

# **Virginia Hospital Center Arlington Health System and Affiliated Organizations**

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**Consolidated Financial Statements and  
Supplementary Consolidating Information**

**Years Ended December 31, 2018 and 2017**



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## **Independent Auditors' Report**

Board of Directors  
Virginia Hospital Center Arlington Health System and Affiliated Organizations  
Arlington, Virginia

We have audited the accompanying consolidated financial statements of Virginia Hospital Center Arlington Health System and Affiliated Organizations, which comprise the consolidated balance sheets as of December 31, 2018 and 2017, and the related consolidated statements of operations, changes in net assets, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

### ***Management's Responsibility for the Consolidated Financial Statements***

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

### ***Auditors' Responsibility***

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated 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 consolidated 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 consolidated 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 consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Virginia Hospital Center Arlington Health System and Affiliated Organizations as of December 31, 2018 and 2017, and the consolidated results of their operations and changes in their net assets and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

***Change in Accounting Principle***

As further described in Note 2 to the consolidated financial statements, Virginia Hospital Center Arlington Health System and Affiliated Organizations adopted Accounting Standards Update (ASU) 2014-09, *Revenue from Contracts with Customers (Topic 606)*, ASU 2016-14, *Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities*, and ASU 2016-18, *Statement of Cash Flows, Restricted Cash (Topic 230)*. Our opinion is not modified with respect to these matters.

***Report on Consolidating Information***

Our audit was conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The consolidating information on pages 26 - 28 is presented for purposes of additional analysis of the consolidated financial statements rather than to present the financial position and results of operations of the individual companies, and is not a required part of the consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The consolidating 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 consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the consolidating information is fairly stated in all material respects in relation to the consolidated financial statements as a whole.

*Dixon Hughes Goodman LLP*

**Tysons, Virginia  
May 6, 2019**

**Virginia Hospital Center Arlington Health System and Affiliated Organizations**  
**Consolidated Balance Sheets**  
**December 31, 2018 and 2017**

	<b>2018</b>	<b>As Adjusted 2017</b>
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 23,855,728	\$ 14,407,465
Current portion of assets whose use is limited	2,347,600	2,498,600
Net patient accounts receivable	60,568,986	47,764,873
Inventories	14,349,571	12,664,645
Prepaid expenses and other assets	13,991,507	11,615,716
	<hr/>	<hr/>
Total current assets	115,113,392	88,951,299
Investments	726,279,206	798,875,450
Assets whose use is limited:		
Held by trustee under bond indenture	2,354,216	2,501,888
Self-insurance trust	9,021,307	8,869,416
By donors	16,870,783	21,745,610
	<hr/>	<hr/>
	28,246,306	33,116,914
Less, assets available for current liabilities	<u>(2,347,600)</u>	<u>(2,498,600)</u>
	25,898,706	30,618,314
Property and equipment:		
Land and land improvements	5,205,891	5,205,891
Buildings and fixed equipment	326,966,848	311,518,526
Movable equipment	400,392,406	344,625,765
Construction in progress	10,630,254	36,215,181
	<hr/>	<hr/>
	743,195,399	697,565,363
Less, accumulated depreciation	<u>(479,553,420)</u>	<u>(446,571,562)</u>
	263,641,979	250,993,801
Other assets	<hr/> 46,430	<hr/> 2,808,084
Total assets	<u><u>\$ 1,130,979,713</u></u>	<u><u>\$ 1,172,246,948</u></u>

**Virginia Hospital Center Arlington Health System and Affiliated Organizations**  
**Consolidated Balance Sheets**  
**December 31, 2018 and 2017**

**(Continued)**

	<b>2018</b>	<b>As Adjusted 2017</b>
<b>LIABILITIES AND NET ASSETS</b>		
Current liabilities:		
Accounts payable and accrued expenses	\$ 49,909,257	\$ 41,092,488
Accrued salaries, wages and related items	11,944,485	10,731,415
Settlements due to third-party payor programs	18,041,233	14,085,430
Interest payable	2,347,600	2,498,600
Other liabilities	333,333	230,727
Current portion of long-term debt	<u>6,255,000</u>	<u>6,125,000</u>
Total current liabilities	<b>88,830,908</b>	74,763,660
Other long-term liabilities	<b>19,715,257</b>	10,926,710
Long-term debt, net, less current portion	<u>93,581,505</u>	<u>99,968,133</u>
Total liabilities	<u><b>202,127,670</b></u>	<u>185,658,503</u>
Net assets:		
Without donor restriction	<b>911,981,260</b>	964,842,835
With donor restriction	<u>16,870,783</u>	<u>21,745,610</u>
	<u><b>928,852,043</b></u>	<u>986,588,445</u>
Total liabilities and net assets	<u><b>\$ 1,130,979,713</b></u>	<u><b>\$ 1,172,246,948</b></u>

See accompanying notes.

**Virginia Hospital Center Arlington Health System and Affiliated Organizations**  
**Consolidated Statements of Operations**  
**Years Ended December 31, 2018 and 2017**

	<u>2018</u>	<u>As Adjusted 2017</u>
Operating revenue:		
Net patient services revenue	<b>\$ 485,453,040</b>	\$457,035,120
Other operating revenue	<b>13,042,431</b>	15,274,620
Total operating revenue	<b>498,495,471</b>	472,309,740
Operating expenses:		
Salaries, wages and benefits	<b>264,271,100</b>	251,962,192
Supplies and other	<b>212,540,194</b>	179,175,440
Professional fees	<b>6,900,522</b>	6,413,741
Depreciation	<b>33,148,276</b>	29,738,409
Interest	<b>4,715,939</b>	5,003,877
Total operating expenses	<b>521,576,031</b>	472,293,659
Operating (loss) income	<b>(23,080,560)</b>	16,081
Nonoperating gains (losses):		
Investment income, net	<b>13,990,842</b>	50,277,415
Change in market value of investments and assets whose use is limited, net	<b>(45,613,743)</b>	50,085,520
Other	<b>(290,076)</b>	(290,676)
Net nonoperating (losses) gains	<b>(31,912,977)</b>	100,072,259
Excess (deficiency) of revenues and gains over expenses and losses	<b>\$ (54,993,537)</b>	<b>\$100,088,340</b>

**Virginia Hospital Center Arlington Health System and Affiliated Organizations**  
**Consolidated Statements of Changes in Net Assets**  
**Years Ended December 31, 2018 and 2017**

	<u>2018</u>	<u>As Adjusted 2017</u>
Net assets without donor restriction:		
Excess of revenues and gains over expenses and losses	\$ (54,993,537)	\$ 100,088,340
Net assets released from restrictions for property and equipment	<u>2,131,962</u>	<u>1,750,432</u>
(Decrease) increase in net assets without donor restriction	<u>(52,861,575)</u>	101,838,772
Net assets with donor restriction:		
Contributions	2,279,449	10,664,939
Investment income, net realized and unrealized gains on restricted investments	(517,358)	1,884,428
Net assets released from restrictions	<u>(6,636,918)</u>	<u>(10,123,310)</u>
(Decrease) increase in net assets with donor restriction	<u>(4,874,827)</u>	<u>2,426,057</u>
Change in net assets	<u>(57,736,402)</u>	104,264,829
Net assets, beginning of year	<u>986,588,445</u>	<u>882,323,616</u>
Net assets, end of year	<u>\$ 928,852,043</u>	<u>\$ 986,588,445</u>

**Virginia Hospital Center Arlington Health System and Affiliated Organizations**  
**Consolidated Statements of Cash Flows**  
**Years Ended December 31, 2018 and 2017**

	<u>2018</u>	<u>As Adjusted 2017</u>
Cash flows from operating activities:		
Change in net assets	\$ (57,736,402)	\$ 104,264,829
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Net realized and unrealized losses (gains) on investments	32,910,786	(59,452,999)
Equity in losses (earnings) of limited partnerships	6,218,909	(36,760,379)
Depreciation	33,148,276	29,738,409
Amortization of debt issuance costs	52,110	55,293
Amortization of bond premium and discount	(183,738)	(194,961)
Restricted contributions received	(1,762,091)	(12,549,367)
Net changes in operating assets and liabilities:		
Accounts receivable	(12,804,113)	(875,107)
Settlements due to third-party payor programs	3,955,803	4,089,326
Inventories, prepaid expenses and other assets	(4,060,717)	4,601,348
Accounts payable and accrued expenses, interest payable and other current and long-term liabilities	18,535,562	9,639,857
Net cash provided by operating activities	<u>18,274,385</u>	<u>42,556,249</u>
Cash flows from investing activities:		
Net change in assets whose use is limited	4,874,827	(2,426,056)
Acquisitions of property and equipment	(45,562,024)	(51,544,451)
Net change in investments	33,466,549	225,011
Decrease (increase) in other long-term assets	2,761,654	(1,172,508)
Net cash used in investing activities	<u>(4,458,994)</u>	<u>(54,918,004)</u>
Cash flows from financing activities:		
Repayment of long-term debt	(6,125,000)	(5,800,000)
Restricted contributions and restricted investment income	1,762,091	12,549,367
Net cash (used in) provided by financing activities	<u>(4,362,909)</u>	<u>6,749,367</u>
Change in cash, cash equivalents, and restricted cash	9,452,482	(5,612,388)
Cash, cash equivalents, and restricted cash at beginning of period	<u>25,778,769</u>	<u>31,391,157</u>
Cash, cash equivalents, and restricted cash at end of period	<u>\$ 35,231,251</u>	<u>\$ 25,778,769</u>

Noncash investing and financing activities:

In 2018 and 2017, the consolidated financial statements include \$591,152 and \$356,722 respectively, in accounts payable relating to the purchase of property and equipment.

## Virginia Hospital Center Arlington Health System and Affiliated Organizations Notes to Consolidated Financial Statements

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### 1. Organization and Nature of Operations

Virginia Hospital Center Arlington Health System (the Corporation) is a tax-exempt, nonstock, not-for-profit corporation established under the laws of the Commonwealth of Virginia.

The Corporation owns or controls certain subsidiaries, which include AHV Group, Inc.; South Arlington, LLC; Arlington Urgent Care, LLC; Arlington Pediatric Center, Inc.; Virginia Hospital Center Foundation and Virginia Hospital Center Physician Group, LLC. The Corporation maintains control over these related organizations principally through certain powers which include the power to elect the boards of directors, approve amendments to the articles of incorporation, articles of organization, by-laws or operating agreements and approve annual budgets.

#### ***Virginia Hospital Center***

Virginia Hospital Center (the Hospital) is a 394-bed acute care facility providing exceptional medical services to the Washington, D.C. metropolitan area. Established in 1944, the Hospital offers comprehensive health care and multiple centers of excellence including cardiology and cardiovascular surgery, oncology and women and infant health. The Hospital is accredited by the Joint Commission and licensed by the Commonwealth of Virginia Department of Health. The Hospital is a member of the Mayo Clinic Care Network (Mayo) which provides the community Mayo expertise at no cost to the patient. The Hospital also operates the Arlington Urgent Care Center for nonemergency conditions that require prompt medical attention. Arlington Urgent Care Center is run by physicians board-certified in family practice or emergency medicine, backed by a team of registered nurses, licensed radiology technicians and ancillary staff. Virginia Hospital Center Physician Group consists of over 100 employed physicians providing primary and specialty care to the community.

#### Support for medical education programs

In 1948, the Hospital established the first medical residency program in the country, in partnership with Georgetown University. Today, the Hospital continues to assist with the education of future physicians through its affiliation with Georgetown University.

#### Other community services

Some of the other important community services provided by the Corporation are as follows:

- a) Rent-free space to PRS Crisis Link, a nonprofit, crisis hotline serving Northern Virginia residents,
- b) Clinic eligibility workers who assist indigent patients to obtain health care services,
- c) Health promotion programs and services, such as smoking cessation, blood pressure screenings and wellness programs, and
- d) Social services to assist patients in arranging for nonhospital health care services.

#### ***Real estate***

AHV Group, Inc., a Virginia for-profit stock corporation, owns and operates certain commercial real estate located in Virginia.

South Arlington, LLC, a Virginia limited liability company, manages certain commercial real estate at Carlin Springs Road located in Arlington, Virginia.

#### ***Community outreach***

Arlington Urgent Care, LLC, a Virginia limited liability company, provides urgent nonemergency health care services from a single site in Virginia.

## Virginia Hospital Center Arlington Health System and Affiliated Organizations Notes to Consolidated Financial Statements

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Arlington Pediatric Center, Inc., a Virginia not-for-profit 501(c)(3) corporation, operates a pediatric clinic which provides comprehensive medical services to under-served children whose family income is below 200% of the poverty level.

### ***Foundation***

Virginia Hospital Center Foundation, a Virginia not-for-profit 501(c)(3) corporation, supports and maintains the programs, services and facilities of the Corporation in part through solicitation, receipt, administration and distribution of philanthropic gifts on behalf of its affiliates.

### ***Virginia Hospital Center Physician Groups***

Virginia Hospital Center Physician Group LLC, a Virginia limited liability company, employs physicians providing primary care, medical specialty and surgical specialty services in various locations in Northern Virginia.

## **2. Significant Accounting Policies**

### ***Basis of presentation***

The accompanying consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States (GAAP) and reflect the operations of the Corporation and its controlled subsidiaries. Intercompany accounts and transactions have been eliminated in consolidation.

### ***Use of estimates***

The preparation of consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements. Estimates also affect the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

### ***Cash and cash equivalents***

The Corporation considers all highly liquid investments purchased with an original maturity of three months or less to be cash and cash equivalents, including overnight investments. Temporary cash and cash equivalents held in investments are included in cash and cash equivalents for consolidated statements of cash flow purposes. Cash, equivalents, and restricted cash consisted of the following:

	<u>2018</u>	<u>2017</u>
Cash and cash equivalents	\$ 23,855,728	\$ 14,407,465
Assets whose use is limited:		
Held by trustee under bond indenture	2,354,216	2,501,888
Self-insurance trust	<u>9,021,307</u>	<u>8,869,416</u>
Total	<u>\$ 35,231,251</u>	<u>\$ 25,778,769</u>

### ***Patient Service Revenue and Receivables***

Patient service revenue is reported at estimated net realizable amounts from patients, third-party payors, and others based on variable consideration for performance obligations performed and satisfied. Patient accounts receivable include provisions for price considerations based on historical and expected net collections considering business and general economic conditions in the Corporation's service area, trends in health care coverage, and various collection indicators.

## **Virginia Hospital Center Arlington Health System and Affiliated Organizations**

### **Notes to Consolidated Financial Statements**

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#### ***Investments***

Investments include marketable equity securities with readily determinable fair values that are deemed to be trading securities. These investments are reported at fair value as determined by quoted market prices. The common collective trusts are valued at the net asset value units of the collective trust. The net asset value is used as a practical expedient to estimate fair value. The net asset value is based on the fair value of the underlying investments held by the fund less its liabilities. Investment income or loss is included in the excess (deficiency) of revenues and gains over expenses and losses unless the income is restricted by donor or law.

Investments also include investments in limited partnerships and other alternative investments (collectively, Alternative Investments), which are made in accordance with the Corporation's investment policies and are monitored through quarterly performance reviews. The Alternative Investments acquire, hold, invest, manage, dispose of, and otherwise deal in and with securities of all kinds and descriptions. Publicly traded securities within the Alternative Investments are generally valued by reference to closing market prices on one or more national securities exchanges or generally accepted pricing services selected by the custodial trustee of the Alternative Investments. Securities not valued by such pricing services will be valued based upon bid quotations obtained from independent dealers in the securities. In the absence of any independent quotations, securities will be valued by the limited partnership's custodial trustee on the basis of data obtained from the best available sources. Alternative Investments are accounted for under the equity method. The equity in earnings or losses from these investments is recorded as a component of investment income in the consolidated statements of operations.

Alternative Investments for which the partnership, fund or other have placed restrictions (other than in the normal course of operations of the partnerships, fund or other) are evaluated for impairment caused by the illiquid nature of the restricted Alternative Investment. Any Alternative Investments determined to be impaired are reduced to a net realizable value based on the best information available.

#### ***Inventories***

Inventories consist primarily of drugs and medical supplies and are carried at the lower of cost or market, as determined principally by the first-in, first-out method.

#### ***Property and equipment***

Property and equipment are carried at cost. Depreciation of land improvements, buildings, and equipment is recorded on the straight-line basis over the estimated useful lives of the associated assets. The general range of estimated useful lives is 10 years for land improvements, 40 years for buildings, and 5 to 15 years for equipment.

Gifts of long-lived assets, such as land, buildings, or equipment are reported as unrestricted support, and are excluded from the excess of revenues and gains over expenses and losses, unless explicit donor stipulations specify how the donated assets must be used. Gifts of long-lived assets with explicit restrictions that specify how the assets are to be used and gifts of cash or other assets that must be used to acquire long-lived assets are reported as restricted support. Absent explicit donor stipulations about how long those long-lived assets must be maintained, expirations of donor restrictions are reported when the donated or acquired long-lived assets are placed in service.

#### ***Excess (deficiency) of revenues and gains over expenses and losses***

The consolidated statements of operations include excess (deficiency) of revenues and gains over expenses and losses. Changes in unrestricted net assets that are excluded from excess (deficiency) of revenues and gains over expenses and losses, consistent with industry practice, include unrealized gains and losses on investments other than trading securities, unrealized gains and losses on qualifying hedging instruments, cumulative effect of changes in accounting principles, permanent transfers of assets to and from affiliates for other than goods or services, and 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).

## Virginia Hospital Center Arlington Health System and Affiliated Organizations Notes to Consolidated Financial Statements

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Activities that result in gains or losses unrelated to the Corporation's primary operations are considered to be nonoperating. All investment income is included in nonoperating gains, net of related costs. Nonoperating gains and losses include income and expenses associated with investments, bequests and other nonrecurring items.

### ***Donor-restricted gifts***

Unconditional promises to give cash and other assets to the Corporation are reported at fair value at the date the promise is received. Conditional promises to give are recorded at the time they become unconditional. Indications of intentions to give are reported at fair value at the date the gift is received. The gifts are reported as either support with donor restriction 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 restriction are reclassified as net assets without donor restriction and reported in the consolidated statements of operations as net assets released from restrictions. Donor-restricted contributions whose restrictions are met within the same year as received are reported as contributions without donor restriction in the accompanying consolidated financial statements.

### ***Estimated malpractice costs***

The provision for estimated medical malpractice claims includes estimates of the ultimate costs for both reported claims and claims incurred but not reported.

### ***Income taxes***

The Corporation is exempt from federal income tax under section 501(c)(3) of the Internal Revenue Code as a not-for-profit corporation. Federal tax law requires that the Corporation be operated in a manner consistent with its initial exemption application in order to maintain its exempt status. Management has analyzed the operations of the Corporation and concluded that it remains in compliance with the requirements for exemption.

The state in which the Corporation operates also provides general exemption from state income taxation for organizations that are exempt from federal income taxation. However, the Corporation is subject to both federal and state income taxation at corporate tax rates on its unrelated business income. Exemption from other state taxes, such as real and personal property taxes, is separately determined.

Current accounting standards define the threshold for recognizing uncertain income tax return positions in the financial statements as "more likely than not" that the position is sustainable, based on technical merits, and also provide guidance on the measurement, classification, and disclosure of tax return positions in the financial statements. Management believes there is no impact on the Corporation's accompanying consolidated financial statements related to uncertain income tax provisions.

### ***Subsequent events***

Management evaluated all events and transactions that occurred after December 31, 2018 through May 6, 2019 at which time the consolidated financial statements were issued. The Corporation did not have any material recognizable subsequent events during this period.

### ***Recent accounting pronouncements***

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2014-09, *Revenue from Contracts with Customers*, which provides a principle-based approach for recognizing revenues through a five-step process. The ASU became effective for the Corporation beginning January 1, 2018. The Corporation elected the full retrospective transition method that resulted in patient service revenue (net of contractual adjustments and discounts) of \$481,687,303 less provision for bad debts of \$24,652,183 being reported as net patient service revenue totaling \$457,035,120 as of December 31, 2017.

## Virginia Hospital Center Arlington Health System and Affiliated Organizations Notes to Consolidated Financial Statements

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During 2018, the Corporation adopted ASU 2016-14, *Not-For-Profit Entities, Presentation of Financial Statements of Not-for Profit Entities*. The ASU addresses the complexity and understandability of net asset classification, deficiencies in information about liquidity of available resources, and the lack of consistency in the type of information provided about expenses and investment return. The 2017 financial statements have been adjusted to reflect retrospective application of the new accounting guidance, except for the disclosures around liquidity and availability of resources. These disclosures have been presented for 2018 as allowed by ASU No. 2016-14. The retrospective application resulted in temporarily restricted net assets of \$20,008,781 and permanently restricted net assets of \$1,736,829 being reported as net assets with donor restrictions totaling \$21,745,610 and unrestricted net assets of \$964,842,835 being reported as net assets without donor restrictions as of December 31, 2017.

In 2018, the Corporation adopted ASU 2016-18, *Statement of Cash Flow, Restricted Cash (Topic 230)*. The ASU addresses the diversity that exists in the classification and presentation of changes in restricted cash on the statement of cash flows. The 2017 financial statements have been adjusted to reflect retrospective application of the new accounting guidance. The retrospective application includes both unrestricted and restricted cash and cash equivalents in the accompanying consolidated statements of cash flows for all periods presented.

In February 2016, the FASB issued ASU 2016-02, *Leases*. The amendments in this ASU revise the accounting related to leasing activities. Under the new guidance, lessees will be required to recognize a lease liability and a right-of-use asset for all leases. The amendments in this ASU are effective for the Corporation beginning on January 1, 2019 and should be applied through a modified retrospective transition approach for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements. Management has not yet determined what the effects of adopting this ASU will be on its consolidated financial statements.

### 3. Patient Service Revenue

Patient care service revenue is reported at the amount that reflects the consideration to which the Corporation expects to be entitled in exchange for providing patient care. These amounts are due from patients, third-party payors (including health insurers and government programs), and others and includes variable consideration for retroactive revenue adjustments due to settlement of audits, reviews, and investigations. Generally, the Corporation bills the patients and third-party payors several days after the services are performed or the patient is discharged from the facility. Revenue is recognized as performance obligations are satisfied.

Performance obligations are determined based on the nature of the services provided by the Corporation. Revenue for performance obligations satisfied over time is recognized based on actual charges incurred in relation to total expected (or actual) charges. Generally, performance obligations satisfied over time relate to patients in the Corporation's hospital receiving inpatient acute care services, psychiatric services, rehabilitative services, or patients receiving services in the Corporation's outpatient centers. The Corporation measures the performance obligation from admission into the hospital, or the commencement of an outpatient service, to the point when the health care services are no longer provided to the patient, which is generally at the time of discharge or completion of the outpatient services. Revenue is generally recognized when goods are provided to patients and customers in a retail setting (for example, pharmaceuticals and medical equipment).

The Corporation determines the transaction price based on standard charges for goods and services provided, reduced by explicit price concessions provided to third-party payors and discounts provided to uninsured patients in accordance with the Corporation's policy, and estimated implicit price concessions related to uninsured patient accounts. The Corporation determines its estimates of price concessions based on contractual agreements, its discount policies, and historical experience with these classes of patients.

Agreements with third-party payors typically provide for payments at amounts less than established charges. A summary of the payment arrangements with major third-party payors follows:

- **Medicare.** Certain inpatient acute care services are paid at prospectively determined rates per discharge based on clinical, diagnostic, and other factors. Certain services are paid based on cost-reimbursement

## Virginia Hospital Center Arlington Health System and Affiliated Organizations Notes to Consolidated Financial Statements

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methodologies subject to certain limits. Physician services are paid based upon established fee schedules. Outpatient services are paid using prospectively determined rates.

The Corporation has recorded approximately \$3,127,000 and \$2,021,000 of revenues related to Medicare outlier payments for the years ended December 31, 2018 and 2017 respectively. These amounts represent approximately 1.9% and 1.4% of Medicare net revenues for 2018 and 2017, and approximately 1% of total net patient service revenues in 2018 and 2017. There can be no assurances that the Corporation will continue to receive these levels of Medicare outlier payments in future periods.

The Hospital is an academic teaching hospital and, as such, receives additional payments from Medicare for certain direct and indirect costs related to its graduate medical education (GME) programs. GME payments accounted for 1% of the Hospital's operating revenue in calendar years 2018 and 2017. The payment methodologies used do not necessarily reflect the actual costs of graduate medical education, and the federal government is continually re-evaluating its policy on graduate medical education and teaching hospital payments. Accordingly, there can be no assurance that the payments received by the Hospital will be sufficient to cover the costs of its medical education programs.

- **Medicaid.** The Commonwealth of Virginia reimburses providers for inpatient services through fixed payment amounts per inpatient discharge that are adjusted based on the patient's assigned case mix intensity similar to a Medicare diagnostic related group (DRG). Outpatient services are reimbursed by the Commonwealth of Virginia under a prospectively determined payment system. The Commonwealth of Virginia also separately reimburses providers for direct and indirect medical education and disproportionate share amounts if qualified. These reimbursements are retroactively settled through the annual cost report. During 2018, the Commonwealth of Virginia expanded its Medicaid program resulting in provider assessments to help facilitate the coverage expansion and to fund Medicaid reimbursement rates for hospitals. For the quarter beginning October 1, 2018, the Corporation will receive \$2,187,832 in rate improvement for its existing Medicaid population, which is included in net patient service revenue, and was assessed \$2,230,573, which is included in the supplies and other line item in the accompanying consolidated financial statements.
- **Other third-party payors.** All other third-party payors, principally Blue Cross, other private insurance companies, health maintenance organizations, preferred provider organizations and other managed care plans, negotiate payment rates directly with the Corporation. Such arrangements include DRG-based payment systems, per diems, case rates and percentage of billed charges. If such rates are not negotiated, then the payors are billed at the Corporation's established charges.

Revenue from the Medicare and Medicaid programs accounted for approximately 33% and 31% of the Corporation's net patient revenue for the years ended December 31, 2018 and 2017, respectively. Laws and regulations concerning government programs, including Medicare and Medicaid, are complex and subject to varying interpretation. As a result of investigations by governmental agencies, various health care organizations have received requests for information and notices regarding alleged noncompliance with those laws and regulations, which, in some instances, have resulted in organizations entering into significant settlement agreements. Compliance with such laws and regulations may also be subject to future government review and interpretation, as well as significant regulatory action, including fines, penalties, and potential exclusion from the related programs. There can be no assurance that regulatory authorities will not challenge the Corporation's compliance with these laws and regulations, and it is not possible to determine the impact (if any) such claims or penalties would have upon the Corporation. In addition, the contracts the Corporation has with commercial payors also provide for retroactive audit and review of claims.

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 agreement with the payor, correspondence from the payor, and the Corporation's historical settlement activity, including an assessment

## Virginia Hospital Center Arlington Health System and Affiliated Organizations Notes to Consolidated Financial Statements

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to ensure that it is probable that a significant reversal in the amount of cumulative revenue recognized will not occur when the uncertainty associated with the retroactive adjustment is subsequently resolved. Estimated settlements are adjusted in future periods as adjustments become known (that is, new information becomes available), or as years are settled or are no longer subject to such audits, reviews, and investigations. Adjustments arising from a change in the transaction price were not significant in 2018 or 2017.

Generally, patients who have third-party payor coverage are responsible for related deductibles and coinsurance, which vary in amount. The Corporation also provides services to uninsured patients, and offers those uninsured patients a discount, either by policy or law, from standard charges. The Corporation estimates the transaction price for patients with deductibles and coinsurance and from those who are uninsured based on historical experience and current market conditions. The initial estimate of the transaction price is determined by reducing the standard charge by any applicable explicit and/or implicit price concessions. Subsequent changes to the estimate of the transaction price are generally recorded as adjustments to patient service revenue in the period of the change. For the years ended in December 31, 2018, and 2017, explicit and implicit price concessions on a consolidated basis were \$951 million and \$856 million, respectively.

The Corporation accepts all patients regardless of their ability to pay. Patients qualify for charity care patients according to the established policies of the Corporation. Amounts determined to qualify as charity care are not pursued for collections, and accordingly are not reported as patient revenue. The Corporation provided approximately \$34,127,000 and \$33,766,000 in gross uncompensated charges for charity care for the years ended December 31, 2018 and 2017, respectively. The total direct and indirect costs of charity care provided for the years ended December 31, 2018 and 2017 were \$10,478,195 and \$10,443,780, respectively. The cost of charity care is calculated on a ratio of costs to charges.

The Corporation has a program for discounting services to patients who do not have insurance and whose income is greater than 200% of published federal poverty guidelines. The cost of the discount currently extended, calculated on a ratio of costs to charges, is \$1,505,082 and \$1,173,179 in 2018 and 2017, respectively.

It is the Corporation's vision to build a healthier community by promoting and providing access to health care services to low income residents in its services area. Regardless of the ability to pay, the Corporation provides a full spectrum of inpatient and outpatient services to members of its community, including over 6300 and 7400 visits to the Hospital's indigent clinic in 2018 and 2017, respectively. The indigent clinic is committed to providing access to quality health care services to low-income, uninsured county residents.

Additionally, the Corporation provides subsidized services to patients seen by the Arlington Free Clinic for indigent patients who require breast and colon cancer screening and treatment services. In addition, the Corporation also accommodated the need for over 14,500 and 16,000 pediatric visits in 2018 and 2017, respectively, at the Arlington Pediatric Center. The Arlington Pediatric Center provides low-cost health care services for families at or below 200% of the federal poverty level. In conjunction with the Arlington Medical Society, the Corporation sponsors an annual trip to Honduras by members of the medical and nursing staff of the Hospital to provide medical care and surgical services.

The Corporation has determined that the nature, amount, timing, and uncertainty of revenue and cash flows are affected by payor classification, method of reimbursement, and timing of when revenue is recognized. The following table provides details of payor composition.

**Virginia Hospital Center Arlington Health System and Affiliated Organizations**  
**Notes to Consolidated Financial Statements**

The composition of net patient care service revenue by primary payor for the years ended December 31 as follows:

	<u>2018</u>	<u>2017</u>
Medicare	\$ 147,197,970	\$ 132,488,941
Medicaid	10,990,078	8,914,492
Managed care and commercial insurers	246,201,337	257,698,806
Other	<u>81,063,655</u>	<u>57,932,881</u>
Total	<u>\$ 485,453,040</u>	<u>\$ 457,035,120</u>

Revenue from patient's deductibles and coinsurance are included in the preceding categories based on the primary payor.

The Corporation has elected the practical expedient allowed under the accounting standards 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 the Corporation's expectation that the period between the time the services is provided to a patient and the time that the patient or a third-party payor pays for that service will be one year or less. However, the Corporation does, in certain instances, 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.

**4. Investments and Assets Whose Use is Limited**

***Investments***

A summary of investments reported at fair value in the accompanying consolidated financial statements as of December 31 is as follows:

	<u>2018</u>		<u>2017</u>	
	<u>Cost</u>	<u>Fair Value*</u>	<u>Cost</u>	<u>Fair Value*</u>
Cash and cash equivalents	\$ 10,080,173	\$ 10,080,173	\$ 10,933,485	\$ 10,933,485
Short-term investments	95,074,097	91,247,688	129,314,279	124,510,403
Marketable equity securities	238,678,595	261,789,508	232,591,604	268,509,276
Common collective trusts	223,093,913	259,447,496	217,506,310	288,716,978
Accrued income	<u>1,843</u>	<u>1,843</u>	<u>342</u>	<u>342</u>
	<u>\$ 566,928,621</u>	<u>\$ 622,566,708</u>	<u>\$ 590,346,020</u>	<u>\$ 692,670,484</u>

\*Common collective trusts are reflected at net asset value which approximates fair value.

The Corporation also has unrestricted investments in limited partnerships and other alternative investments as of December 31, 2018 and 2017 of \$103,712,498 and \$106,204,966, respectively. Investments in limited partnerships and other alternative investments represent multi-strategy hedge funds. These funds invest in other hedge funds that use various types of debt and equity securities and derivative instruments in their strategies. The Corporation utilizes the equity method of accounting to record these investments. For substantially all alternative investments held by the Corporation, the carrying amount approximates the net asset value of the respective fund. Income and losses on these funds are included in nonoperating gains, net in the consolidated statements of operations.

**Virginia Hospital Center Arlington Health System and Affiliated Organizations**  
**Notes to Consolidated Financial Statements**

The total restricted and unrestricted alternative investments as of December 31, 2018 and 2017 are as follows:

	<u>2018</u>	<u>2017</u>
Hedge funds	\$ 63,954,200	\$ 71,134,853
Private equity funds	19,999,507	18,888,244
Real assets	<u>22,167,935</u>	<u>19,072,798</u>
	<b>106,121,642</b>	109,095,895
Less – amounts included in assets whose use is limited	<u>(2,409,144)</u>	<u>(2,890,929)</u>
	<b><u>\$ 103,712,498</u></b>	<b><u>\$ 106,204,966</u></b>

Hedge fund investments include investments with fund of fund managers and direct individual managers incorporating multiple strategies, including capital structure arbitrage, event arbitrage, fixed income arbitrage, long shot investing, and distressed debt. As of December 31, 2018, approximately \$63,954,000 is redeemable before December 2019.

Private equity funds include investments in private equity consisting primarily of venture capital funds, leveraged buyout funds, mid-stage growth capital funds and international private equity funds. As of December 31, 2018, the balance of approximately \$20,000,000 is redeemable from 2021 through 2027.

Real assets include global investments in private and publicly listed entities investing in timber, natural resources, commodities, metals and mining companies. As of December 31, 2018, approximately \$194,000 is redeemable in less than one year and the balance of approximately \$21,974,000 is redeemable from 2019 through 2026.

The Corporation has commitments for the additional purchase of ownership in limited partnerships (private equity and real asset fund) which are classified as alternative investments in the table above. Total unfunded commitments at December 31, 2018 was approximately \$4,013,400 for private equity funds and \$8,003,200 for real asset funds.

***Assets whose use is limited***

Assets whose use is limited that are required for obligations classified as current liabilities are reported as current assets. The composition of assets whose use is limited as of December 31 is as follows:

	<u>2018</u>		<u>2017</u>	
	<u>Cost</u>	<u>Fair Value</u>	<u>Cost</u>	<u>Fair Value</u>
Held by trustee under bond indenture				
Cash and cash equivalents	<u>\$ 2,354,216</u>	<u>\$ 2,354,216</u>	<u>\$ 2,501,888</u>	<u>\$ 2,501,888</u>
Held by trustee for self- insurance				
Cash and cash equivalents	<u>\$ 9,005,307</u>	<u>\$ 9,005,307</u>	<u>\$ 8,853,416</u>	<u>\$ 8,853,416</u>
Held by trustee for environment				
Cash and cash equivalents	<u>\$ 16,000</u>	<u>\$ 16,000</u>	<u>\$ 16,000</u>	<u>\$ 16,000</u>

**Virginia Hospital Center Arlington Health System and Affiliated Organizations**  
**Notes to Consolidated Financial Statements**

	2018		2017	
	Cost	Fair Value*	Cost	Fair Value*
Externally restricted by donors:				
Cash and cash equivalents	\$ 2,353,751	\$ 2,353,751	\$ 3,686,820	\$ 3,686,820
Marketable securities	5,544,279	6,081,124	6,331,208	7,308,897
Common collective trusts	5,182,262	6,026,721	5,290,582	7,858,956
Accrued income	43	43	8	8
	<u>\$ 13,080,335</u>	<u>\$ 14,461,639</u>	<u>\$ 15,308,618</u>	<u>\$ 18,854,681</u>

\*Common collective trusts are reflected at net asset value which approximates fair value.

The Corporation also has investments externally restricted by donors in limited partnerships and other alternative investments as of December 31, 2018 and 2017 of \$2,409,144 and \$2,890,929, respectively. Investments in limited partnerships and other alternative investments represent multi-strategy hedge funds. These funds invest in other hedge funds that use various types of debt and equity securities and derivative instruments in their strategies. The Corporation utilizes the equity method of accounting to record these investments. The carrying amount approximates the net asset value of the respective fund. Income and losses on these funds are included in nonoperating gains, net in the consolidated statements of operations.

The following schedules summarize investment return and its classification in the consolidated statements of operations and the consolidated statement of changes in net assets for the years ended December 31:

	2018		
	Without Donor Restriction	With Donor Restriction	Total
Dividends and interest	\$ 6,882,376	\$ 107,060	\$ 6,989,437
Equity in losses of limited partnerships	(6,169,418)	(49,491)	(6,218,909)
Realized gains on sales of investments	<u>13,277,884</u>	<u>266,544</u>	<u>13,544,428</u>
Investment income – net	13,990,842	324,113	14,314,956
Unrealized losses on trading securities	<u>(45,613,743)</u>	<u>(841,471)</u>	<u>(46,455,214)</u>
Total investment return	<u>\$ (31,622,901)</u>	<u>\$ (517,358)</u>	<u>\$ (32,140,258)</u>

	2017		
	Without Donor Restriction	With Donor Restriction	Total
Dividends and interest	\$ 5,934,495	\$ 99,491	\$ 6,033,986
Equity in earnings of limited partnerships	36,096,994	663,384	36,760,379
Realized gains on sales of investments	<u>8,245,926</u>	<u>125,096</u>	<u>8,371,022</u>
Investment income – net	50,277,415	887,971	51,165,387
Unrealized gains on trading securities	<u>50,085,520</u>	<u>996,457</u>	<u>51,081,977</u>
Total investment return	<u>\$100,362,935</u>	<u>\$ 1,884,428</u>	<u>\$102,247,364</u>

**Virginia Hospital Center Arlington Health System and Affiliated Organizations**  
**Notes to Consolidated Financial Statements**

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**5. Pledges Receivable**

Unconditional promises to give cash and other assets are recorded at fair value in the year that they are made net of an allowance for uncollectible accounts and discounted to their present value. Promises to give that are expected to be received in future years are discounted at 2.8% at December 31, 2018 and 2017. Conditional promises to give are recorded at the time they become unconditional and are reported in prepaid expenses and other assets (current portion) in the current and long-term assets (noncurrent portion) of the accompanying consolidated balance sheets.

The payment terms of the pledges receivable are as follows:

	<u>2018</u>	<u>2017</u>
Receivable in less than one year	\$ <b>\$1,592,351</b>	\$ 4,739,501
Receivable in one to five years	<b>738,273</b>	2,978,073
Receivable in more than five years	<u>-</u>	<u>5,000</u>
Total promises to give	<b>2,330,624</b>	7,722,574
Less – allowance for uncollectible accounts and discount	<u>(102,712)</u>	<u>(138,145)</u>
	<b><u>\$ 2,227,912</u></b>	<b><u>\$ 7,584,429</u></b>

**6. Long-Term Debt**

Long-term debt is comprised of the following as of December 31:

	<u>2018</u>	<u>2017</u>
Hospital Revenue Refunding Bonds (Series 2010) issued through the Industrial Development Authority of Arlington County, Virginia (the Authority) dated March 24, 2010. Principal payments ranging from \$1,000,000 in July 2011 to \$9,875,000 in July 2031 are due annually	<b>\$ 98,910,000</b>	\$ 105,035,000
Net unamortized bond premium	<b>1,635,502</b>	1,867,855
Net unamortized bond discount	<b>(342,204)</b>	(390,820)
Net unamortized debt issuance costs	<u><b>(366,793)</b></u>	<u>(418,902)</u>
	<b>99,836,505</b>	106,093,133
Less – current portion	<u><b>6,255,000</b></u>	<u>6,125,000</u>
	<b><u>\$ 93,581,505</u></b>	<b><u>\$ 99,968,133</u></b>

On March 24, 2010, the Corporation obtained a loan of \$139,410,000 representing proceeds of tax exempt revenue bonds issued by the Authority (Series 2010 Bonds). The Series 2010 Bonds were issued at a net premium of \$3,215,577.

**Virginia Hospital Center Arlington Health System and Affiliated Organizations**  
**Notes to Consolidated Financial Statements**

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Principal repayments due in each of the next five years are as follows:

2019	\$ 6,255,000
2020	5,985,000
2021	6,225,000
2022	6,475,000
2023	6,775,000
Thereafter	<u>67,195,000</u>
	<u>\$ 98,910,000</u>

The Series 2010 Bonds have a fixed interest rate of 4.5% per annum. Interest expense for the years ended December 31, 2018 and 2017 was \$4,715,939 and \$5,003,877, respectively. Interest paid during the years ended December 31, 2018 and 2017 was \$4,997,200 and \$5,287,200, respectively.

**7. Net Assets with Donor Imposed Restrictions**

Net assets with donor restrictions are restricted for the following purposes:

	<u>2018</u>	<u>2017</u>
Health care services and programs	\$ 5,160,542	\$ 6,189,243
Employee education, recognition and support	4,963,619	5,054,843
Buildings and equipment	4,518,710	2,917,095
Pledge receivable for equipment and others	<u>2,227,912</u>	<u>7,584,429</u>
Total net assets with donor restrictions	<u>\$ 16,870,783</u>	<u>\$ 21,745,610</u>

Current accounting standards require certain disclosures for donor-restricted endowment funds for a not-for-profit organization that is subject to an enacted version of the Uniform Prudent Management of Institutional Funds Act of 2006 (UPMIFA). The Commonwealth of Virginia has adopted UPMIFA. In management's opinion, the adoption of UPMIFA had no impact on the accounting for the Corporation's endowment.

Net assets released from donor restrictions during 2018 and 2017 by expending funds satisfying the restricted purposes or by occurrence of other events specified by donors are as follows:

	<u>2018</u>	<u>2017</u>
Purchase of property and equipment	\$ 2,131,962	\$ 1,750,432
Research, professional education, faculty support, uncompensated care and other (included in other operating revenue)	<u>4,504,956</u>	<u>8,372,878</u>
	<u>\$ 6,636,918</u>	<u>\$ 10,123,310</u>

**Virginia Hospital Center Arlington Health System and Affiliated Organizations**  
**Notes to Consolidated Financial Statements**

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**8. Liquidity and Availability**

Financial assets available for general expenditure within one year of the balance sheet date are comprised of the following at December 31, 2018:

Cash and cash equivalents	\$ 23,855,728
Patient accounts receivable, net	60,568,986
Pledges receivable, net	1,551,786
Investments with daily and weekly liquidity	<u>265,405,812</u>
Total	<u>\$ 351,382,312</u>

**9. Employees' Retirement Plans**

The Corporation has 401(k) and 403(b) defined contribution retirement plans (the Plans) that cover substantially all employees who meet certain age and service requirements. The Plans provide that the Corporation make a matching contribution of 65% - 100% contributed by a participant based on years of service not to exceed 8% of the participant's eligible compensation. The Corporation's total contributions related to the Plans for the years ended December 31, 2018 and 2017 were approximately \$6,097,843 and \$5,778,000, respectively.

**10. Operating Leases**

The Corporation leases various facilities under operating leases with expiration dates ranging from December 2018 to March 2021. Future minimum lease payments under noncancelable operating leases as of December 31, 2018 are as follows:

2019	\$ 1,567,972
2020	848,134
2021	589,354
2022	602,822
2023	578,662
Thereafter	<u>628,602</u>
	<u>\$ 4,815,546</u>

Rental expense totaled \$5,934,091 and \$5,142,524 for the years ended December 31, 2018 and 2017, respectively.

**11. Insurance**

***Professional and general liability***

Effective October 2002, the Corporation is self-insured through a revocable trust for professional and general liability claims. Provision for losses related to professional liability risks are based upon an actuarial determination. In addition, the Corporation maintains umbrella coverage from a commercial carrier in excess of the basic self-insurance protection. The Corporation has purchased "tail" coverage for claims arising prior to October 2002. The Corporation accrues the estimated cost of asserted and unasserted professional and general liability claims in the period in which the healthcare services are rendered. It is the opinion of management, based on the advice of actuarial and legal counsel, that the accompanying consolidated financial statements adequately provide for losses resulting from potential unasserted claims and pending or threatened litigation. Amounts accrued as of December 31, 2018 and 2017 were \$11,892,119 and \$9,559,200, respectively.

**Virginia Hospital Center Arlington Health System and Affiliated Organizations**  
**Notes to Consolidated Financial Statements**

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***Worker's compensation***

The Corporation is self-insured with respect to employee worker's compensation costs. Losses from worker's compensation claims identified under the Corporation's incident reporting system, as well as provisions for estimated losses from incurred but not reported incidents, are accrued based on estimates that incorporate the Corporation's past experience as well as other considerations, including the nature of claims or incidents and relevant trend factors. Amounts accrued as of December 31, 2018 and 2017 were \$1,772,510 and \$1,367,510, respectively.

***Health insurance***

The Corporation is self-insured with respect to employee health benefit costs. Health benefit costs are accrued based on past experience and other factors such as health care cost trend factors. Amounts accrued as of December 31, 2018 and 2017 were \$3,281,908 and \$3,041,562 respectively.

**12. Concentrations of Credit Risk**

The Corporation maintains cash balances in various financial institutions. The balances at the financial institutions are insured by the Federal Deposit Insurance Corporation (FDIC) up to \$250,000. At various times there were balances in the financial institutions in excess of the FDIC limit. The Corporation has not experienced any loss in such accounts.

The Corporation grants credit without collateral to its patients, many of whom are insured under third-party agreements. The mix of accounts receivable from patients and third-party payors as of December 31, 2018 and 2017 is as follows:

	<u>2018</u>	<u>2017</u>
Medicare	30%	28%
Medicaid	6%	6%
Managed care and commercial insurers	45%	50%
Other	<u>19%</u>	<u>16%</u>
	<u>100%</u>	<u>100%</u>

**13. Fair Value of Financial Instruments**

The three-level hierarchy for fair value measurements is based upon observable and unobservable inputs. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect the Corporation's market assumptions. These two types of inputs create the following fair value hierarchy:

- Level 1:** Quoted prices for *identical* instruments in active markets;
- Level 2:** Quoted prices for *similar* instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; and model-derived valuations whose significant inputs are observable;
- Level 3:** Instruments whose significant inputs are *unobservable*.

The following is a description of the Corporation's valuation methodologies used to measure and disclose the fair value of its financial assets and liabilities on a recurring basis:

**Virginia Hospital Center Arlington Health System and Affiliated Organizations**  
**Notes to Consolidated Financial Statements**

*Cash and cash equivalents, accounts receivable, accounts payable and accrued expenses, accrued salaries, wages and related items, settlements due to third-party payor programs, and interest payable* – the carrying amount reported in the consolidated balance sheets approximates fair value due to the short-term nature of these instruments.

*Investments* – These assets consist primarily of cash and cash equivalents, short-term investments, marketable equity securities, common collective trusts, and accrued income. The carrying amount of cash and cash equivalents and accrued income reported in the consolidated balance sheets approximates fair value due to the short-term nature of these instruments. Short-term investments include certificates of deposit and U.S. T-bills. Valuation of marketable equity securities is determined by external pricing agencies, over which management exercises oversight to ensure materially accurate valuations. The fair values are based on quoted market prices, if available, or estimated using quoted market prices for similar investments.

*Assets limited as to use* – These assets consist primarily of cash, marketable equity securities, common collective trusts, and accrued income. The carrying amount of cash and accrued income reported in the consolidated balance sheets approximates fair value due to the short-term nature of these instruments. Valuation of marketable equity securities is determined by external pricing agencies, over which management exercises oversight to ensure materially accurate valuations. The fair values are based on quoted market prices. Common collective trusts are valued at the net asset value units of the collective trust. Net asset value is used as a practical expedient to estimate fair value. Net asset value is based on the fair value of the underlying investments held by the fund less its liabilities.

*Long-term debt* – Fair value is determined based on interest rates currently available to hospitals for debt with similar terms and remaining maturities. As of December 31, 2018 and 2017, the fair value of the Corporation’s long-term debt approximates \$102,002,132 and \$110,952,000, respectively.

Following is a summary of the Corporation’s investments measured at fair value on a recurring basis by the level of significant input as of December 31, 2018:

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Assets:				
Investments:				
Cash and cash equivalents	\$ 10,080,173	\$ -	\$ -	\$ 10,080,173
Short-term investments	91,247,688	-	-	91,247,688
Marketable equity securities				
Equity securities	95,228,658	-	-	95,228,658
Mutual funds	166,560,850	-	-	166,560,850
Accrued income	1,843	-	-	1,843
Assets limited as to use:				
Cash and cash equivalents	11,609,676	-	-	11,609,676
Short-term investments	2,119,598	-	-	2,119,598
Marketable securities				
Equity securities	2,212,072	-	-	2,212,072
Mutual funds	3,869,052	-	-	3,869,052
Accrued income	43	-	-	43
	<u>\$382,929,653</u>	<u>\$ -</u>	<u>\$ -</u>	<u>382,929,653</u>
Common collective trusts at net asset value:				
Investments				259,447,496
Assets limited as to use				<u>6,026,721</u>
				<u>\$648,403,870</u>

**Virginia Hospital Center Arlington Health System and Affiliated Organizations**  
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Following is a summary of the Corporation's investments measured at fair value on a recurring basis by the level of significant input as of December 31, 2017:

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Assets:				
Investments:				
Cash and cash equivalents	\$10,933,485	\$ -	\$ -	\$ 10,933,485
Short-term investments	117,407,444	7,102,959	-	124,510,403
Marketable equity securities				
Equity securities	102,064,912	-	-	102,064,912
Mutual funds	166,444,364	-	-	166,444,364
Accrued income	342	-	-	342
Assets limited as to use:				
Cash and cash equivalents	11,668,915	-	-	11,668,915
Short term investments	3,195,864	193,345	-	3,389,208
Marketable securities				
Equity securities	2,778,235	-	-	2,778,235
Mutual funds	4,530,662	-	-	4,530,662
Accrued income	8	-	-	8
	<u>\$419,024,231</u>	<u>\$ 7,296,304</u>	<u>\$ -</u>	<u>\$426,320,535</u>
Common collective trusts at net asset value:				
Investments				288,716,978
Assets limited as to use				<u>7,858,956</u>
				<u>\$722,896,469</u>

**14. Functional Expenses**

The Corporation provides health care services to residents of Arlington, Virginia and the surrounding communities. Natural expenses attributable to more than one functional expense category are allocated across VHC on a variety of bases, where appropriate, including employee salaries, square footage, and operating expenses.

Expenses by functional classification for the year ended December 31, 2018 consists of the following:

	<u>2018</u>		
	<u>Health Care Services</u>	<u>General &amp; Administrative</u>	<u>Total</u>
Salaries and benefits	\$246,880,886	\$ 17,390,214	\$264,271,100
Supplies and other	185,744,703	26,795,491	212,540,194
Professional fees	6,900,522	-	6,900,522
Depreciation	32,874,531	273,745	33,148,276
Interest	<u>4,715,939</u>	<u>-</u>	<u>4,715,939</u>
	<u>\$477,116,581</u>	<u>\$ 44,459,450</u>	<u>\$521,576,031</u>

**Virginia Hospital Center Arlington Health System and Affiliated Organizations**  
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Expenses by functional classification for the year ended December 31, 2017 consists of the following:

	<b>2017</b>		
	<b>Health Care Services</b>	<b>General &amp; Administrative</b>	<b>Total</b>
Salaries and benefits	\$234,272,170	\$ 17,690,022	\$251,962,192
Supplies and other	165,198,742	13,976,699	179,175,441
Professional fees	6,411,880	1,860	6,413,740
Depreciation	29,412,034	326,375	29,738,409
Interest	<u>5,003,877</u>	<u>-</u>	<u>5,003,877</u>
	<u>\$440,298,703</u>	<u>\$ 31,994,956</u>	<u>\$472,293,659</u>

**15. Commitments and Contingencies**

***Certificate of public need commitment***

On December 15, 2006, the Corporation purchased land, building, and fixed equipment located at 601 South Carlin Springs Road, Arlington, Virginia. This facility houses the Arlington Urgent Care Center and the Arlington Pediatric Center and other departments of the Corporation.

The property is currently subject to the terms of a Certificate of Public Need (CPN) issued to the seller by the Virginia Department of Health. The CPN requires that an urgent care facility be maintained and operated on the property. As a part of the agreement to purchase the property, the Corporation has committed to operate an urgent care facility on the property subject to ongoing operating subsidies provided by the seller. The Corporation's commitment to operate the urgent care center will terminate upon withdrawal of the urgent care facility requirement by the Virginia Department of Health or abandonment by the seller. As of December 31, 2018, the urgent care facility obligation had not been terminated.

***Land swap***

On Sept. 24, 2015, the Arlington County Board voted unanimously to approve a non-binding letter of intent for an Option to Purchase an approximately five-acre parcel of County-owned land that will allow the Corporation to move forward with developing a master plan for an expansion of the Hospital on N. George Mason Drive onto the approximately five acres of adjacent County-owned land.

On November 27, 2018, the Arlington County Board approved the Corporation's plan to expand its N. George Mason Drive campus onto the neighboring Edison site. The approval allows the Corporation to move forward with acquiring the Edison site from the County under the terms of a 2015 land purchase agreement between the Hospital and the County. The Corporation intends to close on the land swap in 2019.

***Electronic health record***

In 2018, the Corporation began a two-year implementation of a new electronic health record (EHR). During 2018, nonrecurring operating expenses related to the EHR conversion were approximately \$22,800,000, and capitalized costs were approximately \$16,600,000. The EHR was put into service in April 2018, and future expenditures are expected to consist of routine operating costs and upgrades as required.

## Virginia Hospital Center Arlington Health System and Affiliated Organizations Notes to Consolidated Financial Statements

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### ***Risk factors***

The Corporation provides general acute health care services in the Commonwealth of Virginia. The Corporation and other health care providers in Virginia are subject to certain inherent risks, including the following:

- Dependence on revenues derived from reimbursement by the federal Medicare and state Medicaid programs;
- Government regulation, government budgetary constraints and proposed legislative and regulatory changes; and
- Lawsuits alleging malpractice and related claims.

Such inherent risks require the use of certain management estimates in the preparation of the Corporation's consolidated financial statements, and it is reasonably possible that a change in such estimates may occur.

The federal Medicare and state Medicaid reimbursement programs represent a substantial portion of the Corporation's revenues, and the Corporation's operations are subject to a variety of other federal, state and local regulatory requirements. Failure to maintain required regulatory approvals and licenses and/or changes in such regulatory requirements could have a significant adverse effect on the Corporation.

The Commonwealth of Virginia must operate with balanced budgets and since the Medicaid program is one of the Commonwealth's largest programs, it is possible that Virginia will enact or consider enacting legislation designed to reduce its Medicaid expenditures. The effect of the change in federal and state reimbursement funding mechanisms and related government budgetary constraints on the Corporation cannot be reasonably estimated at this time.

The healthcare industry is subject to numerous laws and regulation from federal, state and local governments, and the government has increased enforcement of Medicare and Medicaid anti-fraud and abuse laws, as well as physician self-referral laws (STARK law and regulation). The Corporation's compliance with these laws and regulations is subject to ongoing internal monitoring as well as periodic governmental review and inquiries, and the Corporation has responded appropriately to any such compliance matters. The Corporation is aware of certain asserted and unasserted compliance matters, and from time to time, the Corporation may agree to resolve certain compliance matters with the government. The Corporation will continue to monitor its compliance and all related government inquiries and respond appropriately. The final outcomes of these matters cannot be determined at this time.

As a result of enacted and pending federal health care reform legislation, substantial changes are occurring in the United States health care system. Such legislation includes numerous provisions affecting the delivery of health care services, the financing of health care costs, reimbursement of health care providers and the legal obligations of health insurers, providers and employers. The ultimate impact of these potential changes on the future financial position, operations and liquidity of the Corporation cannot be reasonably predicted at this time.

***Supplementary Consolidating Information***

**Virginia Hospital Center Arlington Health System and Affiliated Organizations**  
**Consolidating Balance Sheet Information**  
**December 31, 2018**

	<b>Virginia Hospital Center</b>	<b>Physician Services</b>	<b>Community Services</b>	<b>Arlington Pediatric Center</b>	<b>Real Estate</b>	<b>Foundation</b>	<b>Eliminations</b>	<b>Consolidated</b>
Current assets:								
Cash and cash equivalents	\$ 23,854,978	\$ 100	\$ 350	\$ 300	\$ -	\$ -	\$ -	\$ 23,855,728
Current portion of assets whose use is limited	2,347,600	-	-	-	-	-	-	2,347,600
Net patient accounts receivable	57,698,795	3,125,563	(360,940)	105,568	-	-	-	60,568,986
Inventories	14,349,571	-	-	-	-	-	-	14,349,571
Prepaid expenses and other assets	8,972,787	1,027,707	-	144,618	1,763,101	2,083,294	-	13,991,507
<b>Total current assets</b>	<b>107,223,731</b>	<b>4,153,370</b>	<b>(360,590)</b>	<b>250,486</b>	<b>1,763,101</b>	<b>2,083,294</b>	<b>-</b>	<b>115,113,392</b>
Investments	726,279,206	-	-	-	-	-	-	726,279,206
Assets whose used is limited:								
Held by trustee under bond indenture	2,354,216	-	-	-	-	-	-	2,354,216
Self-insurance trust	9,021,307	-	-	-	-	-	-	9,021,307
By donors	16,870,783	-	-	-	-	-	-	16,870,783
	28,246,306	-	-	-	-	-	-	28,246,306
Less assets available for current liabilities	(2,347,600)	-	-	-	-	-	-	(2,347,600)
	25,898,706	-	-	-	-	-	-	25,898,706
Property and equipment:								
Land and land improvements	2,857,208	-	-	-	2,348,683	-	-	5,205,891
Buildings and fixed equipment	318,205,006	3,098,887	-	298,912	5,356,412	7,631	-	326,966,848
Movable equipment	397,370,068	2,493,585	214,154	231,652	40,482	42,465	-	400,392,406
Construction in progress	10,630,254	-	-	-	-	-	-	10,630,254
	729,062,536	5,592,472	214,154	530,564	7,745,577	50,096	-	743,195,399
Less accumulated depreciation	471,997,022	3,802,117	211,294	367,233	3,131,907	43,847	-	479,553,420
	257,065,514	1,790,355	2,860	163,331	4,613,670	6,249	-	263,641,979
Interest in net assets of Foundation	2,181,575	-	-	-	-	-	(2,181,575)	-
Other assets	-	-	-	-	-	46,430	-	46,430
<b>Total assets</b>	<b>\$ 1,118,648,732</b>	<b>\$ 5,943,725</b>	<b>\$ (357,730)</b>	<b>\$ 413,817</b>	<b>\$ 6,376,771</b>	<b>\$ 2,135,973</b>	<b>\$ (2,181,575)</b>	<b>\$ 1,130,979,713</b>

See independent auditors' report.

**Virginia Hospital Center Arlington Health System and Affiliated Organizations**  
**Consolidating Balance Sheet Information**  
**December 31, 2018**

**(Continued)**

	<b>Virginia Hospital Center</b>	<b>Physician Services</b>	<b>Community Services</b>	<b>Arlington Pediatric Center</b>	<b>Real Estate</b>	<b>Foundation</b>	<b>Eliminations</b>	<b>Consolidated</b>
<b>LIABILITIES AND NET ASSETS</b>								
Current liabilities:								
Accounts payable and accrued expenses	\$ 46,642,232	\$ 3,241,789	\$ -	\$ 19,300	\$ 51,538	\$ (45,602)	\$ -	\$ 49,909,257
Accrued salaries, wages and related items	10,259,912	1,684,573	-	-	-	-	-	11,944,485
Settlement due to third-party payment programs	18,041,233	-	-	-	-	-	-	18,041,233
Interest payable	2,347,600	-	-	-	-	-	-	2,347,600
Other liabilities	322,833	-	-	-	10,500	-	-	333,333
Current portion of long-term debt	6,255,000	-	-	-	-	-	-	6,255,000
<b>Total current liabilities</b>	<b>83,868,810</b>	<b>4,926,362</b>	<b>-</b>	<b>19,300</b>	<b>62,038</b>	<b>(45,602)</b>	<b>-</b>	<b>88,830,908</b>
Intercompany amounts	(1,353,341)	-	-	-	1,353,341	-	-	-
Other long-term liabilities	19,715,257	-	-	-	-	-	-	19,715,257
Long-term debt, net - less current portion	93,581,505	-	-	-	-	-	-	93,581,505
<b>Total liabilities</b>	<b>195,812,231</b>	<b>4,926,362</b>	<b>-</b>	<b>19,300</b>	<b>1,415,379</b>	<b>(45,602)</b>	<b>-</b>	<b>202,127,670</b>
Net assets:								
Without donor restriction	906,235,770	1,017,363	(357,730)	124,465	4,961,392	98,281	(98,281)	911,981,260
With donor restriction	16,600,731	-	-	270,052	-	2,083,294	(2,083,294)	16,870,783
	<b>922,836,501</b>	<b>1,017,363</b>	<b>(357,730)</b>	<b>394,517</b>	<b>4,961,392</b>	<b>2,181,575</b>	<b>(2,181,575)</b>	<b>928,852,043</b>
<b>Total liabilities and net assets</b>	<b>\$ 1,118,648,732</b>	<b>\$ 5,943,725</b>	<b>\$ (357,730)</b>	<b>\$ 413,817</b>	<b>\$ 6,376,771</b>	<b>\$ 2,135,973</b>	<b>\$ (2,181,575)</b>	<b>\$ 1,130,979,713</b>

See independent auditors' report.

**Virginia Hospital Center Arlington Health System and Affiliated Organizations**  
**Consolidating Schedule of Operations Information**  
**Years Ended December 31, 2018**

	<b>Virginia Hospital Center</b>	<b>Physician Services</b>	<b>Community Services</b>	<b>Arlington Pediatric Center</b>	<b>Real Estate</b>	<b>Foundation</b>	<b>Eliminations</b>	<b>Consolidated</b>
Operating revenue:								
Net patient services revenue	\$ 451,267,292	\$ 30,959,524	\$ 2,167,728	\$ 1,058,496	\$ -	\$ -	\$ -	\$ 485,453,040
Other operating revenue	10,660,366	122,310	698,792	849,515	1,175,796	878,360	(1,342,708)	13,042,431
Total operating revenue	461,927,658	31,081,834	2,866,520	1,908,011	1,175,796	878,360	(1,342,708)	498,495,471
Operating expenses:								
Salary, wages and benefits	216,839,896	41,245,804	2,618,700	1,986,407	541,783	1,038,510	-	264,271,100
Supplies and other	198,997,857	11,792,391	466,472	814,608	1,150,781	660,793	(1,342,708)	212,540,194
Professional fees	6,439,141	-	461,381	-	-	-	-	6,900,522
Depreciation	32,115,092	773,640	2,600	31,600	223,058	2,286	-	33,148,276
Interest	4,715,939	-	-	-	-	-	-	4,715,939
Total operating expenses	459,107,925	53,811,835	3,549,153	2,832,615	1,915,622	1,701,589	(1,342,708)	521,576,031
Operating income (loss)	2,819,733	(22,730,001)	(682,633)	(924,604)	(739,826)	(823,229)	-	(23,080,560)
Nonoperating gains (losses):								
Investment income, net	13,990,842	-	-	-	-	-	-	13,990,842
Unrealized losses on trading investments	(45,613,743)	-	-	-	-	-	-	(45,613,743)
Other	(59,925)	-	-	-	(230,151)	-	-	(290,076)
Total nonoperating gains (losses)	(31,682,826)	-	-	-	(230,151)	-	-	(31,912,977)
Excess (deficiency) of revenue and gains over expenses and losses	\$ (28,863,093)	\$ (22,730,001)	\$ (682,633)	\$ (924,604)	\$ (969,977)	\$ (823,229)	\$ -	\$ (54,993,537)

See independent auditors' report.