

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

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**Consolidated Financial Statements and  
Supplementary Consolidating Information**

**Years Ended December 31, 2019 and 2018**

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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, 2019 and 2018, 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, 2019 and 2018, 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.

***Emphasis of Matter - 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) 2016-02, *Leases* (Topic 842). 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 28 - 30 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  
April 2, 2020**

**Virginia Hospital Center Arlington Health System and Affiliated Organizations**  
**Consolidated Balance Sheets**  
**December 31, 2019 and 2018**

	<u>2019</u>	<u>2018</u>
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 25,392,923	\$ 23,855,728
Current portion of assets whose use is limited	2,191,225	2,347,600
Net patient accounts receivable	51,852,089	60,568,986
Inventories	15,077,045	14,349,571
Prepaid expenses and other assets	<u>9,173,566</u>	<u>11,913,013</u>
Total current assets	103,686,848	113,034,898
Investments	846,900,341	726,279,206
Assets whose use is limited:		
Held by trustee under bond indenture	2,197,218	2,354,216
Self-insurance trust	9,208,174	9,021,307
By donors	<u>18,917,333</u>	<u>16,870,783</u>
	30,322,725	28,246,306
Less, assets available for current liabilities	<u>(2,191,225)</u>	<u>(2,347,600)</u>
	28,131,500	25,898,706
Property and equipment:		
Land and land improvements	16,979,899	5,205,891
Buildings and fixed equipment	333,475,846	326,966,848
Movable equipment	408,972,520	400,392,406
Construction in progress	<u>27,389,596</u>	<u>10,630,254</u>
	786,817,861	743,195,399
Less, accumulated depreciation	<u>(511,875,585)</u>	<u>(479,553,420)</u>
	274,942,276	263,641,979
Operating lease right-of-use assets	18,854,666	-
Other assets	<u>7,923,144</u>	<u>2,124,924</u>
Total assets	<u><u>\$ 1,280,438,775</u></u>	<u><u>\$ 1,130,979,714</u></u>

See accompanying notes.

**Virginia Hospital Center Arlington Health System and Affiliated Organizations**  
**Consolidated Balance Sheets**  
**December 31, 2019 and 2018**

**(Continued)**

	<u>2019</u>	<u>2018</u>
<b>LIABILITIES AND NET ASSETS</b>		
Current liabilities:		
Accounts payable and accrued expenses	\$ 45,767,682	\$ 49,909,258
Accrued salaries, wages and related items	12,730,292	11,944,485
Settlements due to third-party payor programs	13,191,228	18,041,233
Interest payable	2,191,225	2,347,600
Other liabilities	4,393,868	322,833
Current portion of long-term debt	<u>5,985,000</u>	<u>6,255,000</u>
Total current liabilities	84,259,295	88,820,409
Other long-term liabilities	45,946,998	19,725,757
Long-term debt, net, less current portion	<u>87,473,226</u>	<u>93,581,505</u>
Total liabilities	<u>217,679,519</u>	<u>202,127,671</u>
Net assets:		
Without donor restriction	1,043,841,923	911,981,260
With donor restriction	<u>18,917,333</u>	<u>16,870,783</u>
	<u>1,062,759,256</u>	<u>928,852,043</u>
Total liabilities and net assets	<u>\$ 1,280,438,775</u>	<u>\$ 1,130,979,714</u>

See accompanying notes.

**Virginia Hospital Center Arlington Health System and Affiliated Organizations**  
**Consolidated Statements of Operations**  
**Years Ended December 31, 2019 and 2018**

	<u>2019</u>	<u>2018</u>
Operating revenue:		
Net patient services revenue	<b>\$ 538,016,909</b>	\$ 485,453,040
Other operating revenue	<b>19,429,078</b>	13,042,431
Total operating revenue	<b>557,445,987</b>	498,495,471
Operating expenses:		
Salaries, wages and benefits	<b>274,572,610</b>	264,271,100
Supplies and other	<b>213,540,285</b>	212,540,194
Professional fees	<b>6,433,394</b>	6,900,522
Depreciation	<b>34,950,913</b>	33,148,276
Interest	<b>4,416,909</b>	4,715,939
Total operating expenses	<b>533,914,111</b>	521,576,031
Operating income (loss)	<b>23,531,876</b>	(23,080,560)
Nonoperating gains (losses):		
Investment income, net	<b>50,024,844</b>	13,990,842
Change in market value of investments and assets whose use is limited, net	<b>58,897,124</b>	(45,613,743)
Other	<b>(441,445)</b>	(290,076)
Net nonoperating gains (losses)	<b>108,480,523</b>	(31,912,977)
Excess (deficiency) of revenues and gains over expenses and losses	<b>\$ 132,012,399</b>	\$ (54,993,537)

**Virginia Hospital Center Arlington Health System and Affiliated Organizations**  
**Consolidated Statements of Changes in Net Assets**  
**Years Ended December 31, 2019 and 2018**

	<u>2019</u>	<u>2018</u>
Net assets without donor restriction:		
Excess (deficiency) of revenues and gains over expenses and losses	<b>\$ 132,012,399</b>	\$ (54,993,537)
Net assets released from restrictions for property and equipment	<b>43,174</b>	2,131,962
Cumulative effect of operating leases	<b>(194,910)</b>	-
Increase (decrease) in net assets without donor restriction	<b>131,860,663</b>	(52,861,575)
Net assets with donor restriction:		
Contributions	<b>4,213,377</b>	2,279,449
Investment income, net realized and unrealized gains on restricted investments	<b>1,917,515</b>	(517,358)
Net assets released from restrictions	<b>(4,084,342)</b>	(6,636,918)
Increase (decrease) in net assets with donor restriction	<b>2,046,550</b>	(4,874,827)
Change in net assets	<b>133,907,213</b>	(57,736,402)
Net assets, beginning of year	<b>928,852,043</b>	986,588,445
Net assets, end of year	<b><u>\$ 1,062,759,256</u></b>	<b><u>\$ 928,852,043</u></b>

**Virginia Hospital Center Arlington Health System and Affiliated Organizations**  
**Consolidated Statements of Cash Flows**  
**Years Ended December 31, 2019 and 2018**

	<u>2019</u>	<u>2018</u>
Cash flows from operating activities:		
Change in net assets	\$ 133,907,213	\$ (57,736,402)
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Net realized and unrealized (gains) losses on investments	(65,439,814)	32,910,786
Equity in (earnings) losses of limited partnerships	(34,363,976)	6,218,909
Depreciation	34,950,912	33,148,276
Amortization of debt issuance costs	48,805	52,110
Amortization of bond premium and discount	(172,084)	(183,738)
Amortization of operating right-of-use asset	3,162,827	-
Restricted contributions received	(6,130,892)	(1,762,091)
Net changes in operating assets and liabilities:		
Accounts receivable	8,716,897	(12,804,113)
Settlements due to third-party payor programs	(4,850,005)	3,955,803
Inventories, prepaid expenses and other assets	2,011,974	(4,060,717)
Accounts payable and accrued expenses, interest payable and other current and long-term liabilities	4,167,200	18,535,562
Net cash provided by operating activities	<u>76,009,057</u>	<u>18,274,385</u>
Cash flows from investing activities:		
Net change in assets whose use is limited	(2,046,550)	4,874,827
Acquisitions of property and equipment	(45,655,771)	(45,562,024)
Net change in investments	(20,817,345)	33,466,549
Decrease (increase) in other long-term assets	(5,798,220)	2,761,654
Net cash used in investing activities	<u>(74,317,886)</u>	<u>(4,458,994)</u>
Cash flows from financing activities:		
Repayment of long-term debt	(6,255,000)	(6,125,000)
Restricted contributions and restricted investment income	6,130,892	1,762,091
Net cash used in financing activities	<u>(124,108)</u>	<u>(4,362,909)</u>
Change in cash, cash equivalents, and restricted cash	1,567,064	9,452,482
Cash, cash equivalents, and restricted cash at beginning of period	<u>35,231,251</u>	<u>25,778,769</u>
Cash, cash equivalents, and restricted cash at end of period	<u>\$ 36,798,315</u>	<u>\$ 35,231,251</u>

Noncash activities:

In 2019 and 2018, the consolidated financial statements include \$1,186,581 and \$591,152 respectively, in accounts payable relating to the purchase of property and equipment.

See accompanying notes.

# 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 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>2019</u>	<u>2018</u>
Cash and cash equivalents	\$ 25,392,923	\$ 23,855,728
Assets whose use is limited:		
Held by trustee under bond indenture	2,197,218	2,354,216
Self-insurance trust	<u>9,208,174</u>	<u>9,021,307</u>
Total	<u>\$ 36,798,315</u>	<u>\$ 35,231,251</u>

### ***Patient service revenue and accounts 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.

#### ***Leases***

At lease inception, the Corporation determines whether an arrangement is or contains a lease. Accounting activity associated with operating leases is included in operating lease right-of-use ("ROU") assets, current operating lease liabilities, noncurrent lease liabilities, and supplied and other expenses in the accompanying consolidated financial statements.

ROU assets represent the Corporation's right to use leased assets over the term of the lease. Lease liabilities represent the Corporation's contractual obligation to make lease payments over the lease term.

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

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For operating leases, ROU assets and lease liabilities are recognized at the commencement date. The lease liability is measured as the present value of the lease payments over the lease term. The Corporation uses the rate implicit in the lease if it is determinable. When the rate implicit in the lease is not determinable, the Corporation uses its incremental borrowing rate at the commencement date of the lease to determine the present value of the lease payments. Operating ROU assets are calculated as the present value of the lease payments plus initial direct costs, plus any prepayments less any lease incentives received. Lease terms may include renewal or extension options to the extent they are reasonably certain to be exercised. The assessment of whether renewal or extension options are reasonably certain to be exercised is made at lease commencement. Factors considered in determining whether an option is reasonably certain of exercise include, but are not limited to, the value of any leasehold improvements, the value of renewal rates compared to market rates, and the presence of factors that would cause a significant economic penalty to the Corporation if the option were not exercised. Lease expense is recognized on a straight-line basis over the lease term. The Corporation has elected not to recognize a ROU asset and obligation for leases with an initial term of twelve months or less. The expense associated with short-term leases is included in supplies and other expense in the accompanying consolidated statements of operations.

### ***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).

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

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

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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.

### ***Reclassifications***

Certain reclassifications have been made to the 2018 consolidated financial statement presentation to correspond to the current year’s presentation. Net assets and changes in net assets are unchanged due to these reclassifications.

### ***Adoption of new accounting standards***

On January 1, 2019, the Corporation adopted the requirements of Accounting Standards Update (“ASU”) 2016-02, *Leases* (Topic 842). The objective of this ASU, along with several related ASUs issued subsequently, is to increase transparency and comparability between organizations that enter into lease agreements. For lessees, the key difference of the new standard from the previous guidance is the recognition of a right-of-use (ROU) asset and lease liability on the balance sheet. The most significant change is the requirement to recognize ROU assets and lease liabilities for leases classified as operating leases. The standard requires disclosures to meet the objective of enabling users of financial statements to assess the amount, timing, and uncertainty of cash flows arising from leases.

As part of the transition to the new standard, the Corporation was required to measure and recognize leases that existed at January 1, 2019, using a modified retrospective approach. For leases existing at the effective date, the Corporation elected the package of three transition practical expedients and therefore did not reassess whether an arrangement is or contains a lease, did not reassess lease classification, and did not reassess what qualifies as an initial direct cost.

The adoption of Topic 842 resulted in the recognition of operating ROU assets and lease liabilities of \$18,854,666 and \$19,273,497, respectively. A cumulative effect adjustment of \$194,910 was recorded at the initial application date of January 1, 2019.

### ***Subsequent events***

Management evaluated all events and transactions that occurred after December 31, 2019 through April 2, 2020 at which time the consolidated financial statements were issued. As of the date these consolidated financial statements were issued, the Corporation was in the process of accessing new debt to initiate the first phase of its Campus Master Plan. This initial phase will result in the Corporation developing acute care beds, parking, and increasing outpatient services, and includes acquisition of property adjacent to the Hospital (see Note 15), construction of an approximately 260,000 square foot outpatient pavilion, and construction of a parking structure.

In addition, the Corporation’s response to and business considerations around the COVID-19 pandemic that originated in the first quarter of 2020 is further described in Note 15.

### **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

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

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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 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 \$3,313,000 and \$3,305,000 of revenues related to Medicare outlier payments for the years ended December 31, 2019 and 2018 respectively. These amounts represent approximately 1.7% and 2.0% of Medicare net revenues for 2019 and 2018, and approximately 1.0% of total net patient service revenues in 2019 and 2018. 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 1.0% of the Hospital's operating revenue in calendar years 2019 and 2018. 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 2019, 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 year ending December 31, 2019, the Corporation will receive \$13,900,000 in rate improvement and \$800,000 in mitigation funding for its existing Medicaid population, which is included in net patient service revenue, and was assessed \$16,300,000, which is included in the supplies and other line item in the accompanying consolidated financial statements.

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

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- **Other third-party payors.** All other third-party payors, principally Care First Blue Cross/Blue Shield, 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.

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 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 2019 or 2018.

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, 2019, and 2018, explicit and implicit price concessions on a consolidated basis were approximately \$1 billion and \$951 million, respectively.

The Corporation accepts all patients regardless of their ability to pay. Patients qualify for charity care 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 \$42,233,000 and \$34,127,000 in gross uncompensated charges for charity care for the years ended December 31, 2019 and 2018, respectively. The total direct and indirect costs of charity care provided for the years ended December 31, 2019 and 2018 were \$12,745,102 and \$10,478,195, respectively. The cost of charity care is calculated on a ratio of total costs to charges.

The Corporation has a program for discounting services to patients who do not have insurance and whose income is below 200% of published federal poverty guidelines. The cost of the discount currently extended, calculated on a ratio of costs to charges, is \$1,106,541 and \$1,505,082 in 2019 and 2018, 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 8,500 and 6,300 visits to the Hospital's indigent clinic in 2019 and 2018, respectively. The indigent clinic is committed to providing access to quality health care services to low-income, uninsured county residents.

**Virginia Hospital Center Arlington Health System and Affiliated Organizations**  
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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 16,000 and 14,500 pediatric visits in 2019 and 2018, 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.

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

	<u>2019</u>	<u>2018</u>
Medicare	\$ 201,965,026	\$ 167,697,515
Medicaid	39,788,537	10,927,643
Managed care and commercial insurers	241,747,991	270,614,621
Other	<u>54,515,355</u>	<u>36,213,261</u>
Total	<u>\$ 538,016,909</u>	<u>\$ 485,453,040</u>

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

The Corporation has elected certain practical expedients allowed under the relevant accounting standards, and therefore 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>2019</u>		<u>2018</u>	
	<u>Cost</u>	<u>Fair Value*</u>	<u>Cost</u>	<u>Fair Value*</u>
Cash and cash equivalents	\$ 16,298,512	\$ 16,298,512	\$ 10,080,173	\$ 10,080,173
Short-term investments	97,030,351	94,658,771	95,074,097	91,247,688
Marketable equity securities	247,314,473	272,623,489	238,678,595	261,789,508
Common collective trusts	230,878,417	319,433,538	223,093,913	259,447,496
Accrued income	<u>2,318</u>	<u>2,318</u>	<u>1,843</u>	<u>1,843</u>
	<u>\$ 591,524,071</u>	<u>\$ 703,016,628</u>	<u>\$ 566,928,621</u>	<u>\$ 622,566,708</u>

**Virginia Hospital Center Arlington Health System and Affiliated Organizations**  
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\*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, 2019 and 2018 of \$143,883,713 and \$103,712,498, 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.

The total restricted and unrestricted alternative investments as of December 31, 2019 and 2018 are as follows:

	<u>2019</u>	<u>2018</u>
Hedge funds	\$ 77,706,280	\$ 63,954,200
Private equity funds	27,247,728	19,999,507
Real assets	<u>42,143,660</u>	<u>22,167,935</u>
	147,097,668	106,121,642
Less – amounts included in assets whose use is limited	<u>(3,213,955)</u>	<u>(2,409,144)</u>
	<u>\$ 143,883,713</u>	<u>\$ 103,712,498</u>

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, 2019, approximately \$77,706,000 is redeemable before December 2020.

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, 2019, the balance of approximately \$27,248,000 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, 2019, approximately \$594,000 is redeemable in less than one year and the balance of approximately \$19,567,000 is redeemable from 2022 through 2028.

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, 2019 was approximately \$3,379,000 for private equity funds and \$11,404,000 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>2019</u>		<u>2018</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>\$ 2,197,218</u>	<u>\$ 2,197,218</u>	<u>\$ 2,354,216</u>	<u>\$ 2,354,216</u>

**Virginia Hospital Center Arlington Health System and Affiliated Organizations**  
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	2019		2018	
	Cost	Fair Value	Cost	Fair Value
Held by trustee for self- insurance				
Cash and cash equivalents	<u>\$ 9,192,174</u>	<u>\$ 9,192,174</u>	<u>\$ 9,005,307</u>	<u>\$ 9,005,307</u>
	2019		2018	
	Cost	Fair Value	Cost	Fair Value
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>
	2019		2018	
	Cost	Fair Value*	Cost	Fair Value*
Externally restricted by donors:				
Cash and cash equivalents	\$ 2,478,472	\$ 2,478,472	\$ 2,353,751	\$ 2,353,751
Marketable securities	5,524,306	6,089,638	5,544,279	6,081,124
Common collective trusts	5,157,171	7,135,242	5,182,262	6,026,721
Accrued income	26	26	43	43
	<u>\$ 13,159,975</u>	<u>\$ 15,703,378</u>	<u>\$ 13,080,335</u>	<u>\$ 14,461,639</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, 2019 and 2018 of \$3,213,955 and \$2,409,144, 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:

	2019		
	Without Donor Restriction	With Donor Restriction	Total
Dividends and interest	\$ 10,898,418	\$ 137,275	\$ 11,035,693
Equity in earnings of limited partnerships	33,756,490	607,486	34,363,976
Realized gains on sales of investments	<u>5,369,936</u>	<u>90,610</u>	<u>5,460,546</u>
Investment income – net	50,024,844	835,371	50,860,215
Unrealized gains on trading securities	<u>58,897,124</u>	<u>1,082,144</u>	<u>59,979,268</u>
Total investment return	<u>\$108,921,968</u>	<u>\$ 1,917,515</u>	<u>\$110,839,483</u>

**Virginia Hospital Center Arlington Health System and Affiliated Organizations**  
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	<b>2018</b>		<b>Total</b>
	<b>Without Donor Restriction</b>	<b>With Donor Restriction</b>	
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>

**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 1.68% and 2.8% at December 31, 2019 and 2018. Conditional promises to give are recorded at the time they become unconditional and are reported in prepaid expenses and other assets (current portion) and long-term assets (noncurrent portion) of the accompanying consolidated balance sheets.

The payment terms of the pledges receivable are as follows:

	<b>2019</b>	<b>2018</b>
Receivable in less than one year	\$ 653,989	\$ 1,592,351
Receivable in one to five years	1,084,071	738,273
Receivable in more than five years	<u>12,300</u>	<u>-</u>
Total promises to give	<u>1,750,360</u>	<u>2,330,624</u>
Less – allowance for uncollectible accounts and discount	<u>(189,813)</u>	<u>(102,712)</u>
	<u>\$ 1,560,547</u>	<u>\$ 2,227,912</u>

**6. Long-Term Debt**

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

	<b>2019</b>	<b>2018</b>
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	\$ 92,655,000	\$ 98,910,000
Net unamortized bond premium	1,417,885	1,635,502
Net unamortized bond discount	(296,671)	(342,204)
Net unamortized debt issuance costs	<u>(317,988)</u>	<u>(366,793)</u>
	<u>93,458,226</u>	<u>99,836,505</u>
Less – current portion	<u>5,985,000</u>	<u>6,255,000</u>
	<u>\$ 87,473,226</u>	<u>\$ 93,581,505</u>

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

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

2020	\$ 5,985,000
2021	6,225,000
2022	6,475,000
2023	6,775,000
2024	7,110,000
Thereafter	<u>60,085,000</u>
	<u>\$ 92,655,000</u>

The Series 2010 Bonds have a fixed interest rate of 4.5% per annum. Interest expense for the years ended December 31, 2019 and 2018 was \$4,416,909 and \$4,715,939, respectively. Interest paid during the years ended December 31, 2019 and 2018 was \$4,695,200 and \$4,997,200, respectively.

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

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

	<u>2019</u>	<u>2018</u>
Health care services and programs	\$ 6,773,931	\$ 5,160,542
Employee education, recognition and support	4,871,446	4,963,619
Buildings and equipment	5,521,518	4,518,710
Pledge receivable for equipment and others	<u>1,750,438</u>	<u>2,227,912</u>
Total net assets with donor restrictions	<u>\$ 18,917,333</u>	<u>\$ 16,870,783</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 2019 and 2018 by expending funds satisfying the restricted purposes or by occurrence of other events specified by donors are as follows:

	<u>2019</u>	<u>2018</u>
Purchase of property and equipment	\$ 43,174	\$ 2,131,962
Research, professional education, faculty support, uncompensated care and other (included in other operating revenue)	<u>4,041,168</u>	<u>4,504,956</u>
	<u>\$ 4,084,342</u>	<u>\$ 6,636,918</u>

**Virginia Hospital Center Arlington Health System and Affiliated Organizations**  
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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 as of December 31:

	<u>2019</u>	<u>2018</u>
Cash and cash equivalents	\$ 25,392,923	\$ 23,855,728
Patient accounts receivable, net	50,178,698	60,568,986
Pledges receivable, net	499,212	1,551,786
Investments with daily and weekly liquidity	<u>310,287,926</u>	<u>265,405,812</u>
Total	<u>\$ 386,358,759</u>	<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, 2019 and 2018 were approximately \$6,776,280 and \$6,097,843, respectively.

**10. Leases**

The Corporation has operating leases on land, buildings, and equipment with remaining lease terms from 1 month to 11 years. Most leases include renewal options, with renewal terms extending up to 5 years.

The following table summarizes the components of lease expense for the year ended December 31, 2019:

Operating lease cost	\$ 3,511,366
Short-term lease cost	<u>2,950,288</u>
Total lease cost	<u>\$ 6,461,654</u>

Supplemental cash flow information related to the lease for the year ended December 31, 2019 was as follows:

Cash paid for amounts included in the measurement of lease liabilities:	
Operating cash flows from operating leases	\$ 3,286,867
Noncash amounts included in the measurement of lease liabilities:	
Right-of-use assets obtained in exchange for new operating leases	\$ 9,783,824

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The Corporation recognized \$18,854,666 in ROU assets on the accompanying consolidated balance sheet as of December 31, 2019 classified as noncurrent operating leases. The following table summarizes the components of operating lease liabilities as of December 31, 2019 included in the accompanying consolidated balance sheet in other liabilities.

Current operating lease liabilities	\$ 2,105,376
Noncurrent lease liabilities	<u>17,168,121</u>
Total operating lease liabilities	<u>\$ 19,273,497</u>

The weighted-average discount rates and weighted remaining lease terms for operating leases as of December 31, 2019 were as follows:

Weighted average remaining lease term	7 years
Weighted average discount rate	5.09%

The following table summarizes the maturity of operating lease liabilities as of December 31, 2019:

2020	\$ 2,108,545
2021	2,757,112
2022	2,873,088
2023	2,875,957
2024	2,674,248
Thereafter	<u>9,760,073</u>
	23,049,023
Less: interest	<u>(3,775,526)</u>
Lease liability	<u>\$ 19,273,497</u>

As of December 31, 2019, the Corporation has an additional operating lease that has not yet commenced of \$1.6 million. The operating lease will commence in 2020 with a lease term of 13 years.

The aggregate amount of future minimum lease payments under noncancelable operating leases not recognized on the balance sheet under ASC 840 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>

## **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

**Virginia Hospital Center Arlington Health System and Affiliated Organizations**  
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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, 2019 and 2018 were \$14,798,363 and \$11,892,119, respectively.

**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. There was \$1,772,510 accrued as of both December 31, 2019 and 2018.

**Health insurance**

The Corporation is self-insured with respect to employee health benefit costs. Health benefit costs are accrued based on historical experience and other factors such as health care cost trend factors. Amounts accrued as of December 31, 2019 and 2018 were \$3,819,561 and \$3,281,908 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, 2019 and 2018 is as follows:

	<u>2019</u>	<u>2018</u>
Medicare	31%	30%
Medicaid	10%	6%
Managed care and commercial insurers	41%	45%
Other	<u>18%</u>	<u>19%</u>
	<u><u>100%</u></u>	<u><u>100%</u></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;

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**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:

*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, 2019, and 2018, the fair value of the Corporation's long-term debt approximates \$94,130,844 and \$102,002,132, 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, 2019:

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Assets:				
Investments:				
Cash and cash equivalents	\$ 16,298,512	\$ -	\$ -	\$ 16,298,512
Short-term investments	94,658,771	-	-	94,658,771
Marketable equity securities				
Equity securities	94,315,298	-	-	94,315,298
Mutual funds	178,308,191	-	-	178,308,191
Accrued income	2,318	-	-	2,318
Assets limited as to use:				
Cash and cash equivalents	11,769,455	-	-	11,769,455
Short-term investments	2,114,409	-	-	2,114,409
Marketable securities				
Equity securities	2,106,737	-	-	2,106,737
Mutual funds	3,982,901	-	-	3,982,901
Accrued income	26	-	-	26
	<u>\$403,556,618</u>	<u>\$ -</u>	<u>\$ -</u>	<u>403,556,618</u>

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Common collective trusts at net asset value:

Investments	<b>319,433,538</b>
Assets limited as to use	<u>7,135,242</u>
	<b><u>\$730,125,398</u></b>

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	-	-	95,288,658
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	<u>43</u>	<u>-</u>	<u>-</u>	<u>43</u>
	<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>
	<b><u>\$648,403,870</u></b>

**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 the Corporation on a variety of bases, where appropriate, including employee salaries, square footage, and operating expenses.

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

Expenses by functional classification for the year ended December 31, 2019 consists of the following:

	<b>2019</b>		
	<b>Health Care Services</b>	<b>General &amp; Administrative</b>	<b>Total</b>
Salaries and benefits	\$253,153,017	\$ 21,419,593	\$274,572,610
Supplies and other	183,150,023	30,444,432	213,594,455
Professional fees	6,433,394	-	6,433,394
Depreciation	33,608,818	1,342,095	34,950,913
Interest	4,416,909	-	4,416,909
	<b><u>\$480,762,161</u></b>	<b><u>\$ 53,206,120</u></b>	<b><u>\$533,968,281</u></b>

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

	<b>2018</b>		
	<b>Health Care Services</b>	<b>General &amp; Administrative</b>	<b>Total</b>
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	4,715,939	-	4,715,939
	<b><u>\$477,116,581</u></b>	<b><u>\$ 44,459,450</u></b>	<b><u>\$521,576,031</u></b>

**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 housed the Arlington Urgent Care Center, Arlington Pediatric Center and other departments of the Corporation.

The property was subject to the terms of a Certificate of Public Need (COPN) issued by the Virginia Department of Health. The COPN requires that an urgent care facility be maintained and operated on the property at 601 South Carling Springs Road. 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. On May 24th, 2019, the State Health Commissioner waived the third condition of COPN No. VA-03931 thus ending the obligation to continue the urgent care operations at the 601 South Carlin Springs Road location.

In July 2019, the Corporation sold the property located at 601 South Carlin Springs Road. The Corporation has relocated the urgent care to a new site within Arlington and remains in compliance of the terms of the related COPN.

***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

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

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

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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 closed the land swap on July 15, 2019.

#### ***Capital Commitments***

The Corporation has entered into various contracts for the construction of an Outpatient Pavilion on the Edison Street property. Future commitments under these contracts as of December 31, 2019, were approximately \$61 million. Pay applications cover 30 day periods of time and are due as work is completed. The contracts generally allow for Termination Without Cause upon thirty-days written notice.

On January 3, 2020, the Corporation entered into an additional \$19 million of future commitments for the Outpatient Pavilion Project, subject to the similar terms previously mentioned.

#### ***COVID-19 pandemic***

On March 11, 2020, the World Health Organization declared the global coronavirus disease (COVID-19) outbreak a pandemic; on March 13, 2020, President Trump declared a national emergency; and the Centers for Disease Control and Prevention has confirmed the spread of COVID-19 to the United States, including Virginia and the District of Columbia. In response, the federal government and a large number of state governments, including Virginia, have imposed strict measures to curtail aspects of public life in an effort to control further spreading of COVID-19 as U.S. cases have risen sharply, including school closures and lock-down guidelines.

An outbreak of an infectious disease, including the growth in the magnitude or severity of COVID-19 cases in the Corporation'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. The treatment of a highly contagious disease by the Corporation could also result in a temporary shutdown of areas of the facility or diversion of patients or staffing shortages. Additionally, elective procedures may be deferred, resulting in reduced patient volumes and operating revenues. Further, the changing global economic conditions or potential global health concerns surrounding the COVID-19 pandemic may also affect the Corporation's partners, suppliers, distributors and payors, potentially disrupting or delaying the Corporation's supply chain and delaying reimbursement by governmental or private payors. It is not possible to predict the costs associated with responding to this pandemic or what federal funds may be available to recover unexpected expenses.

In addition to the direct impact to the health care industry, global investment and financial markets (including in the United States) have experienced substantial volatility, with significant declines attributed to COVID-19 concerns and associated economic impacts of the curtailment of public life described above. As with nearly all industries and companies operating through the COVID-19 pandemic, the Corporation expects to encounter further volatility and disruption in its operations and in the local, national and global economies.

Although the Corporation 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 the COVID-19 pandemic is difficult to predict and could materially adversely impact the Corporation's financial condition, liquidity and results of operations, as well as national and local economies.

#### ***Additional 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:

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

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- 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, 2019**

	<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	\$ 25,393,127	\$ 100	\$ 350	\$ 300	\$ -	\$ (954)	\$ -	\$ 25,392,923
Current portion of assets whose use is limited	2,191,225	-	-	-	-	-	-	2,191,225
Net patient accounts receivable	48,668,981	3,295,025	(182,539)	70,622	-	-	-	51,852,089
Inventories	15,077,045	-	-	-	-	-	-	15,077,045
Prepaid expenses and other assets	6,044,538	1,292,145	19,246	666,059	693,679	457,899	-	9,173,566
Total current assets	97,374,916	4,587,270	(162,943)	736,981	693,679	456,945	-	103,686,848
Investments	846,900,341	-	-	-	-	-	-	846,900,341
Assets whose used is limited:								
Held by trustee under bond indenture	2,197,218	-	-	-	-	-	-	2,197,218
Self-insurance trust	9,208,174	-	-	-	-	-	-	9,208,174
By donors	18,917,333	-	-	-	-	-	-	18,917,333
	30,322,725	-	-	-	-	-	-	30,322,725
Less assets available for current liabilities	(2,191,225)	-	-	-	-	-	-	(2,191,225)
	28,131,500	-	-	-	-	-	-	28,131,500
Property and equipment:								
Land and land improvements	14,631,216	-	-	-	2,348,683	-	-	16,979,899
Buildings and fixed equipment	325,222,249	3,107,322	-	272,118	4,866,526	7,631	-	333,475,846
Movable equipment	405,942,428	2,700,439	5,131	241,574	40,483	42,465	-	408,972,520
Construction in progress	27,147,468	86,852	155,276	-	-	-	-	27,389,596
	772,943,361	5,894,613	160,407	513,692	7,255,692	50,096	-	786,817,861
Less accumulated depreciation	504,548,598	4,034,496	5,131	378,648	2,862,578	46,134	-	511,875,585
	268,394,763	1,860,117	155,276	135,044	4,393,114	3,962	-	274,942,276
Operating lease right-of-use assets	8,334,150	8,703,833	-	1,816,683	-	-	-	18,854,666
Interest in net assets of Foundation	1,124,916	-	-	-	-	-	(1,124,916)	-
Other assets	6,786,435	-	-	472,700	-	664,009	-	7,923,144
Total assets	<u>\$ 1,257,047,021</u>	<u>\$ 15,151,220</u>	<u>\$ (7,667)</u>	<u>\$ 3,161,408</u>	<u>\$ 5,086,793</u>	<u>\$ 1,124,916</u>	<u>\$ (1,124,916)</u>	<u>\$ 1,280,438,775</u>

See independent auditors' report.

Virginia Hospital Center Arlington Health System and Affiliated Organizations  
 Consolidating Balance Sheet Information  
 December 31, 2019

(Continued)

	Virginia Hospital Center	Physician Services	Community Services	Arlington Pediatric Center	Real Estate	Foundation	Eliminations	Consolidated
<b>LIABILITIES AND NET ASSETS</b>								
Current liabilities:								
Accounts payable and accrued expenses	\$ 41,504,886	\$ 4,002,874	\$ -	\$ 19,220	\$ 240,702	\$ -	\$ -	\$ 45,767,682
Accrued salaries, wages and related items	11,038,303	1,691,989	-	-	-	-	-	12,730,292
Settlement due to third-party payment programs	13,191,228	-	-	-	-	-	-	13,191,228
Interest payable	2,191,225	-	-	-	-	-	-	2,191,225
Other liabilities	2,935,671	1,342,421	-	115,776	-	-	-	4,393,868
Current portion of long-term debt	5,985,000	-	-	-	-	-	-	5,985,000
Total current liabilities	76,846,313	7,037,284	-	134,996	240,702	-	-	84,259,295
Intercompany amounts	385,930	-	-	-	(385,930)	-	-	-
Other long-term liabilities	36,706,777	7,523,772	-	1,705,949	10,500	-	-	45,946,998
Long-term debt, net - less current portion	87,473,226	-	-	-	-	-	-	87,473,226
Total liabilities	201,412,246	14,561,056	-	1,840,945	(134,728)	-	-	217,679,519
Net assets:								
Without donor restriction	1,037,453,094	590,164	(7,667)	584,811	5,221,521	43,346	(43,346)	1,043,841,923
With donor restriction	18,181,681	-	-	735,652	-	1,081,570	(1,081,570)	18,917,333
	1,055,634,775	590,164	(7,667)	1,320,463	5,221,521	1,124,916	(1,124,916)	1,062,759,256
Total liabilities and net assets	\$ 1,257,047,021	\$ 15,151,220	\$ (7,667)	\$ 3,161,408	\$ 5,086,793	\$ 1,124,916	\$ (1,124,916)	\$ 1,280,438,775

**Virginia Hospital Center Arlington Health System and Affiliated Organizations**  
**Consolidating Schedule of Operations Information**  
**Years Ended December 31, 2019**

	<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	\$ 499,242,168	\$ 35,961,438	\$1,735,714	\$1,077,589	\$ -	\$ -	\$ -	\$ 538,016,909
Other operating revenue	17,133,651	61,372	-	1,041,792	1,187,691	1,426,722	(1,422,150)	19,429,078
Total operating revenue	516,375,819	36,022,810	1,735,714	2,119,381	1,187,691	1,426,722	(1,422,150)	557,445,987
Operating expenses:								
Salary, wages and benefits	222,046,731	46,612,762	2,344,644	1,955,270	444,057	1,169,146	-	274,572,610
Supplies and other	200,325,185	11,832,333	86,304	839,894	961,471	917,248	(1,422,150)	213,540,285
Professional fees	6,529,172	(306,375)	210,597	-	-	-	-	6,433,394
Depreciation	34,207,831	492,121	2,860	25,259	220,556	2,286	-	34,950,913
Interest	4,416,909	-	-	-	-	-	-	4,416,909
Total operating expenses	467,525,828	58,630,841	2,644,405	2,820,423	1,626,084	2,088,680	(1,422,150)	533,914,111
Operating income (loss)	48,849,991	(22,608,031)	(908,691)	(701,042)	(438,393)	(661,958)	-	23,531,876
Nonoperating gains (losses):								
Investment income, net	50,024,844	-	-	-	-	-	-	50,024,844
Unrealized losses on trading investments	58,897,124	-	-	-	-	-	-	58,897,124
Other	(192,767)	-	-	-	(248,678)	-	-	(441,445)
Total nonoperating gains (losses)	108,729,201	-	-	-	(248,678)	-	-	108,480,523
Excess (deficiency) of revenue and gains over expenses and losses	\$ 157,579,192	\$ (22,608,031)	\$ (908,691)	\$ (701,042)	\$ (687,071)	\$ (661,958)	\$ -	\$ 132,012,399

See independent auditors' report.