 and, therefore, classified the financing obligation as a current liability on the accompanying Consolidated Balance Sheets as of December 31, 2019. This transaction was accounted for as a noncurrent liability on the accompanying Consolidated Balance Sheets as of December 31, 2018. The financing obligation was \$183.1 million and \$184.5 million as of December 31, 2019 and 2018, respectively.

Future minimum payments under this agreement, excluding the put option, with the remaining terms of one year or more consisted of the following at December 31, 2019 (in thousands):

	Financing Obligation
2020	\$ 8,750
2021	5,000
2022	5,000
2023	5,000
2024	5,000
Thereafter	1,234,533
Total lease payments	\$ 1,263,283

On March 6, 2020, Inova received notice from the lessor to exercise the put option. The purchase and sale of this property is expected to close on April 30, 2020. The purchase price at closing will be approximately \$184.2 million and is expected to be paid from funds on hand. Future minimum payments above would cease to exist subsequent to exercise.

14. Professional and Other Insurance Liabilities

IHS maintains coverage for professional and general liability through claims-made policies issued by InovaCap, LLC (“InovaCap”). InovaCap is a wholly owned captive insurance company domiciled in Vermont. Because InovaCap is a wholly owned subsidiary of IHS, its assets, liabilities, revenues and expenses are fully consolidated in the accompanying financial statements.

InovaCap retains risk of \$2.4 million per claim and \$19 million in annual aggregate for professional liability. Additional risk is reinsured in umbrella forms through Lloyds of London, other European companies, Zurich North American, and CNA, together providing limits of \$50 million per claim, and \$50 million in the aggregate, in excess of the InovaCap retention. The accompanying Consolidated Balance Sheets at December 31, 2019 and 2018 include in other noncurrent obligations \$25.2 million and \$26.7 million, respectively, based on actuarial estimates of payments to be made under its professional liability insurance programs for known claims, as well as for estimated losses on unfiled claims, which relate to events occurring in 2019 and prior years. The liabilities are discounted at 1.95% and 2.50% at December 31, 2019 and 2018, respectively.

Inova Health System
Notes to Consolidated Financial Statements (continued)
December 31, 2019 and 2018

14. Professional and Other Insurance Liabilities (continued)

Investments and other assets held by InovaCap of \$92.8 million and \$80.4 million at December 31, 2019 and 2018, respectively, are restricted by statute from being transferred to another subsidiary or obligated for any other purpose and accordingly are included as assets whose use is limited in the accompanying Consolidated Balance Sheets.

15. Fairfax County Leases

The land upon which the majority of Inova Fairfax Hospital and the entirety of Inova Mount Vernon Hospital are located and the related buildings are leased to IHS by the Board of Supervisors of Fairfax County, Virginia (“County”), under an agreement that was partially amended in 2010 (the “County Lease”). The 2010 agreement included sale of property whereby a portion of the Inova Fairfax Hospital campus land was taken out of the County Lease and ownership of that land was conveyed to IHS. There is also land owned by IHS, off-site of the hospital campus that was conveyed to Fairfax County. Effective as of December 3, 2010, the 2010 agreement extends the County Lease for the residual land for a term of 99 years and, thus, the County Lease now expires in December 2019. Under the County Lease, the property and equipment leased from the County are recorded as leasehold interests at the cost to construct or acquire. Upon termination of the County Lease, such property, including leasehold improvements and equipment will revert to the County, subject to all related long-term liabilities of IHS incurred to finance the construction and acquisition of such property, buildings and equipment.

The County Lease also requires IHS to set aside funds in an amount at least equal to the depreciation expense on the related leasehold interests. Such funds may be expended by IHS for major repairs or alterations, construction of or additions to buildings, or the purchase or replacement of equipment. IHS’ Board of Trustees has also designated additional funds for the purpose of plant expansion.

The terms of the County Lease outline an indigent care policy to assure all individuals in the County have access to medically necessary care. Patients’ payment obligations under the policy are determined using a sliding income scale which is based on the federal poverty guidelines. During the term of the County Lease, IHS has agreed to notify the County of any intent to incur additional debt in excess of \$1.0 million. IHS has also agreed to notify the County of any intent to enter into contractual agreements for the management or operation of Inova Fairfax Hospital or Inova Mount Vernon Hospital by persons other than IHS, or any intent to change hospital rates.

16. Other Commitments and Contingencies

IHS has entered into several contracts for the acquisition of equipment and for the construction of facilities. Future commitments under these contracts at December 31, 2019 and 2018 were approximately \$114.3 million and \$291.9 million, respectively. IHS currently anticipates that these projects will be financed with a combination of bond proceeds, funds generated from earnings and donations. These projects include expansion and renovation of Fairfax, Mt. Vernon, Loudoun, Alexandria and Fair Oaks hospitals and the Inova Center for Personalized Health campus.

IHS is subject to various legal claims and contingencies arising in the ordinary course of its business. While the outcomes of such matters are uncertain, management believes that their ultimate resolution will not have a material adverse effect on IHS’ financial position or on the changes in its net assets or cash flows.

Inova Health System
Notes to Consolidated Financial Statements (continued)
December 31, 2019 and 2018

17. Functional Expenses

IHS' primary program service is serving the health care needs of the community by establishing, maintaining, and operating hospital facilities, programs, and other services. Natural expenses attributable to more than one functional expense category are allocated across IHS on a variety of bases, where appropriate, including employee salaries, square footage, and operating expenses.

Expenses by functional classification for the years ended December 31, 2019 and 2018 consist of the following (in thousands):

	<u>Health Care Services</u>	<u>General and Administrative</u>	<u>Total</u>
Year ended December 31, 2019			
Salaries and benefits	\$ 1,596,625	\$ 237,841	\$ 1,834,466
Other operating expenses	1,221,455	185,023	1,406,478
Depreciation and amortization	180,528	69,346	249,874
Interest	48,941	4,401	53,342
Total Operating Expenses	<u>\$ 3,047,549</u>	<u>\$ 496,611</u>	<u>\$ 3,544,160</u>
Year ended December 31, 2018			
Salaries and benefits	\$ 1,460,278	\$ 233,635	\$ 1,693,913
Other operating expenses	1,076,911	153,856	1,230,767
Medical claims	7,234	-	7,234
Depreciation and amortization	161,470	63,162	224,632
Interest	45,608	4,527	50,135
Total Operating Expenses	<u>\$ 2,751,501</u>	<u>\$ 455,180</u>	<u>\$ 3,206,681</u>

18. Disposal of Business Line

IHS completed the sale of all of the non-monetary assets of its wholly owned subsidiary, INTotal, to United Healthcare Insurance Company ("UnitedHealth") in 2017. The sales price included \$12 million in cash and approximately \$20.4 million of additional estimated consideration payable in the fourth quarter of 2018. This estimated consideration is measured based on the number of members assigned to the UnitedHealth contract after Virginia Medicaid completes its procurement process. During the fourth quarter of 2018, IHS received the final consideration from UnitedHealth in the amount of \$24.8 million resulting in an additional \$4.7 million gain, which is included in the gain on disposal of business line in the accompanying Consolidated Statements of Operations and Changes in Net Assets for the year ended December 31, 2018.

Inova Health System
Notes to Consolidated Financial Statements (continued)
December 31, 2019 and 2018

19. Net Assets with Donor Imposed Restrictions

Net assets with donor restrictions are restricted for the following purposes as of 2019 and 2018 (in thousands):

	<u>2019</u>	<u>2018</u>
Subject to expenditure for specified purpose		
Healthcare services and programs	\$ 186,413	\$ 167,270
Employee education, recognition and support	8,500	8,179
Research	14,652	10,894
Buildings and equipment	4,683	4,894
Total net assets with donor restrictions	<u>\$ 214,248</u>	<u>\$ 191,237</u>

20. Pledges Receivable

Pledges receivable are included in the other current assets and other long-term assets in the accompanying Consolidated Balance Sheets. Amounts due in less than one year, one to five years, and more than five years were as follows as of December 31, 2019 and 2018 (in thousands):

	<u>2019</u>	<u>2018</u>
Less than one year	\$ 8,495	\$ 13,577
One to five years	49,873	53,100
More than five years	19,375	10,400
Total pledges receivable	<u>77,743</u>	<u>77,077</u>
Present value discount	(6,883)	(6,573)
Allowance for uncollectible pledges	(12,642)	(12,691)
Net pledges receivable	<u>\$ 58,218</u>	<u>\$ 57,813</u>

21. Liquidity and Availability

Financial assets available for general expenditure within one year of the balance sheet date comprise the following at December 31, 2019 and 2018 (in thousands):

	<u>2019</u>	<u>2018</u>
Cash and cash equivalents	\$ 404,350	\$ 333,100
Patient accounts receivable, net	363,704	321,920
Pledges receivable, net	6,346	10,863
Other receivables	22,512	21,092
Investments with three-day liquidity	2,732,808	2,277,641
Total	<u>\$ 3,529,720</u>	<u>\$ 2,964,616</u>



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Report of Independent Auditors on Other Supplementary Information

The Board of Trustees
Inova Health System

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 consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the 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 financial statements as a whole.

Ernst & Young LLP

March 20, 2020

Inova Health System Obligated Group
Consolidated Balance Sheets
December 31, 2019 and 2018
(in thousands)

	2019	2018
		(as adjusted)*
ASSETS		
Current Assets		
Cash and cash equivalents	\$ 380,562	\$ 302,609
Assets whose use is limited, current	198,565	198,955
Patient accounts receivable, net	347,019	307,466
Other current assets	149,624	123,084
Total Current Assets	1,075,770	932,114
Property, Equipment and Leasehold Interests, net	2,454,055	2,332,600
Assets Whose Use Is Limited, noncurrent	5,452,319	4,621,462
Other Assets		
Investments in and receivables from affiliates	146,014	138,474
Goodwill and other intangible assets, net	27,404	30,474
Long-term right of use assets	89,339	103,219
Long-term investments	50,479	49,765
Interest rate swap	–	6,522
Other long-term assets	134,069	126,217
Total Other Assets	447,305	454,671
TOTAL ASSETS	\$ 9,429,449	\$ 8,340,847
LIABILITIES AND NET ASSETS		
Current Liabilities		
Accounts payable and other accrued expenses	\$ 424,144	\$ 380,630
Third-party settlements	44,546	46,354
Notes payable and other liabilities	108,152	108,715
Financing obligation	183,167	–
Current portion of long-term debt	227,905	227,210
Current lease liability	21,626	25,269
Total Current Liabilities	1,009,540	788,178
Non-current Liabilities		
Long-term debt, less current portion	1,419,245	1,456,776
Financing obligation	–	184,461
Long-term lease liability	75,324	84,855
Interest rate swap	2,977	–
Other non-current obligations	42,050	50,846
Total Non-current Liabilities	1,539,596	1,776,938
Net Assets		
Without donor restrictions	6,694,261	5,608,819
With donor restrictions	186,052	166,912
Total Net Assets	6,880,313	5,775,731
TOTAL LIABILITIES AND NET ASSETS	\$ 9,429,449	\$ 8,340,847

*Refer to Note 2 regarding the adoption of the new lease accounting standard, including impacts on previously reported results.

NOTE: The Obligated Group consists of Inova Health System Foundation, Inova Health Care Services and Loudoun Hospital Center, and the financial statements presented for the Obligated Group includes only their accounts, which includes their investment interest in controlled, affiliated entities, but does not include in the revenues, expenses, assets or liabilities of the Obligated Group the revenues, expenses, assets, or liabilities of any of those controlled, affiliated entities.

Inova Health System Obligated Group
Consolidated Statements of Operations and Changes in Unrestricted Net Assets
For the Periods Ended December 31 , 2019 and 2018
(in thousands)

	<u>2019</u>	<u>2018</u>
Operating Revenues		
Net patient service revenue	\$ 3,421,107	\$ 3,055,929
Other operating revenue	122,311	132,462
Total Operating Revenues	<u>3,543,418</u>	<u>3,188,391</u>
Operating Expenses		
Salaries and benefits	1,718,656	1,579,412
Other operating expenses	1,344,975	1,175,689
Depreciation and amortization	240,792	215,232
Interest	52,904	49,581
Total Operating Expenses	<u>3,357,327</u>	<u>3,019,914</u>
Operating Income before Gain on Disposal of Business Line	186,091	168,477
Gain on Disposal of Business Line	–	4,714
Investment income (loss) and other, net	898,279	(305,028)
Excess of Revenues Over Expenses (Expenses over Revenues)	<u>1,084,370</u>	<u>(131,837)</u>
Unrealized (losses) gain on investments, net	(394)	710
Capital infusion to controlled affiliate	–	(4,141)
Sale of noncontrolling position	–	8,624
Amortization of or prior service credit and net actuarial gains of postretirement medical plan	(337)	–
Distributions received from non-obligated group members	–	40,000
Other	1,803	672
Increase (Decrease) in net assets without donor restrictions	<u>\$ 1,085,442</u>	<u>\$ (85,972)</u>

NOTE: The Obligated Group consists of Inova Health System Foundation, Inova Health Care Services and Loudoun Hospital Center, and the financial statements presented for the Obligated Group includes only their accounts, which includes their investment interest in controlled, affiliated entities, but does not include in the revenues, expenses, assets or liabilities of the Obligated Group the revenues, expenses, assets, or liabilities of any of those controlled, affiliated entities.

Inova Health System Obligated Group
Consolidated Statements of Cash Flows
For the Periods Ended December 31 , 2019 and 2018
(in thousands)

	2019	2018
		(as adjusted)*
Operating Activities		
Change in net assets	\$ 1,104,582	\$ (58,758)
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation and amortization	240,792	215,232
Net realized and unrealized (gains) losses on investments	(822,837)	403,720
Change in fair value of interest rate swaps	9,499	(4,850)
Equity investment gains, net	(20,454)	(31,293)
Gain on sale of long-lived assets	—	(2,253)
Loss on extinguishment of debt	—	120
Increase in accounts receivable and third-party settlements, net	(50,503)	(15,804)
(Increase) decrease in other current assets	(22,463)	52,921
Increase in accounts payable and other current liabilities	56,581	11,017
Decrease in other non-current obligations	(4,965)	(346)
Restricted contributions and other restricted income	(35,286)	(42,410)
Other	(30,801)	(23,493)
Net Cash Provided by Operating Activities	424,145	503,803
Investing Activities		
Capital expenditures	(372,807)	(432,835)
Proceeds from sale of long-lived assets	—	20,242
Investments in and advances to joint ventures and affiliates	12,914	(4,107)
Purchases of investments	(2,183,016)	(1,237,255)
Proceeds from sale of investments	2,110,046	1,149,366
Net Cash Used in Investing Activities	(432,863)	(504,589)
Financing Activities		
Principal payments on long-term debt	(30,145)	(41,790)
Proceeds from issuance of long-term debt	—	484,977
Refunding of long-term debt	—	(220,050)
Restricted contributions and other restricted income	35,639	27,839
Other	(6,002)	(2,655)
Net Cash (Used in) Provided by Financing Activities	(508)	248,321
Net (Decrease) Increase in Cash, Cash Equivalents and Restricted Cash	(9,226)	247,535
Cash, Cash Equivalents and Restricted Cash at Beginning of Year	456,770	209,235
CASH, CASH EQUIVALENTS AND RESTRICTED CASH AT END OF YEAR	447,544	456,770
Less: Restricted cash included in assets whose use is limited (Note 2)	66,982	154,161
CASH AND CASH EQUIVALENTS AT END OF YEAR	\$ 380,562	\$ 302,609

*Refer to Note 2 regarding the adoption of the new lease accounting standard, including impacts on previously reported results.

NOTE: The Obligated Group consists of Inova Health System Foundation, Inova Health Care Services and Loudoun Hospital Center, and the financial statements presented for the Obligated Group includes only their accounts, which includes their investment interest in controlled, affiliated entities, but does not include in the revenues, expenses, assets or liabilities of the Obligated Group the revenues, expenses, assets, or liabilities of any of those controlled, affiliated entities.