

**LEXINGTON RETIREMENT COMMUNITY, INC.
DBA: KENDAL AT LEXINGTON**

FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2018 AND 2017

CliftonLarsonAllen LLP



WEALTH ADVISORY | OUTSOURCING | AUDIT, TAX, AND CONSULTING



**LEXINGTON RETIREMENT COMMUNITY, INC.
DBA: KENDAL AT LEXINGTON
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YEARS ENDED DECEMBER 31, 2018 AND 2017**

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INDEPENDENT AUDITORS' REPORT

Audit and Oversight Committee
Lexington Retirement Community, Inc.
dba: Kendal at Lexington
Lexington, Virginia

We have audited the accompanying financial statements of Lexington Retirement Community, Inc. dba: Kendal at Lexington, which comprise the balance sheets as of December 31, 2018 and 2017, and the related statements of operations, changes in net assets, and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of 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 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 audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion


In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Lexington Retirement Community, Inc. dba: Kendal at Lexington as of December 31, 2018 and 2017, and the results of its operations, changes in its net assets and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis-of-Matters Regarding a Change in Accounting Principle

As discussed in Note 1 to the financial statements, the Corporation adopted a provision of Financial Accounting Standards Board Accounting Standards Updates 2016-14, *Presentation of Financial Statements for Not-for-Profit Entities*. The new accounting standard changes the presentation of various classifications and disclosures within the financial statements. Our opinion is not modified with respect to that matter.

As discussed in Note 1 to the financial statements, the Corporation adopted a provision of Financial Accounting Standards Board Accounting Standards Updates 2016-01, *Financial Instruments*. The new accounting standard, among other things, requires investments in equity securities to be measured at fair value with unrealized holding gains and losses included within the performance indicator. Our opinion is not modified with respect to that matter.

As discussed in Note 1 to the financial statements, the Corporation adopted a provision of Financial Accounting Standards Board Accounting Standards Updates 2014-09, *Revenue from Contracts with Customers*. The new accounting standard clarifies how revenue is to be recognized and requires expanded disclosures related to the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. Our opinion is not modified with respect to that matter.



CliftonLarsonAllen LLP

Plymouth Meeting, Pennsylvania
April 16, 2019

LEXINGTON RETIREMENT COMMUNITY, INC.
DBA: KENDAL AT LEXINGTON
BALANCE SHEETS
DECEMBER 31, 2018 AND 2017

ASSETS	<u>2018</u>	<u>2017</u>
CURRENT ASSETS		
Cash and Cash Equivalents	\$ 416,369	\$ 403,840
Accounts Receivable, Net of Allowance for Doubtful Accounts of \$143,809 in 2018 and \$62,267 in 2017	381,421	579,287
Contributions Receivable and Other	123,125	145,647
Entry Fee Receivable	954,741	905,028
Prepaid Expenses and Other	187,358	751,255
Current Portion of Assets Limited as to Use	<u>3,053,697</u>	<u>1,524,239</u>
Total Current Assets	5,116,711	4,309,296
INVESTMENTS	17,611,356	17,026,064
ASSETS LIMITED AS TO USE		
By Trustee Under Bond Indenture	21,305,627	27,242,505
By Board	2,647,723	1,425,931
Escrowed Deposits	2,600,322	1,438,220
By Donors	<u>2,463,820</u>	<u>2,056,077</u>
Total	29,017,492	32,162,733
Less: Current Portion of Assets Limited as to Use	<u>(3,053,697)</u>	<u>(1,524,239)</u>
Total Assets Limited as to Use	25,963,795	30,638,494
PROPERTY AND EQUIPMENT		
Land	824,971	824,971
Buildings and Improvements	53,441,516	53,158,243
Equipment and Furniture	4,603,732	4,453,695
Construction in Progress	<u>9,886,709</u>	<u>3,083,234</u>
Total	68,756,928	61,520,143
Less: Accumulated Depreciation	<u>(25,970,373)</u>	<u>(23,967,088)</u>
Property and Equipment, Net	42,786,555	37,553,055
OTHER ASSETS		
Contributions Receivable	134,032	362,216
Insurance Deposits	596,911	537,250
Beneficial Interest in Charitable Remainder Unitrust Receivable	<u>20,281</u>	<u>18,960</u>
Total Other Assets	<u>751,224</u>	<u>918,426</u>
Total Assets	<u><u>\$ 92,229,641</u></u>	<u><u>\$ 90,445,335</u></u>

See accompanying Notes to Financial Statements.

LEXINGTON RETIREMENT COMMUNITY, INC.
DBA: KENDAL AT LEXINGTON
BALANCE SHEETS (CONTINUED)
DECEMBER 31, 2018 AND 2017

LIABILITIES AND NET ASSETS	<u>2018</u>	<u>2017</u>
CURRENT LIABILITIES		
Current Portion of Long-Term Debt	\$ 1,020,000	\$ 1,010,000
Accounts Payable and Accrued Expenses	2,821,485	1,619,116
Accrued Interest Payable	1,008,731	514,239
Due to The Kendal Corporation	9,360	3,701
Entry Fee Refund Payable	-	20,920
Total Current Liabilities	<u>4,859,576</u>	<u>3,167,976</u>
 LONG-TERM LIABILITIES		
Long-Term Debt, Net of Current Portion	48,241,495	49,433,695
Deferred Entrance Fee Revenue	29,864,418	30,193,692
Refundable Contract Obligations	239,550	239,550
Entry Fee Deposits	<u>2,600,322</u>	<u>1,438,220</u>
Total Long-Term Liabilities	<u>80,945,785</u>	<u>81,305,157</u>
 Total Liabilities	85,805,361	84,473,133
 NET ASSETS		
Without Donor Restrictions	1,147,788	1,973,369
Without Donor Restrictions - Board Designated	<u>2,647,723</u>	<u>1,425,931</u>
Total Net Assets Without Donor Restrictions	3,795,511	3,399,300
With Donor Restrictions	<u>2,628,769</u>	<u>2,572,902</u>
Total Net Assets	<u>6,424,280</u>	<u>5,972,202</u>
 Total Liabilities and Net Assets	<u><u>\$ 92,229,641</u></u>	<u><u>\$ 90,445,335</u></u>

See accompanying Notes to Financial Statements.

LEXINGTON RETIREMENT COMMUNITY, INC.
DBA: KENDAL AT LEXINGTON
STATEMENTS OF OPERATIONS
YEARS ENDED DECEMBER 31, 2018 AND 2017

	<u>2018</u>	<u>2017</u>
REVENUE		
Net Residential Services Revenue	\$ 6,442,137	\$ 6,285,662
Health Center Fees	5,407,508	6,145,133
Amortization of Deferred Entry Fees	2,949,364	2,863,725
Investment Income	734,853	484,653
Unrealized (Loss) Gain on Equity Securities	(985,879)	1,076,812
Contributions	31,000	514,413
Other Income	390,884	396,865
Net Assets Released from Restrictions	40,247	21,229
Total Revenue	<u>15,010,114</u>	<u>17,788,492</u>
OPERATING EXPENSES		
General and Administrative	1,952,954	1,962,749
Housekeeping and Laundry	327,075	339,757
Maintenance	896,825	818,135
Food Service	1,728,266	1,682,825
Health Service	4,146,803	4,070,988
Employee Benefits	1,275,725	1,255,829
Utilities	564,819	541,893
Real Estate Taxes	234,681	234,808
Affiliation and Service Fee	452,208	441,557
Interest Expense	874,153	885,769
Depreciation Expense	2,068,642	2,042,494
Provision for Bad Debt Expense	101,767	41,256
Total Operating Expenses	<u>14,623,918</u>	<u>14,318,060</u>
INCOME FROM OPERATIONS	386,196	3,470,432
NONOPERATING LOSS		
Loss on Disposal of Property and Equipment	(4,023)	(1,146)
Total Nonoperating Loss	<u>(4,023)</u>	<u>(1,146)</u>
EXCESS OF REVENUE OVER EXPENSES	<u>\$ 382,173</u>	<u>\$ 3,469,286</u>

See accompanying Notes to Financial Statements.

LEXINGTON RETIREMENT COMMUNITY, INC.
DBA: KENDAL AT LEXINGTON
STATEMENTS OF CHANGES IN NET ASSETS
YEARS ENDED DECEMBER 31, 2018 AND 2017

	<u>2018</u>	<u>2017</u>
EXCESS OF REVENUE OVER EXPENSES	\$ 382,173	\$ 3,469,286
OTHER CHANGES IN NET ASSETS - WITHOUT DONOR RESTRICTIONS		
Unrealized Loss on Fixed Income Securities and Other Investments	(467)	-
Net Assets Released from Restrictions Used for Purchase of Property and Equipment	<u>14,505</u>	<u>-</u>
Increase in Net Assets - Without Donor Restrictions	396,211	3,469,286
CHANGES IN NET ASSETS WITH DONOR RESTRICTIONS		
Contributions	242,125	503,427
Investment (Loss) Income	(30,338)	142,884
Provision for Bad Debt Expense	(102,489)	-
Change in the Beneficial Interest in Charitable Remainder Unitrust Receivable	1,321	1,885
Net Assets Released from Restrictions Used for Purchase of Property and Equipment	(14,505)	-
Net Assets Released from Restrictions Used for Operations	<u>(40,247)</u>	<u>(21,229)</u>
Increase in Net Assets - With Donor Restrictions	55,867	626,967
INCREASE IN NET ASSETS	452,078	4,096,253
Net Assets - Beginning of Year (As Restated)	<u>5,972,202</u>	<u>1,875,949</u>
NET ASSETS - END OF YEAR	<u><u>\$ 6,424,280</u></u>	<u><u>\$ 5,972,202</u></u>

See accompanying Notes to Financial Statements.

LEXINGTON RETIREMENT COMMUNITY, INC.
DBA: KENDAL AT LEXINGTON
STATEMENTS OF CASH FLOWS
YEARS ENDED DECEMBER 31, 2018 AND 2017

	2018	2017
CASH FLOWS FROM OPERATING ACTIVITIES		
Increase in Net Assets	\$ 452,078	\$ 4,096,253
Adjustments to Reconcile Increase in Net Assets to Net Cash Provided by Operating Activities:		
Loss on Disposals of Property and Equipment	4,023	1,146
Unrealized and Realized (Loss) Gain on Investments and Assets Limited As to Use	1,076,016	(1,177,237)
Depreciation Expense	2,068,642	2,042,494
Amortization of Deferred Financing Costs	52,245	29,090
Entry Fee Amortization	(2,949,364)	(2,863,725)
Deferred Entry Fees Received, Net of Refunds	2,503,019	4,728,822
Amortization of Original Issue Premium	(224,445)	(171,800)
(Increase) Decrease in:		
Accounts Receivables, Net	197,866	80,386
Contributions Receivable and Other	249,385	(32,548)
Prepaid Expenses and Other	563,897	(481,124)
Increase (Decrease) in:		
Accounts Payable and Accrued Expenses	811,174	731,012
Accrued Interest Payable	494,492	268,499
Due to Kendal Corporation	5,659	(1,990)
Net Cash Provided by Operating Activities	5,304,687	7,249,278
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of Property and Equipment	(6,914,969)	(2,839,607)
Purchases and Sales of Investments, Net	(1,661,308)	437,292
Deposit of Self Insurance	(59,661)	(219,608)
(Increase) Decrease in Assets Limited As to Use	3,145,240	(27,484,968)
Net Cash Used by Investing Activities	(5,490,698)	(30,106,891)
CASH FLOWS FROM FINANCING ACTIVITIES		
First Generation Entry Fees Received, Net of Refunds	1,208,540	1,182,320
Payments for Debt Issuance Costs	-	(694,691)
Proceeds from Issuance of Debt	-	21,907,104
Repayment of Long-Term Debt	(1,010,000)	(20,000)
Net Cash Provided by Financing Activities	198,540	22,374,733
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	12,529	(482,880)
Cash and Cash Equivalents - Beginning of Year	403,840	886,720
CASH AND CASH EQUIVALENTS - END OF YEAR	<u>\$ 416,369</u>	<u>\$ 403,840</u>
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION		
Cash Paid for Interest, Net of Capitalized Interest	<u>\$ 1,022,670</u>	<u>\$ 759,979</u>

See accompanying Notes to Financial Statements.

LEXINGTON RETIREMENT COMMUNITY, INC.
DBA: KENDAL AT LEXINGTON
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2018 AND 2017

NOTE 1 ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization

Lexington Retirement Community, Inc. (LRC) or (the Corporation) was formed March 16, 1995 as a Virginia nonstock corporation for the purpose of establishing, maintaining, operating, and managing a continuing care retirement community in Lexington, Virginia. LRC is exempt from federal income tax under Section 501(c)(3) of the Internal Revenue Code (IRC).

Effective March 11, 1997, LRC amended its bylaws for the purpose of affiliating with The Kendal Corporation, a Pennsylvania nonprofit organization. Certain activities of LRC require the approval of The Kendal Corporation. The amended bylaws specify the composition of LRC's board of directors and create authority for a residents' association. LRC has registered the trade name Kendal at Lexington with the Commonwealth of Virginia.

In July 2000, LRC commenced operations. LRC consists of 120 independent living residences in cottages, cottage clusters, and apartments, plus an assisted living facility for 20 residents.

Effective September 6, 2001, LRC became the sole member of Lexington Health Investors, LLC (LHI). LHI was a Virginia limited liability company whose purpose was to operate a 60-bed nursing facility on approximately two acres of land, which was transferred by LRC. LHI was exempt from federal income tax under Section 501(c)(3) of the IRC. LHI financed the construction of the facility, which began in September 2001 and was completed in September 2002, through a loan from a local hospital as well as a tax-exempt bond issue. LRC was the sole member of LHI. On December 31, 2009, LHI dissolved and all assets, liabilities, and net assets were transferred to LRC.

Use of Estimates

The preparation of the financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the 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 cash and cash equivalents to include all highly liquid investments with maturities of three months or less.

LEXINGTON RETIREMENT COMMUNITY, INC.
DBA: KENDAL AT LEXINGTON
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2018 AND 2017

NOTE 1 ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES
(CONTINUED)

Allowance for Doubtful Accounts

The Corporation provides an allowance for uncollectible accounts using management's estimate about the collectibility of past due accounts. Residents are not required to provide collateral for services rendered. Payment for services is required upon receipt of invoice or claim submitted. Accounts past due more than 30 days are individually analyzed for collectibility. When all collection efforts have been exhausted, the accounts are written off against the related allowance. Management believes that the allowance for doubtful accounts is adequate to provide for estimated uncollectible accounts associated with the accounts receivable balances.

Entry Fee Receivable

Entry fee receivable represents entrance fees that are deferred for up to 12 months after a resident occupies a unit. The receivable is expected to be collected during the next 12 months and is, therefore, categorized as a current asset as of December 31, 2018 and 2017. Management determined that no allowance is necessary on the entry fee receivable.

Investments

Investments are comprised primarily of mutual funds, equity securities and debt securities and are measured at fair value in the balance sheets. Fair values are based on quoted market prices, if available, or estimated using quoted market prices for similar securities. Investment income, including interest and dividends, unrealized gains (losses) on equity securities, declines in market value deemed to be other than temporary and earnings on trustee held funds, are reported as investment income, and included in the deficiency of revenue over expenses. The cost of substantially all securities sold is based on the specific identification method. Unrealized gains (losses) from fixed income and other securities are excluded from the excess of revenue over expenses.

Investments are exposed to various risks, such as interest rate, market, and credit risks. Due to the risk associated with certain investments, it is reasonably possible that changes in the value of the investments will occur in the near term and that such changes could materially affect the amounts reported in the balance sheet.

Assets Limited as to Use

Assets limited as to use include assets held by trustees under bond indenture agreements, escrowed deposits, and certain donor-restricted assets. In addition, unrestricted resources designated by the Corporation's board are reported as assets limited as to use. Assets limited as to use are carried at fair value. Certain amounts required for obligations classified as current liabilities are reported in current assets.

The Corporation's board has designated a portion of cash and investments for specific purposes, which include future capital replacements and repairs, fellowship assistance, employee education, and other general purposes. The Corporation's board retains control of these assets and may at its discretion subsequently use the funds for other purposes.

LEXINGTON RETIREMENT COMMUNITY, INC.
DBA: KENDAL AT LEXINGTON
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2018 AND 2017

**NOTE 1 ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES
(CONTINUED)**

Concentration of Credit Risk

The Corporation maintains its cash accounts at commercial banks. The balances are insured by the Federal Deposit Insurance Corporation (FDIC) up to certain limits. At times, cash in the bank may exceed FDIC insurable limits. The funds on deposit in brokerage accounts are insured by the SIPC up to \$500,000.

Property and Equipment

The Corporation capitalizes all expenditures for property and equipment with costs over \$1,000 and an estimated life greater than one year. The cost of maintenance and repairs are charged against operations as incurred. Property and equipment is stated at cost or at fair value at the date of donation. Depreciation of office furniture and equipment is computed using the straight-line method over estimated useful lives ranging from 3 to 20 years. Buildings and improvements are depreciated on a straight-line basis over 3 to 40 years. Depreciation expense was \$2,068,642 and \$2,042,494 and for the years ended December 31, 2018 and 2017, respectively.

Net Assets

The Corporation reports information regarding its financial position and activities according to the existence or absence of donor-imposed restrictions. Accordingly, net assets and changes therein are classified and reported as follows:

Net Assets Without Donor Restrictions – Include net assets available for use in general operations and not subject to donor restrictions. At times, the governing board can designate, from net assets without donor restrictions, net assets for a board-designated purposes.

Net Assets With Donor Restrictions – Include net assets subject to donor-imposed restrictions. Some donor-imposed restrictions are temporary in nature, such as those that will be met by the passage of time or other events specified by the donor. Other donor-imposed restrictions are perpetual in nature, where the donor stipulates that resources be maintained in perpetuity. Donor-imposed restrictions are released when a restriction expires, that is, when the stipulated time has elapsed, when the stipulated purpose for which the resource has been fulfilled, or both.

Unconditional promises to give cash and other assets are accrued at estimated fair market value at the date each promise is received. Donor-restricted contributions are reported as increases in net assets with donor restrictions, depending on the nature of the restrictions. When a restriction expires, net assets with donor restrictions are reclassified to net assets without donor restrictions and reported as an increase in net assets without donor restrictions.

LEXINGTON RETIREMENT COMMUNITY, INC.
DBA: KENDAL AT LEXINGTON
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2018 AND 2017

**NOTE 1 ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES
(CONTINUED)**

Deferred Entrance Fee Revenue

Nonrefundable entry fees paid by residents pursuant to a continuing care contract are recorded as deferred revenue and amortized into operating revenue over the actuarially determined life expectancy of each resident or couple, adjusted annually (time-based). Upon death of a sole surviving resident, any remaining unamortized portion of the entry fee is recognized as revenue.

A resident may terminate their contract at any time during the first 90 days, without notice. After that, 30 days' notice is required. In both instances, the paid entry fee is decreased by 2% per month. Amounts refundable are equal to the original fee paid less 2% for each month of occupancy. At December 31, 2018 and 2017, the portion of deferred entry fee revenue subject to such refund provisions amounted to approximately \$7,715,000 and \$8,644,000, respectively.

Other contracts include a 50% and a 90% refundable option upon the death of the resident or upon termination by the resident. Refunds are payable once the resident's unit is reoccupied. Refundable amounts under these contracts are not amortized to revenue.

Obligation to Provide Future Services

The Corporation annually calculates the present value of the net cost of future services and the use of facilities to be provided to current residents and compares that amount with the balance of deferred entry fee revenue. If the present value of the net cost of future services and the use of facilities exceeds the deferred entry fee revenue, a liability is recorded (obligation to provide future services and use of facilities) with the corresponding charge to income. The obligation is discounted at 5.5% in 2018 and 2017, based on the expected long-term rate of return on investments. Increases or decreases in the obligation are charged or credited to operations, respectively. This calculation did not result in a liability as of December 31, 2018 and 2017.

Charitable Gift Annuities

The Corporation receives assets from donors under gift annuity agreements in exchange for a promise to pay a fixed amount during the annuitant's or specified beneficiary's life. Assets received are recorded at fair value, and a liability is recognized for the present value of future cash flows expected to be paid to the donor. Contribution revenue is recognized for the difference between these amounts. Adjustments to the annuity liability are made annually to reflect changes in the discount rate and the life expectancies of the donors. As of December 31, 2018 and 2017, the Corporation was not the beneficiary of charitable gift annuities.

LEXINGTON RETIREMENT COMMUNITY, INC.
DBA: KENDAL AT LEXINGTON
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2018 AND 2017

**NOTE 1 ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES
(CONTINUED)**

Charitable Remainder Unitrust

The Corporation is the beneficiary of one charitable remainder unitrust. Each year, the trustees pay the recipients during the recipient's life an annuity amount. Upon the death of the recipient, the trustee will distribute the principal and income of the trust. The trust requires the Corporation to use the principal and income for a specified purpose.

Performance Indicator

The statement of operations include excess of revenues over expenses, known as the performance indicator. Changes in net assets without donor restrictions, which are excluded from the performance indicator, include unrealized gains (losses) on investments from fixed income and other securities and net assets released from restrictions used for purchase of property and equipment.

Net Residential and Health Care Services Revenue (Resident Services Revenue)

Resident services revenue is reported at the amount that reflects the consideration to which the Corporation expects to be entitled in exchange for providing resident care. These amounts are due from residents, 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 residents and third-party payors several days after the services are performed. 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. The Corporation believes that this method provides a faithful depiction of the transfer of services over the term of the performance obligation based on the inputs needed to satisfy the obligation. Generally, performance obligations satisfied over time relate to residents in the facility receiving skilled nursing services or residents receiving services in the facility. The Corporation measures the performance obligation from admission into the facility, or the commencement of an outpatient service, to the point when it is no longer required to provide services to that resident, which is generally at the time of discharge or completion of the outpatient services. Revenue for performance obligations satisfied at a point in time is generally recognized when goods are provided to the residents.

The Corporation does not believe it is required to provide additional goods or services related to that sale. The Corporation determines the transaction price based on standard charges for goods and services provided, reduced by contractual adjustments provided to third-party payors, discounts provided to uninsured patients in accordance with the Corporation's policy and/or implicit price concessions provided to residents. The Corporation determines its estimates of contractual adjustments based on contractual agreements, its policies, and historical experience. The Corporation determines its estimate of implicit price concessions based on its historical collection experience.

LEXINGTON RETIREMENT COMMUNITY, INC.
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NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2018 AND 2017

NOTE 1 ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES
(CONTINUED)

Net Residential and Health Care Services Revenue (Resident Services Revenue)
(Continued)

Medicare and Medicaid

Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term. The Corporation believes that it is in compliance with all applicable laws and regulations and is not aware of any pending or threatened investigations involving allegation of potential wrongdoing. While no such regulatory inquiries have been made, compliance with such laws and regulations can be subject to future government review and interpretation, as well as significant regulatory action including fines, penalties, and exclusion from the Medicare and Medicaid programs.

Medicare Reimbursement

The Balanced Budget Act of 1997 modified how payment is made for Medicare SNF services. SNFs are reimbursed on the basis of a prospective payment system (PPS). The PPS payment rates are adjusted for case mix and geographic variation in wages and cover all costs of furnishing SNF covered services (routine, ancillary, and capital related costs). Annual cost reports are required to be submitted to the designated Medicare Administrative Contractor; however, they do not contain a cost settlement. Nursing facilities licensed for participation in the Medicare and Medical Assistance programs are subject to annual licensure renewal. If it is determined that a nursing facility is not in substantial compliance with the requirements of participation, Centers for Medicare and Medicaid Services (CMS) may impose sanctions and penalties during the period of noncompliance. Such a payment ban would have a negative impact on the revenues of the licensed nursing facility.

Medicaid Reimbursement

Beginning in 2017, the Virginia Department of Medical Assistance Services (DMAS), with the support of the Governor and the General Assembly, began transitioning Medicaid members that have full Medicaid coverage and are age 65 or older or are disabled, to a mandatory Medicaid managed care program (MCO), referred to as the Commonwealth Coordinated Care Plus (CCC Plus). The CCC Plus program consists of six managed care health plans and became effective for the Corporation's Medicaid residents November 1, 2017. The Corporation is reimbursed by each MCO according to their contract. Currently, all six organization use the Commonwealth of Virginia Medicaid Fee Schedule.

Net Residential Services Revenue

Residential service revenue is comprised of revenue from the independent living services (Residential Living). Residential services revenue is recorded at established rates with vacancies and absence allowances deducted to arrive at net residential services revenue. Monthly residential occupancy fees are recognized as revenue in the month of assessment.

**LEXINGTON RETIREMENT COMMUNITY, INC.
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NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2018 AND 2017**

**NOTE 1 ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES
(CONTINUED)**

**Net Residential and Health Care Services Revenue (Resident Services Revenue)
(Continued)**

Health Care Services Revenue

Health care services is comprised of revenue from the assisted living and skilled nursing facility.

The composition of the Corporation's health service revenue by primary payor for the years ended December 31, 2018 and 2017 is as follows:

	2018	2017
Traditional Medicaid	\$ 63,617	\$ 1,540,471
Traditional Medicare	1,180,430	1,349,778
Private Pay, Managed Care Organizations and Other (Including Medicare and Medicaid MCO's)	4,163,461	3,254,884
Total Resident Services Revenue	<u>\$ 5,407,508</u>	<u>\$ 6,145,133</u>

The composition of revenue based on service lines, method of reimbursement and timing of revenue recognition for the years ended December 31, 2018 and 2017 is as follows:

	2018	2017
Service lines		
Residential Living	\$ 6,442,137	\$ 6,285,662
Skilled Nursing	4,662,304	5,342,348
Assisted Living	745,201	802,785
Retail Sales (Dining)	193,348	166,764
Rental Income	67,060	67,810
Other Ancillary Charges	130,479	162,291
Total	<u>\$ 12,240,529</u>	<u>\$ 12,827,660</u>
Method of reimbursement		
Fee for services	\$ 11,980,121	\$ 12,593,086
Other	260,408	234,574
Total	<u>\$ 12,240,529</u>	<u>\$ 12,827,660</u>
Timing of revenue and recognition		
Health care services transferred over time	\$ 11,980,121	\$ 12,593,086
Sales at point in time	260,408	234,574
Total	<u>\$ 12,240,529</u>	<u>\$ 12,827,660</u>

**LEXINGTON RETIREMENT COMMUNITY, INC.
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**NOTE 1 ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES
(CONTINUED)**

Health Care Services Revenue (Continued)

Occupancy Percentages

During the years ended December 31, 2018 and 2017, the occupancy percentages and the percentages of the Borden Health Center residents covered under the Medicaid program, Medicare program, private pay, managed care organizations (MCO) and other were as follows:

	2018	2017
Traditional Medicaid	2%	39%
Traditional Medicare	6%	9%
Private Pay, Managed Care Organizations and Other (Including Medicare and Medicaid MCO's)	92%	52%
Total	100%	100%

Revenue from resident's deductibles and coinsurance are included in the categories presented above based on the primary payor.

Professional Liability Insurance

The Corporation's professional liability insurance is on the claims made basis.

Income Taxes

The Corporation has been granted exempt status relative to federal and state corporate income taxes under Section 501(c)(3) of the IRC and applicable state codes. The Corporation follows the guidance in the income tax standard regarding the recognition and measurement of uncertain tax positions. The guidance clarifies the accounting for uncertainty in income taxes recognized in an entity's financial statements. The guidance further prescribes recognition and measurement of tax provisions taken or expected to be taken on a tax return that are not certain to be realized. The application of this standard has no impact on the Corporation's financial statements.

New Accounting Pronouncements – ASU 2016-14

During the year ended December 31, 2018, the Corporation adopted a provision of Financial Accounting Standards Board (FASB) Accounting Standards Update (ASU) 2016-14, *Presentation of Financial Statements for Not-For-Profit Entities*. This new accounting standard results in a reduction of three classes of net assets (unrestricted, temporarily restricted, and permanently restricted) to two (net assets with donor restrictions and net assets without donor restrictions) and enhanced disclosures within the financial statements. The adoption of this accounting standard did not have an impact on the Corporation's financial position or changes in its net deficit.

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NOTE 1 ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES
(CONTINUED)

New Accounting Pronouncements – ASU 2016-01

During the year ended December 31, 2018, the Corporation adopted a provision of Financial Accounting Standards Board (FASB) Accounting Standards Update (ASU) 2016-01, *Financial Instruments*. This new accounting standard requires unrealized gains and losses resulting from the change in fair value of investments in equity securities to be included within the Corporation's performance indicator on the statements of operations and statement of changes in net assets. The adoption of this accounting standard did not have an impact on the Corporation's financial position or changes in its net assets.

New Accounting Pronouncements – ASU 2014-09

During the year ended December 31, 2018, the Corporation adopted ASU 2014-09, *Revenue from Contracts with Customers*. The guidance requires the Corporation to recognize revenue to depict the transfer of goods or services to customers in an amount that reflects the consideration to which the Corporation expects to be entitled in exchange for those goods or services. The guidance also requires expanded disclosures relating to the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. Additionally, qualitative and quantitative disclosures are required regarding customer contracts, significant judgments and changes in judgments, and assets recognized from the costs to obtain or fulfill a contract. The adoption was retrospectively applied and the beginning net assets as of January 1, 2017 were restated.

Subsequent Events

In preparing these financial statements, the Corporation has evaluated events and transactions for potential recognition or disclosure through April 16, 2019, the date the financial statements were available to be issued.

NOTE 2 RELATED PARTY TRANSACTIONS

On December 1, 2014, Kendal at Lexington entered into an Affiliation Agreement with the Kendal Corporation of Kennett Square, Pennsylvania. Under the terms of the Affiliation Agreement, The Kendal Corporation has certain reserve powers which include approval of any change in purpose, incurring indebtedness over a certain threshold, the manner in which the Kendal name is used, material changes in contracts with residents, certain real estate transactions, dissolution, acquisition, merger or change in control of the corporation, selection of new board members, amendment to certain sections of the bylaws and Articles of Incorporation of Kendal at Lexington. The Kendal Corporation also has the right to review the operation, strategic, and other plans, projections, and performance of its Affiliates and may request, or require, changes, if it deems them necessary. The bylaws also specify that the two organizations may have certain board members in common, and that the president of The Kendal Corporation, or his/her designee, is entitled to attend the board meetings, ex officio.

LEXINGTON RETIREMENT COMMUNITY, INC.
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NOTE 2 RELATED PARTY TRANSACTIONS (CONTINUED)

The Kendal Corporation does not own its affiliates or any of their assets. The Kendal System is a federal-type model that seeks to be sensitive to local environments, with the most decision-making at the local level, added to the benefit of being part of a larger, national system. Oversight of each Kendal organization is provided by a local volunteer board of directors, and residents and community members serve together on those boards.

The Kendal Corporation maintains reserve funds, which are available according to the purpose of each fund, solely at the discretion of The Kendal Corporation board of directors; these funds include Contingency Reserve and a System Growth Fund. The Kendal Corporation sponsors pension, deferred compensation, and self-insured medical plans for employees, which affiliates may participate in.

Effective November 17, 2016, Kendal at Lexington entered into an agreement for Development Services with the Kendal Corporation for project direction, planning, and coordination of design, budget, financing, and oversight of construction of expansion and renovation project. Total fees of \$175,266 and \$437,500 were incurred for the years ended December 31, 2018 and 2017, respectively (See Note 12).

Kendal at Lexington pays a System Fee to The Kendal Corporation as defined by the Affiliation Agreement. Total system fees of \$452,208 and \$441,557 were incurred for the years ended December 31, 2018 and 2017, respectively.

NOTE 3 ENTRY FEE DEPOSITS

As of December 31, 2018 and 2017, some prospective residents have paid an entry fee deposit, signed a Residency Agreement, and selected a unit. These deposits (which are refundable if the prospective resident does not move in) are held in escrow and are reflected in the financial statements as assets limited as to use. Under the terms of the escrow agreement, interest on these deposits is the property of the Corporation and is recorded as investment income by the Corporation when earned. Upon individual occupancies, deposits will be released from escrow and recorded as deferred entry fee revenue on the balance sheets. As of December 31, 2018 and 2017, entry fee deposits for the new Sunrise Ridge cottages were \$2,379,140 and \$1,196,320, respectively. The remaining balance of \$221,182 and \$241,900 represents deposits on existing units.

**LEXINGTON RETIREMENT COMMUNITY, INC.
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DECEMBER 31, 2018 AND 2017**

NOTE 4 INVESTMENTS AND ASSETS LIMITED AS TO USE

Fund Held by Bond Trustee

The Corporation is required to hold the funds in various accounts based on the terms in the Indenture dated October 1, 2016 and Supplemental Indentures for Series 2017A and 2017B dated December 1, 2017.

Debt Service Reserve Funds

Debt service reserve funds have been established to provide a reserve for payment of principal and interest on the bonds in the event the Corporation's principal and interest payments are insufficient to meet debt service requirements.

Construction Fund

Construction fund has been established to hold bond proceeds temporarily for the Phase III expansion and renovation project.

Interest Funds

Interest funds have been established to pay interest costs related to 2016, Series 2017A and 2017B bond debt.

Principal Funds

Principal funds have been established to service the required principal payments to bondholders.

Board-Designated Funds

The board-designated funds are designated for the following:

	2018	2017
Health Centers Renovations	\$ 1,418,333	\$ 453,201
Phase III Project	434,420	414,362
Undesignated	279,260	286,126
Executive Search	250,000	-
Resident Financial Assistance	193,745	198,508
Staff Education	71,965	73,734
Total	<u>\$ 2,647,723</u>	<u>\$ 1,425,931</u>

Escrowed Deposits

The escrowed deposits are cash restricted for deposits made by prospective residents.

Investments, recorded at fair value, are summarized by type of investment as follows:

	2018		2017	
	Fair Value	Cost	Fair Value	Cost
Cash and Cash Equivalents	\$ 2,867,124	\$ 2,867,124	\$ 2,946,288	\$ 2,946,288
Mutual Funds	13,667,741	13,160,514	14,074,645	12,492,133
Fixed Income and Equities	1,076,491	1,077,000	5,131	5,150
Total	<u>\$ 17,611,356</u>	<u>\$ 17,104,638</u>	<u>\$ 17,026,064</u>	<u>\$ 15,443,571</u>

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NOTE 4 INVESTMENTS AND ASSETS LIMITED AS TO USE (CONTINUED)

Escrowed Deposits (Continued)

Assets limited as to use, recorded at fair value, are summarized by type of investment as follows:

	2018		2017	
	Fair Value	Cost	Fair Value	Cost
Cash and Cash Equivalents	\$ 5,634,158	\$ 5,634,158	\$ 32,162,733	\$ 32,162,733
U.S. Government Securities	18,173,874	18,124,189	-	-
Fixed Income	97,918	98,705	-	-
Mutual Funds	5,111,542	5,111,542	-	-
Total	<u>\$ 29,017,492</u>	<u>\$ 28,968,594</u>	<u>\$ 32,162,733</u>	<u>\$ 32,162,733</u>

The composition of assets limited as to use is as follows:

	2018	2017
Held by Trustee for Construction	\$ 15,551,111	\$ 21,033,749
Held by Trustee for Debt Service Reserve	3,091,229	3,053,209
Held by Trustee for Bond Principal and Interest	2,663,287	3,155,547
Board-Designated Funds	2,647,723	1,425,931
Escrowed Deposits for Entry Fees	2,600,322	1,438,220
By Donors	2,463,820	2,056,077
Total	<u>\$ 29,017,492</u>	<u>\$ 32,162,733</u>

Investment income from investments and assets limited as to use is as follows:

Without Donor Restrictions:	2018	2017
Dividends and Interest Income, Net of Fees	\$ 735,073	\$ 485,599
Net Realized Gain (Loss) on Investments	(220)	(946)
Total	<u>\$ 734,853</u>	<u>\$ 484,653</u>
Net Unrealized Gain (Loss) on Investments	<u>\$ (986,346)</u>	<u>\$ 1,076,812</u>
With Donor Restrictions:		
Dividends and Interest Income, Net of Fees	\$ 59,111	\$ 41,513
Net Realized Loss on Investments	(20)	(89)
Net Unrealized Gain (Loss) on Investments	(89,429)	101,460
Total	<u>\$ (30,338)</u>	<u>\$ 142,884</u>

The Corporation performs due diligence on the valuation of their investments. The Corporation reviews its portfolio and evaluates whether declines in the fair value of securities should be considered other-than-temporary. Management considers in this evaluation factors such as general market conditions, the issuer's financial condition and near-term prospects, conditions in the issuer's industry, the recommendation of its investment advisors, and the length of time and extent to which the market value has been less than cost, and the ability and intent of the Corporation to hold investments in the long term.

**LEXINGTON RETIREMENT COMMUNITY, INC.
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NOTE 4 INVESTMENTS AND ASSETS LIMITED AS TO USE (CONTINUED)

Escrowed Deposits (Continued)

For the years ended December 31, 2018 and 2017 management does not believe that the declines in the market value of investments are considered other-than-temporary.

NOTE 5 NET ASSETS

Net assets with donor restrictions are comprised of the following:

	2018	2017
Health Centers Renovations	\$ 1,056,484	\$ 778,234
Resident Financial Assistance (Fellowship Fund)	1,209,028	1,192,204
Contributions Receivable	267,438	516,823
Staff Education	67,551	72,183
Other	28,268	13,458
Total	<u>\$ 2,628,769</u>	<u>\$ 2,572,902</u>

Net assets with donor restrictions held in perpetuity at December 31, 2018 and 2017 were \$230,922 for resident financial assistance and \$53,432 for staff education.

Interpretation of Relevant Law

The Commonwealth of Virginia adopted the Uniform Prudent Management of Institutional Funds Act (the Act) effective during 2008. The board of directors of the Corporation has interpreted the Act as requiring the preservation of the fair value of the original gift as of the gift date of the donor-restricted endowment funds absent explicit donor stipulations to the contrary. As a result of this interpretation, the Corporation classifies as net assets with donor restrictions (1) the original value of gifts donated to the permanent endowment, (2) the original value of subsequent gifts to the permanent endowment, and (3) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund.

The endowment remains in net assets with donor restrictions until those amounts are appropriated for expenditure by the Corporation in a manner consistent with the standard of prudence prescribed in the Act. In accordance with the Act, the Corporation considers the following factors in making a determination to appropriate or accumulate donor restricted endowment funds:

- The duration and preservation of the fund
- The purposes of the Corporation and the donor-restricted endowment fund
- General economic conditions
- The possible effect of inflation and deflation
- The expected total return from income and the appreciation of investments
- Other resources of the Corporation
- The investment policy of the Corporation

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NOTE 5 NET ASSETS (CONTINUED)

Interpretation of Relevant Law (Continued)

The following were the changes in the endowment net assets for the years ended December 31, 2018 and 2017:

	With Donor Restrictions
Endowment Net Assets, December 31, 2016	\$ 389,326
Investment Income, Net of Fees	15,044
Net Appreciation	
Realized and Unrealized Gains, Net	36,737
Endowment Net Assets, December 31, 2017	441,107
Investment Income, Net of Fees	20,622
Net Depreciation	
Realized and Unrealized Losses, Net	(31,206)
Net Asset Releases	(18,715)
Endowment Net Assets, December 31, 2018	\$ 411,808

Funds with Deficiencies

From time-to-time, the fair value of assets associated with individual donor-restricted endowment funds may fall below the level that the donor or the Act requires the Corporation to retain as a fund of perpetual duration. As of December 31, 2018 and 2017, there were no deficiencies of this nature that are reported in assets with donor restrictions.

Other Policies

The Corporation has established guidelines for accepting, investing, managing and using donor restricted and donor unrestricted endowments. Once the requirements are met to establish an endowment, a portion of the endowment is deemed expendable for spending. Up to 5% of the three-year rolling average market value of the endowment principal, appreciated/depreciated value and unspent investment earnings at year-end is deemed expendable. Any funds not expended in that year, may be carried over for future use.

LEXINGTON RETIREMENT COMMUNITY, INC.
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NOTE 6 CONSTRUCTION IN PROGRESS

Construction in progress primarily consists of costs related to the Phase III renovations and expansion of the community. Kendal at Lexington is in the process of constructing 30 residential living cottages, a maintenance building, an emergency access road, plus expanding and renovating the Webster Assisted Living Center, the Benjamin Borden Health Center, and the main dining room. Total project related costs are estimated to be \$35,914,000. As of December 31, 2018, total incurred costs related to Phase III were \$9,871,089. The balance of \$15,620 represents renovations to existing units. As of December 31, 2017, \$2,960,823 related to renovations to the Benjamin Borden Health Center and \$122,411 to existing residential units.

NOTE 7 LONG-TERM DEBT

In October 2016, the Industrial Development Authority of the city of Lexington, Virginia, issued \$28,210,000 of tax-exempt Residential Care Facility Refund Revenue Bonds. Principal is due annually on January 1 of each year. Interest is due semiannually on January 1 and July 1 beginning January 1, 2017.

The proceeds of the Series 2016 Bonds were used to refund the Authority's Residential Care Facilities Mortgage Revenue Bonds Series 2007A, to fund a debt service reserve fund for the Series 2016 Bonds, and to finance cost of issuing the Series 2016 Bonds. At the time of issuance, a portion of the proceeds were placed into escrow to refund the Series 2007A Bonds on January 1, 2017. As of December 31, 2017, the Series 2007A Bonds were no longer outstanding and deemed to be fully defeased. The Series 2016 Bonds were issued at a premium of \$1,765,790.

In December 2017, the Industrial Development Authority of the city of Lexington, Virginia, issued \$20,380,000 of tax-exempt Residential Care Facility Revenue Bonds Series 2017A. Interest is due semiannually on January 1 and July 1 beginning July 1, 2018. Principal payments begin in 2038.

The proceeds of the Series 2017A Bonds are to be used to (1) pay the costs of improvement to Kendal at Lexington, including, but not limited to (a) 30 new residential cottages, (b) an expansion and renovation to the existing dining facility and the addition of a second floor exterior patio, (c) an expansion and renovation to the existing Benjamin Borden Nursing Health Center, (d) the expansion and renovation to the existing Webster Assisted Living Health Center, (e) the construction of a new emergency road access to the Community, (f) the construction of a new maintenance facility and (g) the lowering of the road to the main entrance, (2) pay all or a portion of the costs of issuance in connection with the issuance of the Series 2017A Bonds, and (5) pay working capital and other routine capital expenditures. The bonds were issued at a premium of \$1,477,102.

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NOTE 7 LONG-TERM DEBT (CONTINUED)

In addition, the Authority issued its Residential Care Facility Revenue Bond Series 2017B in the principal amount up to \$13,000,000. The Series 2017B was sold directly to STI Institutional & Government, Inc. (an Affiliate of SunTrust Bank). The Series 2017B Bond was to be used to (1) pay the costs of the Series 2017 project, (2) pay a portion of the cost of issuance in connection with the issuance of the Series 2017B Bond, (3) fund interest on the Series 2017B Bond prior to, during and up to one year after the completion of the Series 2017 Project, and (4) pay working capital and other routine capital expenditures. Interest is due monthly. The rate is equal to 67.0% of LIBOR, plus .5% multiplied by the Margin Rate Factor. The maturity date is January 1, 2023. At December 31, 2018 and 2017, the outstanding debt on the Series 2017B Bonds was \$50,001.

The components and maturities of long-term debt are as follows:

<u>Description</u>	<u>2018</u>	<u>2017</u>
Series 2016:		
Tax-Exempt Serial Bonds, Maturing between 2019 and 2024 at Rates Varying from 3.00% to 4.00% and Amounts Ranging from \$1,020,000 to \$1,215,000	\$ 6,660,000	\$ 7,670,000
Tax-Exempt Term Bond, 2.75%, Maturing 2026	2,565,000	2,565,000
Tax-Exempt Term Bond, 4.00%, Maturing 2031	6,480,000	6,480,000
Tax-Exempt Term Bond, 3.25%, Maturing 2031	760,000	760,000
Tax-Exempt Term Bond, 4.00%, Maturing 2037	8,815,000	8,815,000
Tax-Exempt Term Bond, 3.375%, Maturing 2037	1,900,000	1,900,000
Series 2017B:		
Variable Intermediate Term Bond, 2.52%, Maturing January 1, 2023.	50,001	50,001
Series 2017A:		
Tax-Exempt Term Bonds, 5.0%. Maturing 1/1/2042	7,965,000	7,965,000
Tax-Exempt Term Bonds, 4.0%. Maturing 1/1/2043	1,840,000	1,840,000
Tax-Exempt Term Bonds, 5.0%. Maturing 1/1/2048	10,575,000	10,575,000
Long-Term Debt	<u>47,610,001</u>	<u>48,620,001</u>
Unamortized Debt Issuance Costs	(1,195,153)	(1,247,399)
Unamortized Bond Premium	<u>2,846,647</u>	<u>3,071,093</u>
Total	49,261,495	50,443,695
Less: Current Portion of Long-Term Debt	<u>(1,020,000)</u>	<u>(1,010,000)</u>
Long-Term Debt, Net of Current Portion	<u><u>\$ 48,241,495</u></u>	<u><u>\$ 49,433,695</u></u>

LEXINGTON RETIREMENT COMMUNITY, INC.
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NOTES TO FINANCIAL STATEMENTS
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NOTE 7 LONG-TERM DEBT (CONTINUED)

As of December 31, 2018, aggregate principal maturities for long-term debt and bond premium amortization over the next five years and thereafter are as follows:

<u>Year Ending December 31,</u>	<u>Amount</u>	<u>Bond Premium</u>
2019	\$ 1,020,000	\$ 224,445
2020	1,050,000	211,736
2021	1,080,000	198,658
2022	1,125,000	177,220
2023	1,170,000	156,690
Thereafter	42,165,001	1,877,898
Total	<u>\$ 47,610,001</u>	<u>\$ 2,846,647</u>

A summary of interest expense is as follows:

	<u>2018</u>	<u>2017</u>
Interest Costs Incurred	\$ 1,857,517	\$ 885,769
Less: Amounts Capitalized	(983,364)	-
Net Interest Expense	<u>\$ 874,153</u>	<u>\$ 885,769</u>

Interest income earned on project funds totaling \$264,345 was capitalized during 2018 as a reduction of construction in progress.

The Corporation has pledged certain assets, including, but not limited to gross receipts, which include all revenues, investments, accounts, inventory and entry fees, to the extent they are not held in escrow under Virginia requirements; as well as the rights under the residency agreements. Donor-restricted gifts cannot be used as collateral. There is a lien on, as well as a security interest in, all fixtures, furniture, and equipment.

Among other things, the Corporation is required to meet certain marketing and financial covenants under the security agreements related to the bond issues. There are financial and operational covenants associated with the bonds. As of December 31, 2018, management is not aware of any instances of noncompliance with the required covenants.

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NOTE 8 RETIREMENT PLANS

The Corporation participates in The Kendal Corporation Pension Plan, a noncontributory defined benefit plan along with other entities affiliated with The Kendal Corporation. An employee is eligible for the plan when the employee has worked 1,000 hours per year, attained the age of 21, and has completed one year of eligible service. In order to be vested, an employee needs five years of vesting service. A year of vesting service is earned when an employee works at least 1,000 hours. Total expenses related to the plan during fiscal 2018 and 2017 were \$43,600 and \$52,000, respectively. On January 1, 2015, the plan was frozen.

Effective July 1, 2006, the Corporation participates in a defined contribution plan under IRC Section 403(b) through The Kendal Corporation. The plan contains an employer grant and/or match component for eligible employees. Effective January 1, 2015, The Kendal Corporation established a defined contribution plan under 401(a) of the IRC. Kendal at Lexington participates in the plan. Eligible employees must have attained age 21 and must complete one eligibility year of service. The Corporation's grant and/or matching contribution is discretionary. All employees are eligible to make contributions to the 403(b) plan. The Corporation may elect a basic contribution percentage of annual compensation or a grant subject to certain limitations. Contributions accrued by the Corporation were \$238,644 and \$232,845 for the years ended December 31, 2018 and 2017, respectively.

NOTE 9 CONCENTRATION OF CREDIT RISK

The Corporation grants credit without collateral to their residents, most of whom are insured under third-party payor agreements. The mix of the Corporation's net receivables from residents and third-party payors as of December 31 was as follows:

	2018	2017
Traditional Medicare	35%	36%
Traditional Medicaid	0%	26%
Residents, Managed Care Organizations and Other (Including Medicare and Medicaid MCO's)	65%	38%
Total	<u>100%</u>	<u>100%</u>

NOTE 10 FAIR VALUE OF FINANCIAL INSTRUMENTS

Fair value measurement applies to reported balances that are required or permitted to be measured at fair value under an existing accounting standard. The Corporation emphasizes that fair value is a market-based measurement, not an entity-specific measurement. Therefore, a fair value measurement should be determined based on the assumptions that market participants would use in pricing the asset or liability and establishes a fair value hierarchy.

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NOTE 10 FAIR VALUE OF FINANCIAL INSTRUMENTS (CONTINUED)

The fair value hierarchy consists of three levels of inputs that may be used to measure fair value as follows:

Level 1 – Inputs that utilize quoted prices (unadjusted) in active markets for identical assets or liabilities that the Corporation has the ability to access.

Level 2 – Inputs that include quoted prices for similar assets and liabilities in active markets and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument. Fair values for these instruments are estimated using pricing models, quoted prices of securities with similar characteristics, or discounted cash flows.

Level 3 – Inputs that are unobservable inputs for the asset or liability, which are typically based on an entity's own assumptions, as there is little, if any, related market activity.

In instances where the determination of the fair value measurement is based on inputs from different levels of the fair value hierarchy, the level in the fair value hierarchy within which the entire fair value measurement falls is based on the lowest level input that is significant to the fair value measurement in its entirety.

The following table presents the fair value hierarchy for the balances of the assets of the Corporation measured at fair value on a recurring basis as of December 31:

<u>December 31, 2018</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Investments:				
Cash and Cash Equivalents	\$ 2,867,124	\$ -	\$ -	\$ 2,867,124
Mutual Funds	13,667,741	-	-	13,667,741
Fixed Income	1,076,491	-	-	1,076,491
Total	<u>\$ 17,611,356</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 17,611,356</u>
Assets Limited as to Use:				
Cash and Cash Equivalents	\$ 5,634,158	\$ -	\$ -	\$ 5,634,158
U.S. Government Securities	18,173,874	-	-	18,173,874
Fixed Income	97,918	-	-	97,918
Mutual funds	5,111,542	-	-	5,111,542
Total	<u>\$ 29,017,492</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 29,017,492</u>
Beneficial Interest in				
Charitable Remainder Unitrust	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 20,281</u>	<u>\$ 20,281</u>
<u>December 31, 2017</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Investments:				
Cash and Cash Equivalents	\$ 2,946,288	\$ -	\$ -	\$ 2,946,288
Mutual Funds	14,074,645	-	-	14,074,645
Equities	5,131	-	-	5,131
Total	<u>\$ 17,026,064</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 17,026,064</u>
Assets Limited as to Use:				
Cash and Cash Equivalents	<u>\$ 32,162,733</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 32,162,733</u>
Beneficial Interest in				
Charitable Remainder Unitrust	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 18,960</u>	<u>\$ 18,960</u>

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NOTE 10 FAIR VALUE OF FINANCIAL INSTRUMENTS (CONTINUED)

Investments and Assets Limited as to Use

Investments and assets limited as to use are recorded at fair value on a recurring basis. Fair value measurement is based upon quoted prices, if available. If quoted prices are not available, fair values are measured using independent pricing models or other model-based valuation techniques such as the present value of future cash flows, adjusted for the security's credit rating, prepayment assumptions, and other factors such as credit loss assumptions. Securities valued using Level 1 inputs include those traded on an active exchange, such as the New York Stock Exchange, as well as U.S. government and corporate obligations and agency mortgage-backed securities that are traded by dealers or brokers in active over-the-counter markets.

Beneficial Interest in Charitable Remainder Unitrust

Fair values of the beneficial interest in a charitable remainder unitrust are determined based upon good faith estimates of the trust's assets less the present value of estimated future payments to the recipient. The present value is based upon an estimated discount rate and applicable mortality tables and, accordingly, is classified as using a Level 3 input.

NOTE 11 FUNCTIONAL EXPENSES

The Corporation provides residential and health care services to residents. The functional expenses are allocated based on a wage allocation if the expense is not directly attributable specifically to program, general and administrative or fundraising. The functional allocation of these expenses related to these services is as follows:

	2018			
	Continuing Care Expenses	General & Administrative	Fundraising	Total
Wages	\$ 4,504,843	\$ 826,690	\$ 4,104	\$ 5,335,637
Payroll taxes	319,244	58,584	-	377,828
Legal	-	5,212	-	5,212
Accounting Fees	-	139,374	-	139,374
Consulting Services	987,727	265,814	-	1,253,541
Office Expense	1,141,297	209,431	148	1,350,876
Occupancy	654,992	120,197	-	775,189
Property and Liability Insurance	-	141,198	-	141,198
Repairs and Maintenance	13,801	2,532	-	16,333
Printing, Books and Periodicals	21,645	3,972	38	25,655
Travel	40,655	7,461	128	48,244
Conferences and Meetings	14,229	2,611	-	16,840
Interest Expense	-	874,153	-	874,153
Depreciation	1,747,888	320,754	-	2,068,642
Dues and Licenses	12,877	2,363	325	15,565
Miscellaneous Expense	9,438	1,732	-	11,170
Information Technology	1,062	200,171	-	201,233
Advertising	119,958	22,013	-	141,971
System Fees	-	452,208	-	452,208
Other Employee Benefits	835,681	153,356	-	989,037
Pension Expense	238,481	43,764	-	282,245
Provision for Bad Debt Expense	-	101,767	-	101,767
Total Functional Expenses	<u>\$ 10,663,818</u>	<u>\$ 3,955,357</u>	<u>\$ 4,743</u>	<u>\$ 14,623,918</u>

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NOTE 11 FUNCTIONAL EXPENSES (CONTINUED)

	2017			
	Continuing Care Expenses	General & Administrative	Fundraising	Total
Wages	\$ 4,372,674	\$ 766,350	\$ 3,908	\$ 5,142,932
Payroll taxes	309,595	54,259	-	363,854
Legal	-	8,228	-	8,228
Accounting Fees	-	127,312	-	127,312
Consulting Services	977,260	256,668	-	1,233,928
Office Expense	1,103,628	193,421	551	1,297,600
Occupancy	641,806	112,482	-	754,288
Property and Liability Insurance	-	149,579	-	149,579
Repairs and Maintenance	36,242	6,352	-	42,594
Printing, Books and Periodicals	88,521	15,514	720	104,755
Travel	29,913	5,242	-	35,155
Conferences and Meetings	16,267	2,851	888	20,006
Interest Expense	-	885,769	-	885,769
Depreciation	1,730,031	312,463	-	2,042,494
Dues and Licenses	12,231	2,144	250	14,625
Miscellaneous Expense	49,900	8,745	-	58,645
Information Technology	2,172	160,256	-	162,428
Advertising	119,707	20,980	-	140,687
System Fees	-	441,557	-	441,557
Other Employee Benefits	821,541	143,982	-	965,523
Pension Expense	242,368	42,477	-	284,845
Provision for Bad Debt Expense	-	41,256	-	41,256
Total Functional Expenses	<u>\$ 10,553,856</u>	<u>\$ 3,757,887</u>	<u>\$ 6,317</u>	<u>\$ 14,318,060</u>

NOTE 12 COMMITMENTS AND CONTINGENCIES

Compliance

The Corporation operates in the health care industry and may be subject to legal proceedings and claims from time-to-time that arise in the course of providing its services. The Corporation maintains malpractice insurance coverage on a claims-made basis, which provides coverage for claims occurring during the policy year. Management has determined that no provision is required for amounts expected to be paid under the policy's deductible limits for unasserted claims not covered by the policy and any other uninsured liability.

The health care industry is subject to numerous laws and regulations of federal, state, and local governments. These laws and regulations include, but are not necessarily limited to, matters such as licensure, accreditation, and government health care program participation requirements, reimbursement for patient services, and Medicare and Medicaid fraud and abuse.

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NOTE 12 COMMITMENTS AND CONTINGENCIES (CONTINUED)

Development Agreement

On November 16, 2016, the Corporation entered into a development agreement with Kendal Corporation for the management, in collaboration with the executive director, of the expansion and re-positioning of its campus, including renovations and additions to the health centers, additional residential living cottages, new and expanded dining venues and kitchen renovations, an emergency access road, and a maintenance building. The fee related to this agreement is a minimum of \$875,000 up to a maximum of \$1,050,000, which will be paid over the construction period of the project. As of December 31, 2018 and 2017, \$700,266 and \$525,000 was capitalized and included in Construction in Progress, respectively. As of December 31, 2017, \$262,500 is included in accounts payable and accrued expenses.

Other

In the normal course of business, there could be various outstanding claims and contingent liabilities. No contingent liabilities are reflected in the accompanying financial statements. No such liabilities have been asserted and, therefore, no estimate of loss, if any, is determinable.

NOTE 13 INSURANCE

In 2014, the Corporation began participating in an insurance risk retention group, the Peace Church Risk Retention Group (the PCRRG), a group insurance captive corporation licensed by the state of Vermont, to cover basic professional and general liability insurance on a claims-made basis. Entrance into the captive required a capital purchase of stock of \$50,682. The investment is accounted by the cost method and is included in other assets on the balance sheet.

NOTE 14 SELF-INSURED GROUP HEALTH PLAN

Effective January 1, 2014, Kendal at Lexington elected to participate in a self-insured medical and prescription plan established by The Kendal Corporation for the benefit of the employees of The Kendal Corporation and the employees of participating Kendal affiliates, the "Welfare Plan". The Kendal Corporation serves as the Welfare Plan sponsor and has established operational guidelines for the Welfare Plan as well as an oversight committee which includes representatives from participating Affiliates. With the assistance of consultants, the committee will estimate future claims as well as required premiums to fund future claims and establish required cash balances. The total premium determined for the Welfare Plan will be allocated using the participating lives for each participating entity. The premiums will be determined based on a shared risk pool and will not be adjusted to reflect the claims experience of any participating entity. There is an initial commitment of five years from the effective date of participation.

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NOTE 14 SELF-INSURED GROUP HEALTH PLAN (CONTINUED)

The Welfare Plan is administered by an insurance carrier and backed by a letter of credit. The Welfare Plan is responsible for funding employer liability losses to a maximum of \$125,000 per participant and \$1,000,000 in the aggregate per policy year. Third party stop-loss insurance coverage is in place for losses that exceed these amounts.

Kendal at Lexington has executed a Joinder Agreement with The Kendal Corporation to participate in the Welfare Plan effective January 1, 2014. In conjunction with execution of this agreement, Kendal at Lexington's ownership interest in the Welfare Plan is \$546,229 and \$486,568 as of December 31, 2018 and 2017, respectively.

Self-Insurance expense was \$648,777 and \$652,109 for the years ended December 31, 2018 and 2017, respectively.

NOTE 15 LIQUIDITY AND AVAILABILITY

Financial assets available for general expenditures, that is, without donor or other restrictions limiting their use, within one year of the balance sheet date, comprise the following at December 31, 2018 and 2017:

	2018	2017
Financial Assets at Year End:		
Cash and Cash Equivalents	\$ 416,369	\$ 403,840
Accounts Receivable, Net	381,421	579,287
Contributions Receivable, Net	257,157	507,863
Entry Fee Receivable	954,741	905,028
Investments	17,611,356	17,026,064
Assets Limited to Use:		
Funds Held by Trustee	21,305,627	27,242,505
Board-Designated	2,647,723	1,425,931
Donor-Restricted	2,463,820	2,056,077
Escrowed Deposits	2,600,322	1,438,220
Total Financial Assets	48,638,536	51,584,815
Less Amounts not Available to be Used Within One Year:		
Board-Designated with Liquidity Horizons Greater Than One Year	2,647,723	1,425,931
Funds Held by Trustee	21,305,627	27,242,505
Donor-Restricted with Liquidity Horizons Greater Than One Year	2,463,820	2,056,077
Contributions Receivable, Net	257,157	507,863
Escrowed Deposits	2,600,322	1,438,220
Financial Assets Not Available to be Used Within One Year	29,274,649	32,670,596
Financial Assets Available to Meet General Expenditures Within One Year	<u>\$ 19,363,887</u>	<u>\$ 18,914,219</u>

As of December 31, 2018, the Corporation has a net working capital of \$257,135 and days (based on normal expenditures) cash on hand of 606.

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NOTE 16 CUMULATIVE EFFECT – CHANGE IN ACCOUNTING FOR DEFERRED MARKETING COSTS

During the year ended December 31, 2018, the Corporation adopted ASU 2014-09, *Revenue from Contracts with Customers*. Previously, the Corporation deferred costs of acquiring initial continuing-care contracts that were expected to be recovered from future revenues. These costs included salaries, direct response advertising costs, and initial branding of the project. The costs were amortized on a straight-line basis over the average expected remaining lives of the residents under the contract. Amortization began upon the earlier of one year from initial occupancy of the independent living units or upon stabilized occupancy of those units. Under ASU 2014-09, these deferred marketing costs no longer qualify for capitalization as the new guidance only allows for capitalization of incremental costs of obtaining a contract with a customer if the Corporation expects to recover those costs.

The following table presents the opening net assets, as adjusted for the cumulative effect of the change in accounting for deferred marketing costs.

	Net Assets Without Donor Restrictions	Net Assets With Donor Restrictions	Total Net Assets
Net Assets Without Donor Restrictions, as Originally Reported - January 1, 2017	\$ 111,223	\$ 1,945,935	\$ 2,057,158
Cumulative Effect of Change in Accounting for Deferred Marketing Costs	(181,209)	-	(181,209)
Net Deficit Without Donor Restrictions, as Restated - January 1, 2017	<u>\$ (69,986)</u>	<u>\$ 1,945,935</u>	<u>\$ 1,875,949</u>



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