



**CHILDREN'S HOSPITAL & MEDICAL CENTER AND
AFFILIATES**

Consolidated Financial Statements

December 31, 2018 and 2017

(With Independent Auditors' Report Thereon)

**CHILDREN'S HOSPITAL & MEDICAL CENTER AND
AFFILIATES**

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Independent Auditors' Report

The Board of Directors
Children's Hospital & Medical Center and Affiliates
Omaha, Nebraska:

We have audited the accompanying consolidated financial statements of Children's Hospital & Medical Center and Affiliates (the Company), which comprise the consolidated balance sheets as of December 31, 2018 and 2017, and the related consolidated statements of operations, changes in net assets, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with U.S. generally accepted accounting principles; this includes the 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 audit 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 auditors' 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 financial position of Children's Hospital & Medical Center and Affiliates as of December 31, 2018 and 2017, and the results of their operations and their cash flows for the years then ended, in accordance with U.S. generally accepted accounting principles.



Emphasis of Matter

As discussed in Note 1 (t) to the consolidated financial statements, the Company adopted new accounting guidance for Accounting Standards Update (ASU) No. 2014-09, *Revenue from Contracts with Customers (Topic 606)*, and ASU No. 2016-14, *Presentation of Financial Statements of Not-for-Profit Entities*. Our opinion is not modified with respect to these matters.

Other Matters

Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The consolidating information included in exhibits 1 through 3 is presented for purposes of additional analysis 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 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 information is fairly stated in all material respects in relation to the consolidated financial statements as a whole.

KPMG LLP

Omaha, Nebraska
May 24, 2019

**CHILDREN'S HOSPITAL & MEDICAL CENTER AND
AFFILIATES**

Consolidated Balance Sheets

December 31, 2018 and 2017

(Dollars in thousands)

Assets	2018	2017
Current assets:		
Cash and cash equivalents	\$ 67,804	73,630
Patient accounts receivable	69,690	70,944
Current portion of pledges receivable	6,486	6,881
Other receivables	6,853	7,791
Prepaid expenses and other assets	16,567	15,841
Estimated third-party payor settlements	10,295	10,187
Total current assets	177,695	185,274
Pledges receivable, net of current portion	9,051	11,284
Construction funds	57,303	91,606
Assets limited as to use	84,480	68,799
Long-term investments	377,855	348,133
Property and equipment, net	288,891	229,197
Other assets	6,520	7,307
Total assets	\$ 1,001,795	941,600
Liabilities and Net Assets		
Current liabilities:		
Current portion of long-term debt	\$ 5,039	5,043
Trade accounts payable	22,988	19,188
Construction payables	12,594	2,597
Affiliate payables	1,481	1,385
Accrued salaries	28,969	25,477
Other accrued expenses	12,379	11,996
Total current liabilities	83,450	65,686
Long-term debt and other obligations, net of current portion	176,017	181,084
Other liabilities	7,123	8,524
Total liabilities	266,590	255,294
Net assets:		
Without donor restrictions	680,746	639,008
Noncontrolling interest	3,013	3,459
Total net assets without donor restrictions	683,759	642,467
With donor restrictions	51,446	43,839
Total net assets	735,205	686,306
Total liabilities and net assets	\$ 1,001,795	941,600

See accompanying notes to consolidated financial statements.

**CHILDREN'S HOSPITAL & MEDICAL CENTER AND
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Consolidated Statements of Operations

Years ended December 31, 2018 and 2017

(Dollars in thousands)

	2018	2017
Unrestricted revenue, gains, and other support:		
Patient service revenue	\$ 460,586	415,363
Contributions for use in operations	3,898	4,569
Other revenue	13,572	13,551
Total unrestricted revenue, gains, and other support	478,056	433,483
Operating expenses:		
Salaries, wages, and agency staffing	198,145	180,037
Employee benefits	47,159	40,467
Supplies and pharmaceuticals	59,713	52,900
Outside services and professional fees	44,195	36,764
Other operating expenses	23,353	29,944
Depreciation and amortization	21,375	24,677
Affiliation support	22,037	14,154
Occupancy	10,365	10,920
Interest	3,076	3,808
Loss on sale of property and equipment	—	238
Total operating expenses	429,418	393,909
Operating income	48,638	39,574
Other income:		
Net investment (loss) income	(9,119)	41,253
Change in interest rate swap valuation	903	690
Other nonoperating income	—	166
Total other (loss) income, net	(8,216)	42,109
Excess of revenue, gains, and other support over expenses	40,422	81,683
Other changes in net assets without donor restrictions:		
Net assets released from restrictions used for property and equipment	870	1,502
Increase in net assets without donor restrictions	\$ 41,292	83,185

See accompanying notes to consolidated financial statements.

**CHILDREN'S HOSPITAL & MEDICAL CENTER AND
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Consolidated Statements of Changes in Net Assets

Years ended December 31, 2018 and 2017

(Dollars in thousands)

	2018	2017
Unrestricted net assets without donor restrictions:		
Excess of revenue, gains, and other support over expenses	\$ 40,422	81,683
Net assets released from restrictions used for property and equipment	870	1,502
Increase in unrestricted net assets without donor restrictions	41,292	83,185
Changes in net assets with donor restrictions		
Contributions restricted by donor	8,438	9,762
Investment income	220	152
Change in value of split-interest agreements	(368)	(161)
Net assets released from restrictions	(683)	(1,646)
Increase in net assets with donor restrictions	7,607	8,107
Net assets, beginning of year	686,306	595,014
Net assets, end of year	\$ 735,205	686,306

See accompanying notes to consolidated financial statements.

**CHILDREN'S HOSPITAL & MEDICAL CENTER AND
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Consolidated Statements of Cash Flows

Years ended December 31, 2018 and 2017

(Dollars in thousands)

	2018	2017
Cash flows from operating activities:		
Increase in net assets	\$ 48,899	91,292
Adjustments to reconcile increase in net assets to net cash provided by operating activities:		
Change in interest rate swap valuation	(903)	(690)
Depreciation and amortization	21,375	24,677
Loss on sale of property and equipment	—	238
Realized and unrealized (gains) loss on investments, net	23,115	(31,346)
Change in value of split-interest agreements	368	161
Restricted contributions and investment income, net	(8,658)	(9,914)
Amortization of debt issuance costs	44	21
Amortization of debt (premiums) and discounts, net	(107)	(293)
Changes in operating assets and liabilities:		
Patient accounts receivable	1,254	(14,752)
Other receivables	938	3,980
Prepaid expenses and other assets	(726)	(4,059)
Estimated third-party payor settlements	(108)	(58)
Other assets	419	(409)
Trade accounts payable	4,151	1,626
Affiliate payables	95	138
Accrued salaries	3,492	2,831
Other accrued expenses	383	60
Other liabilities	(498)	583
Net cash provided by operating activities	93,533	64,086
Cash flows from investing activities:		
Purchase of property and equipment	(71,422)	(24,513)
Proceeds from sale of property and equipment and land	—	5,216
Proceeds from sale of long-term investments and assets limited to use	89,264	120,148
Purchases of long-term investments and assets limited to use	(157,245)	(139,803)
Proceeds from sale and (purchases) of construction funds, net	33,766	(91,067)
Net cash used in investing activities	(105,637)	(130,019)
Cash flows from financing activities:		
Payments on long-term debt and other obligations	(4,826)	(62,389)
Issuance of long-term debt	—	154,061
Debt issuance costs incurred	—	(925)
Principal payments under finance lease obligation	(182)	—
Restricted contributions and investment income received	11,286	9,053
Net cash provided by financing activities	6,278	99,800
Net (decrease) increase in cash and cash equivalents	(5,826)	33,867
Cash and cash equivalents beginning of year	73,630	39,763
Cash and cash equivalents end of year	\$ 67,804	73,630
Supplemental disclosure of cash flow information:		
Cash paid for the year for interest	\$ 2,957	4,118
Non cash operating and investing activities:		
Purchases of property and equipment in accounts payable	\$ 12,594	788
Issuance of capital lease	—	538

See accompanying notes to consolidated financial statements.

CHILDREN'S HOSPITAL & MEDICAL CENTER AND AFFILIATES

Notes to Consolidated Financial Statements

December 31, 2018 and 2017

(Dollars in thousands)

(1) Organization and Basis of Presentation

The accompanying consolidated financial statements include the accounts of Children's Hospital & Medical Center (the Hospital) and its affiliates (collectively, the Company). The affiliates are Children's Physicians and Children's Hospital & Medical Center Foundation (the Foundation), both not-for-profit organizations; and Children's Health Network, a not-for-profit taxable corporation. Significant transactions between entities have been eliminated in consolidation.

The mission of the Hospital is to improve the life of every child through dedication to exceptional clinical care, research, education, and advocacy. The Hospital operates a 145-bed pediatric hospital, which includes seven surgical suites, a state of the art hybrid heart catheterization lab, an outpatient surgery center, a heart transplant program and a fetal care center that focuses on the coordination of care for babies diagnosed with complex congenital defects before birth. The Hospital was recognized by U.S. News and World Report in five specialties for cardiology and heart surgery, pulmonology, gastroenterology and GI surgery, orthopedics, diabetes and endocrinology. Children's Specialty Pediatric Center offers more than 50 outpatient specialty clinics, providing diagnostics, treatment, and therapy. In addition, the Hospital provides outpatient behavioral health and a full array of pediatric home healthcare services to children and adolescents who have immediate or long-term healthcare needs. The Hospital is home to the region's only Level IV Newborn Intensive Care Unit and the only dedicated pediatric emergency department with Level II Pediatric Trauma verification. The Hospital also provides specialty pediatric care services in communities across a five-state region.

Children's Physicians is a pediatric healthcare provider organization for Omaha and surrounding communities that owns and operates primary care pediatric clinics. The clinics also serve as resident training sites for pediatric residents. Children's Physicians has two voting members—Children's Hospital & Medical Center, a Nebraska not-for-profit corporation (two-thirds or majority voting membership) and Creighton University, a Nebraska not-for-profit corporation (one-third or noncontrolling voting membership). As of December 31, 2018, Children's Physicians operates 15 clinical sites. Creighton University's accumulated noncontrolling interest is recognized in the consolidated balance sheets as part of net assets.

The Foundation's purpose is to manage and distribute funds solicited from the public to further the mission and purpose of the Hospital.

Children's Health Network is a messenger model physician hospital organization composed of more than 460 general pediatricians, family practitioners, and pediatric specialists, including Children's Hospital & Medical Center employed physicians and other providers committed to improving the health status of children.

In 2007, the Hospital entered into an Institutional Affiliation Agreement with the Board of Regents of the University of Nebraska acting through the University of Nebraska Medical Center (UNMC), which provides 50% ownership of Nebraska Pediatric Practice (NPP) for each party. Under the terms of this agreement, the Hospital is responsible for funding any annual operating deficits incurred as a result of NPP operations (note 16) and is accounted for using the equity method as reflected in affiliation support in the consolidated statements of operations. The agreement also provides for joint funding of other activities in support of pediatrics.

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(2) Summary of Significant Accounting Policies

(a) Use of Estimates

The preparation of consolidated financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements, and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates. Significant items subject to such estimates and assumptions include the useful lives of fixed assets, allowances for contractual adjustments and other price concessions, investment valuation, and professional liability reserves and loss recoverables.

(b) Cash and Cash Equivalents

Cash and cash equivalents include highly liquid investments with original maturities of three months or less that have not otherwise been classified as long-term assets due to a designation for long-term purposes.

(c) Investments and Investment Income

Investments in equity securities with readily determinable fair values and investments in debt securities are measured at fair value in the accompanying consolidated balance sheets. Alternative investments are valued at net asset value as a practical expedient to estimated fair values. The estimated values as determined by the respective fund's general manager and investment managers may differ significantly from the values that would have been used had ready markets existed. Real estate held in investments is valued based on the contributed value at the time of donation.

The Company has designated its investment portfolio as trading. Accordingly, unrealized gains and losses on investments are reported within excess of revenue, gains, and other support over expenses. For purposes of the consolidated statements of cash flows, the Company presents the purchase and sale of securities as an investing activity.

Investment income or loss (including realized and unrealized gains and losses on investments, interest, and dividends) is included in the excess of revenue, gains, and other support over expenses, unless the income or loss is restricted by donor.

(d) Assets Limited to Use

Assets limited to use represent investments and cash and cash equivalents limited for specific purposes, such as certain improvements to healthcare facilities. These investments are stated at fair value.

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(e) Property and Equipment

Property and equipment acquisitions are recorded at cost or, if donated, at fair market value on the date of the gift. Depreciation is provided over the estimated useful life of each class of depreciable asset and is computed using the straight-line method based on the following estimated useful lives:

Buildings and leasehold improvements	3–30 years
Equipment and furnishings	3–20 years

Interest cost incurred on borrowed funds during the period of construction of capital assets is capitalized as a component of the cost of acquiring those assets.

Equipment under capital lease obligations is stated at the present value of future minimum lease payments amortized on the straight-line method over the shorter period of the lease term or the estimated useful life of the equipment. Such amortization is presented with depreciation in the consolidated financial statements.

Gifts of long-lived assets, such as land, buildings, or equipment, are reported as unrestricted support and are included from the excess of revenue, gains, and other support over expenses, 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.

(f) Other Assets

Other assets include interests in split-interest agreements and deferred compensation assets. The Hospital and Foundation have been named the beneficiaries of irrevocable charitable remainder trust agreements in which each will receive certain funds upon termination of the trusts. Contribution revenue is recognized in the period in which the gift is established or when the Hospital or Foundation receives notice of the gift's existence. The contribution and associated receivable are recorded by discounting the future gift amount to its net present value. Adjustments to reflect the amortization of the discount rate and changes in actuarial assumptions are recognized as a change in value of split-interest agreements.

The Foundation is also a beneficiary of perpetual trusts and annually receives the income on the trusts' assets as earned in perpetuity. Contribution revenue is recognized in the period in which the trusts are established or when the Foundation receives notice of the trust's existence. The contributions and associated assets are recorded by discounting the future gift amount to its net present value.

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The Hospital offers a 457b retirement plan. The Hospital maintains investment balances, within other assets, equal to the Hospital's total liability under this deferred compensation retirement plan. The investment balances related to the 457b retirement plan were \$3,299 and \$3,690 as of December 31, 2018 and 2017, respectively. A corresponding liability for this 457b plan is recorded in other noncurrent liabilities.

(g) *Deferred Debt Issuance Costs*

Financing and legal costs incurred in connection with the issuance of long-term debt are amortized over the term of the related debt using the effective interest rate method. Unamortized costs are presented on the consolidated balance sheets as a direct deduction of debt liabilities.

(h) *Net Assets With Donor Restrictions*

Net assets with donor restrictions are those whose use has been limited by donors to a specific time period or purpose and net assets which have been restricted by donors to be maintained in perpetuity. The Company applies the provisions of the Nebraska Uniform Prudent Management of Institutional Funds Act (the Act) in managing its endowment. The Company classifies as net assets with donor restrictions (a) the original value of the gifts donated to the permanent endowment, (b) the original value of subsequent gifts to the permanent endowment, and (c) 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.

(i) *Net Assets Without Donor Restrictions*

Net assets without donor restriction represent assets accumulated through the Company's operations that are not restricted by outside donors. This includes assets with a board designation or assets whose use is contractually limited, such as proceeds of debt issues deposited with a trustee and limited to use in accordance with the requirements of the master agreement.

(j) *Patient Service Revenue*

Patient service revenue is reported at the amount that reflects the consideration to which the Hospital and Children's Physicians (collectively, the Healthcare Providers) expects to be entitled in exchange for providing patient care. These amounts, representing transaction price, 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 Company bills the patients and third-party payors several days after the services are performed and/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 Healthcare Providers. Revenue for performance obligations satisfied over time is recognized based on actual charges incurred in relation to total expected (or actual) charges. The Company believes that this method provides a reasonable depiction of the transfer of services over the term of the performance obligation based on the input needed to satisfy the obligation. Generally, performance obligations satisfied over time relate to patients receiving inpatient acute care services. The Company

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measures the performance obligation from admission into the healthcare provider to the point when it is no longer required to provide services to that patient, which is generally at the time of discharge. Revenue for performance obligations satisfied at a point in time is recognized when goods or services are provided and the Healthcare Providers do not believe it is required to provide additional goods or services. Performance obligations satisfied at a point in time include cafeteria sales and billing services. Because performance obligations relate to contracts with a duration of less than one year, the Healthcare Providers elected to apply the optional exemption provided in Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Subtopic 606-10-50-14(a), *Revenue from Contracts with Customers*, and, therefore, is not required to disclose the aggregate amount of the transaction price allocated to performance obligations that are unsatisfied or partially unsatisfied at the end of the reporting period. The unsatisfied or partially unsatisfied performance obligation referred to above are primarily related to inpatient acute care services at the end of the reporting period. The performance obligations for these contracts are generally completed when the patients are discharged, which generally occurs within days or weeks of the end of the reporting period.

The Company determines the transaction price, which involves significant estimates and judgment, based on standard charges for goods and services provided, and reduced by explicit and implicit price concessions, including contractual adjustments provided to third-party payors, discounts provided to uninsured and underinsured patients in accordance with policy, and/or implicit price concessions based on the historical collection experience of patient accounts. The Company determines the transaction prices associated with services provided to patients who have third-party payor coverage based on reimbursement terms per contractual agreements, discount policies, and historical experience. For uninsured patients who do not qualify for charity care, the Company determines the transaction price associated with services on the basis of charges reduced by implicit price concessions. Implicit price concessions included in the estimate of the transaction price are based on historical collection experience for applicable patient portfolios. Patients who meet the Company's criteria for free care "charity" are provided care without charge; such amounts are not reported as revenue. Subsequent changes to the estimate of the transaction price are generally recorded as adjustments to patient service revenue in the period of the change. 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 using the most likely outcome method. These settlements are estimated based on the terms of the payment agreements with the payor, correspondence from the payor, and 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 period as new information becomes available or as years are settled or are no longer subject to such audits, reviews, and investigations.

The Company uses a portfolio approach to account for categories of patient contracts as a collective group rather than recognizing revenue on an individual contract basis. The portfolios consist of major payor classes for inpatient revenue and outpatient revenue. Based on the historical collection trends and other analyzes, the Company believes that revenue recognized by utilizing the portfolio approach

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approximates the revenue that would have been recognized if an individual contract approach were used.

(k) Financial Assistance

In support of the mission of the Company, the Healthcare Providers provide care to patients who meet certain criteria under its financial assistance policy without charge or at amounts less than their established rates. Because the Healthcare Providers do not pursue collection of amounts determined to qualify for financial assistance, they are not reported as revenue. The amount of cost for services and supplies furnished under the Company's financial assistance policy aggregated at \$4,836 and \$3,634 in 2018 and 2017, respectively, utilizing the ratio of costs to charges.

(l) Donor-Restricted Gifts

Unconditional promises to give cash and other assets to the Company are reported at fair value at the date the promise is received. Conditional promises to give and indications of intentions to give are reported at fair value when the conditions have been substantially met. Intentions to give are not recorded until they become unconditional promises to give. The gifts are reported as 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 restrictions are reclassified as net assets without donor restrictions 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 reflected in net assets without donor restrictions in the accompanying consolidated financial statements.

Unconditional promises to give that are expected to be collected within one year are recorded at net realizable value. Unconditional promises to give that are expected to be collected in future years are recorded at the present value of their estimated future cash flows. The discounts on those amounts are computed using risk-free interest rates applicable to the years in which the promises are received. Amortization of the discounts is included in contribution revenue.

(m) Fair Value of Financial Instruments

In accordance with FASB ASC Topic 820, *Fair Value Measurement*, the Company utilizes valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs to the extent possible. The Company determines fair value based on assumptions that market participants would use in pricing an asset or liability in the principal or most advantageous market. When considering market participant assumptions in fair value measurements, the following fair value hierarchy distinguishes between observable and unobservable inputs, which are categorized in one of the following levels:

- Level 1 inputs: Unadjusted quoted prices in active markets for identical assets or liabilities accessible to the reporting entity at the measurement date
- Level 2 inputs: Other than quoted prices included in Level 1 inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the asset or liability

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- Level 3 inputs: Unobservable inputs for the asset or liability used to measure fair value to the extent that observable inputs are not available, thereby allowing for situations in which there is little, if any, market activity for the asset or liability at measurement date.

(n) Derivative Instruments and Hedging Activities

The Company accounts for derivatives and hedging by recognizing all derivative instruments as either assets or liabilities in the consolidated balance sheets at their respective fair values. Changes in the fair value of derivatives are recognized in other income.

The fair value of interest rate swaps is determined using pricing models developed based on the LIBOR swap rate and other observable market data.

(o) Income Taxes

All affiliated entities, with the exception of Children's Health Network, have been recognized as not-for-profit corporations by the Internal Revenue Service as described in Section 501(c)(3) of the Internal Revenue Code (the Code) and are exempt from federal income taxes on related income pursuant to Section 501(a) of the Code. Children's Health Network is a not-for-profit taxable corporation that has net taxable operating losses and, therefore, has no tax liability. The United States is the major tax jurisdiction for the Company and 2015 is the earliest tax year subject to examination.

The Company recognizes the effect of income tax positions only if those positions are more likely than not of being sustained. Recognized income tax positions are measured at the largest amount that is greater than 50% likely of being realized. Changes in recognition or measurement are reflected in the period in which the change in judgment occurs. During 2018 and 2017, the Company did not record any amounts related to uncertain tax positions or any accrued interest and penalties.

(p) Excess of Revenue, Gains, and Other Support Over Expenses

The consolidated statements of operations include excess revenue and gains over expenses and losses, which is an indicator of financial performance. Changes in unrestricted net assets, which are excluded from excess of revenue, gains, and other support over expenses, consistent with industry practice, include contributions of long-lived assets (including assets acquired using contributions that by donor restriction were to be used for purposes of acquiring such assets) and other net asset transfers.

Other activities that result in gains or losses peripheral to the Company's primary mission are considered to be nonoperating. Nonoperating activities include investment earnings and changes in fair value of interest rate swaps.

(q) 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.

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(r) Reclassifications

Certain reclassifications have been made to the prior year consolidated financial statements to conform to the current year presentation. Reclassifications related to the adoption of new accounting standards are discussed in note 1(s). Additionally, reclassification were made to further disaggregate investment presentation.

(s) Recently Issued Accounting Standards

On January 1, 2018, the Company retrospectively adopted Accounting Standards Update (ASU) No. 2016-14, *Presentation of Financial Statements of Not-for-Profit Entities*. ASU No. 2016-14 improves the current net asset classification requirements and the information presented in financial statements and notes about a not-for-profit entity's liquidity, financial performance, and cash flows. The guidance requires entities to present two classes of net assets on the face of the consolidated balance sheets: net assets with donor restrictions and net assets without donor restrictions. Further, the guidance provides for enhanced disclosures. As a result of the adoption, 2017 temporarily restricted net assets of \$37,872 and permanently restricted net assets of \$5,967 have been combined for presentation in 2018 as net assets with donor restrictions.

On January 1, 2018, the Company adopted ASU No. 2014-09 (ASC Topic 606) following the modified retrospective method of application for the adoption of the guidance to all contracts existing on January 1, 2018 resulting in no impact to the Company's existing revenue streams. The adoption of ASC Topic 606 resulted in changes to the presentation and disclosure of revenue related to uninsured or underinsured patients. Prior to the adoption of ASC Topic 606, the Company presented a separate provision for bad debts related to self-pay patients, as well as copays and deductibles owed by patients with insurance. Under ASC Topic 606, the estimated uncollectible amounts due from these patients are generally considered a direct reduction to patient service revenue and, correspondingly, resulted in a reduction in the amounts presented separately as provision for bad debt. As such, the 2017 provision for bad debt of \$2,871 has been reclassified and presented as a reduction to patient service revenue for the 2018 presentation. Such amount was also reclassified in the consolidated statement of cash flows to the change in patient accounts receivable. Additionally, the allowance for uncollectible accounts of \$3,868 at January 1, 2018 was reclassified as a component of patient accounts receivable in the accompanying consolidated balance sheets.

In February 2016, the FASB issued ASU No. 2016-02, *Leases* (Topic 842). ASU No. 2016-02 requires the lessee to recognize assets and liabilities for leases with lease terms of more than 12 months. For leases with a term of 12 months or less, the Company is permitted to make an accounting policy election by class of underlying asset not to recognize lease assets and lease liabilities. Further, the lease standard requires a finance lease to recognize both interest expense and amortization expense related to the right of use asset. Operating leases generally recognize the associated expense on a straight-line basis. ASU No. 2016-02 requires the Company to adopt the standard using a modified retrospective approach and adoption beginning on January 1, 2019. Approximately \$25 million of right of use assets and liabilities were recorded on the consolidated balance sheet upon adoption. There was no significant impact to the Company's results of operations and cash flows.

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In June 2018, the FASB issued ASU 2018-08, *Clarifying the Scope and Accounting Guidance for Contributions Received and Contributions Made*, which provides assistance in determining if a transaction should be accounted for as a contribution or as an exchange, as well and providing guidance in determining whether a contribution is conditional. Companies should apply this guidance on a modified prospective basis, although a retrospective application is permitted. The new standard is effective for the Company for fiscal years beginning after June 15, 2018. The Company is currently evaluating the impact that ASU No. 2018-08 will have on its financial position, results of operations, and cash flows.

(3) Patient Service Revenue and Patient Accounts Receivable

The Healthcare Providers have agreements with government and other third-party payors that provide for payments at amounts different from the provider's established rates. The following summarizes the payment arrangements with government payors:

Inpatient services rendered to Medicaid program beneficiaries are paid at the base rate plus outliers. Outpatient Medicaid services are reimbursed based on a percentage rate representing the discounted average ratio of cost to charges. The Hospital also receives a Disproportionate Share Payment annually from the State of Nebraska Department of Health and Human Services.

Physician clinic services are paid based on fee schedule amounts.

The Healthcare Providers have entered into payment agreements with certain commercial insurance carriers and preferred provider organizations. The basis for payment under these agreements consists primarily of discounts from established charges.

The following table sets forth the Healthcare Providers' patient service revenue at its established rates for the years ended December 31, 2018 and 2017:

	<u>2018</u>	<u>2017</u>
Patient service revenue:		
Hospital:		
Hospital billing		
Inpatient services	\$ 208,421	188,627
Outpatient services	170,524	154,332
Professional billing	14,333	13,026
Home health	18,859	17,044
Children's Physicians	<u>48,449</u>	<u>42,334</u>
Total patient service revenue	<u>\$ 460,586</u>	<u>415,363</u>

Patient service revenue from the Medicaid program accounted for approximately 30% and 31% of the Healthcare Providers' patient service revenue for the years ended December 31, 2018 and 2017,

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respectively. Laws and regulations concerning government programs, including Medicaid, are complex and subject to varying interpretation. As a result of the investigations by government 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 organization 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 actions, including fines, penalties, and potential exclusion from related programs. There can be no assurance that regulator authorities will not challenge the Company'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 Company.

Patient service revenue, recognized in 2018 and 2017 from major payor sources is as follows:

	<u>2018</u>		<u>2017</u>	
Medicaid	\$ 137,346	29.8 %	126,893	30.5 %
Commercial insurance	321,904	69.9	286,933	69.1
Other government payors	138	—	623	0.1
Patient (self-pay)	<u>1,198</u>	<u>0.3</u>	<u>914</u>	<u>0.3</u>
Patient service revenue	<u>\$ 460,586</u>	<u>100.0 %</u>	<u>415,363</u>	<u>100.0 %</u>

The Company grants credits without collateral to its patients, most of whom are local residents of Nebraska and western Iowa and are insured under third-party payor agreements. The mix of patient receivables from patients and third-party payors at December 31, 2018 and 2017 are as follows:

	<u>2018</u>	<u>2017</u>
Medicaid	42 %	49 %
Commercial insurance and other third-party payors	47	43
Patients	<u>11</u>	<u>8</u>
	<u>100 %</u>	<u>100 %</u>

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(4) Pledges Receivable

The Company has received certain pledges to support operations and other designated purposes. Pledges receivable were discounted utilizing interest rates ranging from 1.43% to 3.09%. At December 31, 2018 and 2017, pledges receivable consist of the following:

	2018	2017
Rainbow House Redevelopment	\$ 10	930
Dr. C. C. & Mabel L. Criss Heart Center	300	627
Changing Lives Together capital campaign	15,122	16,889
Specialty Pediatric Center	400	401
Kellie's Korner Fund	480	—
Other	25	26
	16,337	18,873
 Less:		
Unamortized discount	630	516
Allowance for uncollectibles	170	192
Net pledges receivable	\$ 15,537	18,165
 Amounts due in:		
Less than one year	\$ 6,486	6,881
One to five years	9,851	11,992
	16,337	18,873
 Less unamortized discounts and allowances	800	708
Net pledges receivable	\$ 15,537	18,165

(5) Financial Assets and Liquidity Resources

As of December 31, 2018, the Company has a working capital balance of \$94,245 and average day's cash on hand of 444 days, based on normal expenditures.

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The following reflects the Company's financial assets as of December 31, 2018, reduced by amounts not available for general use because of contractual or donor-imposed restrictions within one year of the balance sheet date:

	2018
Financial assets	
Cash and cash equivalents	\$ 67,804
Patient Accounts Receivable	69,690
Assets limited as to use	84,480
Investments	377,855
Construction funds	57,303
Other assets	6,520
Total financial assets	663,652
Less those unavailable for general expenditures within one year, due to:	
Contractual or donor-imposed restrictions	(49,716)
Board designations	(52,987)
Financial assets available to meet cash needs for general expenditures within one year	560,949
Liquidity resources:	
Bank lines of credit	10,000
Total financial assets and liquidity resources available within one year	\$ 570,949

The Company has certain board-designated and donor-restricted assets limited to use, which are available for general expenditure within one year in the normal course of operations. Accordingly, these assets have been included in the qualitative information above for financial assets to meet general expenditures within one year. The Company has other assets limited to use for donor-restricted purposes and funds designated for capital purposes, which are not available for general expenditure within the next year. However, the board-designated amounts could be made available, if necessary.

As of December 31, 2018, the Company was in compliance with all financial-related bond covenants.

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(6) Investments

The composition of investments, construction funds, and assets limited as to use at December 31, 2018 and 2017 is as follows:

	<u>2018</u>	<u>2017</u>
At fair value:		
Cash and cash equivalents	\$ 43,332	33,120
Corporate and municipal bonds	241,237	267,085
Common and preferred stocks	30,907	28,879
Mutual funds	<u>148,231</u>	<u>115,899</u>
	463,707	444,983
At net asset value:		
Investment in partnerships	55,931	63,552
At cost:		
Real estate held for resale	<u>—</u>	<u>3</u>
Total	<u>\$ 519,638</u>	<u>508,538</u>

All investment income and realized and unrealized gains and losses related to investment transactions are included in investment income in the consolidated statements of operations.

Investment income is comprised of the following for the years ended December 31, 2018 and 2017:

	<u>2018</u>	<u>2017</u>
Other-than-temporary impairment	\$ —	(719)
Dividend and interest income	13,996	9,907
Net realized gains	2,644	13,133
Net unrealized gains	<u>(25,759)</u>	<u>18,932</u>
Total investment income	<u>\$ (9,119)</u>	<u>41,253</u>

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For investments in partnerships, the Company used the net asset value reported by the underlying fund as a practical expedient to estimate the fair value of the investment. Below is a summary of investments accounted for at net asset value:

	<u>2018</u>	<u>2017</u>	Redemption frequency (if currently eligible)	Redemption notice period
Absolute return (a)	\$ 39,077	47,658	Quarterly/annually Life of investment	45–90 days
Private equity/venture capital funds (b)	8,171	7,330	Life of investment	Life of investment
Real assets (c)	1,187	723	Life of investment	Life of investment
Domestic equity (d)	<u>7,496</u>	<u>7,841</u>	Quarterly/annually	60 days
	<u>\$ 55,931</u>	<u>63,552</u>		

- (a) This category includes investments in funds that invest primarily in event-driven investments, which seek to exploit situations in which announced or anticipated events create inefficiencies in valuations of securities (hedging using multiple strategies such as merger arbitrage, restructuring, exchange offers, distressed debt, credit, options and other derivatives, and initial public offerings). At December 31, 2018, \$2,939 of this category is locked-up for the life of the investment.
- (b) This category includes seven partnerships. Six partnerships invest primarily in private equities related to the oil and gas sectors predominately in North America. The seventh partnership in this category invests in growth-oriented equities across a broad variety of sectors. At December 31, 2018, there were unfunded commitments of \$3,387 related to this category. It is estimated that the underlying assets of the fund will be liquidated over the next 1 to 9 years.
- (c) This category includes investments in funds that invest in a geographically diverse portfolio of real estate investments, principally industrial, office, residential, and retail properties. The term of each partnership is 10 years from the date of when substantially all capital commitments are invested. It is estimated that the underlying assets of the fund will be liquidated over the next 1 to 13 years.
- (d) This category invests in funds that primarily invest in U.S. common stocks. Those included in this category pursue a long-short strategy. Lockup period ranges from 12 to 36 months from the original subscription period. Redemption dates range between March 31, 2019 and December 31, 2019.

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Due to the nature of the investments held by the funds, changes in market conditions, and the economic environment may significantly impact the net asset value of the funds and, consequently, the fair value of the Company's interests in the funds. Although a secondary market exists for these investments, it is not active and individual transactions are typically not observable. When transactions do occur in this limited secondary market, they may occur at discounts to the reported net asset value. It is, therefore, reasonably possible that if the Company were to sell these investments in the secondary market, a buyer may require a discount to the reported net asset value and the discount could be significant.

The Company has designated certain investment funds to be used for specified purposes as of December 31, 2018 and 2017. These board designations include the Pediatric Enrichment Fund with balances of \$19,194 and \$40,813 as of December 31, 2018 and 2017, respectively. The Children's Hospital Research Institute with \$21,600 and \$0 as of December 31, 2018 and 2017, respectively, and \$10,000 each year supporting the UNMC affiliation agreement. Also included are reserve funds held by trustee for the Series 2008B Bonds of \$790 and \$788, respectively.

(7) Property and Equipment

Property and equipment as of December 31, 2018 and 2017 consisted of the following:

	<u>2018</u>	<u>2017</u>
Land	\$ 28,605	19,381
Building and leasehold improvements	272,700	271,004
Equipment and furnishings	123,667	119,849
Construction in progress	<u>84,234</u>	<u>18,513</u>
	509,206	428,747
Less accumulated depreciation and amortization	<u>220,315</u>	<u>199,550</u>
	<u>\$ 288,891</u>	<u>229,197</u>

Depreciation expense for the years ended December 31, 2018 and 2017 was approximately \$21,375 and \$24,677, respectively. The Company capitalized \$2,658 and \$2,446 of interest cost during the years ended December 31, 2018 and 2017, respectively.

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(8) Other Assets

Other assets consist of the following as of December 31, 2018 and 2017:

	<u>2018</u>	<u>2017</u>
Interest in charitable remainder and perpetual trusts	\$ 3,221	3,618
Investments held for deferred compensation	3,299	3,689
	<u>\$ 6,520</u>	<u>7,307</u>

(9) Long-Term Debt

Long-term debt as of December 31, 2018 and 2017 consisted of the following:

	<u>2018</u>	<u>2017</u>
Health Facilities Revenue Refunding Bonds, Series 2008A, variable interest, 1.71% at December 31, 2018, principal maturing in varying annual amounts commencing August 15, 2019, final maturity August 15, 2032	\$ 34,870	34,870
Health Facilities Revenue Refunding Bonds, Series 2014, fixed interest, 3.01% at December 31, 2018, principal maturing in varying annual amounts commencing August 15, 2018, final maturity August 15, 2030	18,620	18,945
Health Facilities Revenue Refunding Bonds, Series 2017, fixed interest, 4.55% at December 31, 2018, principal maturing in varying annual amounts commencing November 15, 2027, final maturity November 15, 2047	95,530	95,530
Health Facilities Revenue Refunding Bonds, Series 2017B, fixed interest, 2.15% at December 31, 2018, principal maturing in varying annual amounts commencing August 15, 2019, final maturity August 15, 2030	22,695	26,885
Mortgage note payable, interest at 9.49%, principal and interest due quarterly through 2027, secured by the related property	5,003	5,355
Capital lease obligation, 4.50% interest at December 31, 2018, principal paid in varying amounts through 2020	314	454
	<u>177,032</u>	<u>182,039</u>
Net unamortized premium on 2017 Bonds	4,884	4,992
Less debt issuance costs	860	904
Less current portion	<u>5,039</u>	<u>5,043</u>
Long-term debt and other obligations, net of current portion	<u>\$ 176,017</u>	<u>181,084</u>

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The overall effective-interest rate on the Series 2008A, 2014, 2017, and 2017B Bonds was 3.91% and 3.71% for 2018 and 2017, respectively. The Series 2014 Bonds have a fixed rate of 3.01%. The Series 2017 Bonds have fixed rates with a minimum rate of 3.25% and a maximum rate of 5.00%. The Series 2017B Bonds have a fixed interest rate at 2.15%.

Aggregate future principal payments on long-term debt and other obligations are as follows:

	Long-term debt	Capital lease obligation
Year ending December 31:		
2019	\$ 4,832	207
2020	5,000	107
2021	5,182	—
2022	5,382	—
2023	5,593	—
Thereafter	150,729	—
Total	\$ 176,718	314

On August 12, 2008, \$34,870 of Health Facilities Revenue Refunding Bonds, Series 2008A were issued by the Hospital Authority No. 2 of Douglas County, Nebraska pursuant to the Master Trust Indenture and Loan Agreement between the Hospital and Foundation (Obligated Group) and First National Bank of Omaha, Nebraska (Master Trustee).

On March 1, 2017, The Hospital issued a \$95,530 tax-exempt bond through Hospital Authority No. 2 of Douglas County, Nebraska pursuant to the Master Trust Indenture and Loan Agreement between the Hospital and Foundation (Obligated Group) and First National Bank of Omaha, Nebraska (Master Trustee). Series Bonds were made up of a combination of Serial and Term bonds with a final maturity of November 15, 2047. The Series 2017 Bonds were issued at various fixed interest rates. The Hospital deposited the bond proceeds to a construction fund invested in corporate and municipal bonds. The fund is presented as assets limited as to use on the consolidated balance sheets. The bond proceeds and additional funds will be used to pay for committed expenditures to improve healthcare facilities and construct the Tower Project (collectively, the Project) (note 10).

On November 28, 2017, the Hospital issued a \$26,885 tax-exempt bond Series 2017B through Hospital Authority No. 2 of Douglas County, Nebraska Health Facilities Revenue Refunding Bonds. The Series 2017B Bonds were issued at a fixed interest rate of 2.15% and have a final maturity of August 15, 2030.

The Hospital has entered into an interest rate swap agreement with Piper Jaffray Financial Products Inc. and Morgan Stanley Capital Services, Inc. with original notional value of \$34,720. The Hospital has accounted for derivatives and hedging activities in accordance with ASC Topic 815, *Derivatives and*

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Hedging, which requires that the derivatives be recorded at fair value in the consolidated financial statements and the change in the derivative's fair value is recognized currently in earnings unless specific hedge accounting criteria are met. The Hospital has not met the requirements for hedge accounting, and accordingly, the change in the value of the swap is reflected in other income in the consolidated statements of operations.

The amount outstanding at December 31, 2018 and terms of the agreements are as follows:

<u>Series</u>	<u>Outstanding amount of swap</u>	<u>Interest rate</u>
2008A	\$ 26,780	3.655 %

The following items related to the interest rate swap are included in the consolidated financial statements:

	<u>2018</u>	<u>2017</u>
Statements of operations:		
Swap interest – operating expenses	\$ 633	843
Change in fair value of swap transaction	903	690
Balance sheets:		
Interest rate swap – other liabilities	\$ 3,460	4,363
Accrued interest payable – current liabilities	44	60

(10) Commitments

The Company is in the process of constructing the Tower Project with an estimated total cost of \$385,000 and expected completion date of June 2021. Total construction costs included in the accompanying consolidated balance sheets as of December 31, 2018 and 2017 are \$67,392 and \$14,254, respectively. The Tower Project will be funded through the use of bond proceeds, existing investments, philanthropy, and future cash flows from operations.

(11) Operating Leases

The Company leases various equipment and other building spaces for operations under various noncancelable operating lease arrangements that expire between January 2018 and December 2027 and require varying minimum annual rentals. Several of the building leases also require the payment of property taxes and normal maintenance on the properties.

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The total minimum rental and facility services commitments at December 31, 2018 are as follows:

	Building and equipment rental commitments	Facility services commitments
2019	\$ 3,737	1,052
2020	3,423	1,061
2021	1,918	446
2022	857	—
2023	497	—
Due thereafter	1,528	—

Included in the accompanying consolidated statements of operations is total rental expense of \$6,519 and \$6,349 and total rental income of \$724 and \$579 for the years ended December 31, 2018 and 2017 respectively.

(12) Net Assets Without Donor Restrictions

Net assets without donor restrictions are as follows December 31, 2018 and 2017:

	2018	2017
Undesignated	\$ 627,341	585,931
Children's Hospital Research Institute	21,600	—
Pediatric Enrichment Fund	19,194	40,813
Board-designated affiliation agreement	10,000	10,000
Noncontrolling interest	3,013	3,459
Board-designated operating programs	2,611	2,264
Total net assets without donor restrictions	<u>\$ 683,759</u>	<u>642,467</u>

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(13) Net Assets With Donor Restrictions

Net assets with donor restrictions are subject to the following purpose on December 31, 2018 and 2017:

	<u>2018</u>	<u>2017</u>
Changing Lives Together Capital Campaign	\$ 37,864	30,639
Carolyn Scott Rainbow House	9	884
Specialty Pediatric Center	258	254
Charitable Remainder Trust	2,520	2,784
Dr. C.C. & Mabel L. Criss Heart Center	1,567	1,572
Kellie's Korner Fund	343	—
Other	2,220	1,739
	<u>44,781</u>	<u>37,872</u>
Total net assets with donor restrictions	\$ <u>44,781</u>	<u>37,872</u>

Net assets with donor restrictions include endowment funds, which are to be held in perpetuity, and perpetual trusts. The income is expendable for the identified activities:

	<u>2018</u>	<u>2017</u>
Changing Lives Together Capital Campaign	\$ 945	493
Carolyn Scott Rainbow House	1,023	1,023
William Fleming Endowed Chair in Cardiothoracic Surgery	660	640
Barbara W. and Ronald W. Shafer Endowed Chair in Orthopedics	1,010	1,009
Other	3,027	2,802
	<u>6,665</u>	<u>5,967</u>
	\$ <u>6,665</u>	<u>5,967</u>

Realized and unrealized gains and losses on investment transactions related to restricted investments are included in net assets with donor restrictions and released from restrictions in accordance with the Foundation's spending policy and donor stipulation.

(14) Professional Liability Insurance

The Company carries a professional liability policy that provides \$1,000 of coverage for injuries per claim and \$3,000 aggregate, with a deductible of \$25 per claim and \$125 aggregate. This policy expires on August 1, 2019. Claims made prior to such date were insured. The Company also carries a physician professional liability policy that provides \$1,000 of coverage for injuries per claim and \$3,000 aggregate, with a deductible of \$10 per claim and no aggregate. In addition, the Company carries an umbrella excess liability policy (hospital professional and physician professional) that also provides \$25,000 per claim and aggregate coverage. These policies provide coverage on a claims-made basis, covering incidents that

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occurred subsequent to the retroactive date stated in the policy and first reported to the insurance company while the coverage is in force. In the event the Company should elect not to purchase insurance from the present carrier and fails to purchase the appropriate extended reporting endorsement, any unreported claims that occurred during the policy year may not be recoverable from the carrier.

The Company has provided for claims, including estimates of the ultimate costs of both reported claims and claims incurred but not reported at year-end. Management is presently not aware of any unasserted general and professional liability claims that would have a material adverse impact on the accompanying consolidated financial statements.

(15) Workers' Compensation Agreement

The Company has established a self-insured workers' compensation program that provides coverage for workers' compensation claims for the Company. An aggregate retention policy is provided through a commercial insurance company, which provides coverage up to the state of Nebraska's statutory requirements and the employer's liability up to \$1,000. The responsibility for the initial \$450 on each claim resides with the Company, subject to an aggregate retention limit of \$5,756. The Company has provided for claim payments, including estimates of the ultimate costs for both reported claims and claims incurred but not reported at year-end.

(16) Transactions with Affiliates

As discussed in note 1, Creighton University has a noncontrolling interest in Children's Physicians. For financial reporting purposes, the assets, liabilities, and operations of Children's Physicians are consolidated in the accompanying consolidated financial statements. Creighton University's 33% interest in Children's Physicians is reported as a noncontrolling interest in net assets on the consolidated balance sheets, and the income or loss therefrom is included in other operating revenue in the consolidated statements of operations and changes in net assets. The noncontrolling interest related to excess of revenue over expenses was \$(446) and \$(614) for the years ended December 31, 2018 and 2017, respectively.

The following is a summary of transactions between Creighton University and Children's Physicians, as reflected in the accompanying consolidated financial statements at December 31:

	2018	2017
Consolidated balance sheets:		
Payable for operating, overhead, and physician labor costs	\$ 1,483	1,385
Consolidated statements of operations:		
Operating and overhead expenses	\$ 168	150
Physician labor costs	5,418	5,318

As described in note 1, the Hospital and the Board of Regents of the University of Nebraska, acting on behalf of UNMC, entered into a members' agreement, on June 30, 2008, as the only members of NPP. Under the terms of this agreement, the Hospital is responsible for funding any annual operating deficit

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incurred as a result of NPP operations. The Company established board-designated funds to support the principles of this agreement. The board-designated funds include the Institutional Affiliation Agreement Fund of \$10,000 and the Pediatric Enrichment Fund in the amount of \$19,193 and \$40,813 for the years ended December 31, 2018 and 2017, respectively. In 2018, \$21,600 of the Pediatric Enrichment Fund was board designated to support the Children's Hospital Research Institute.

The following is a summary of transactions among NPP, UNMC, and the Company, related to market rates or costs incurred, as reflected in the accompanying consolidated financial statements:

	2018	2017
Consolidated balance sheets:		
Receivable for billing fees, clinical support, and occupancy	\$ 1,384	3,063
Prepaid tax levy reserve	5,796	8,054
Payable for operating loss shortfall, net	(4,441)	(2,190)
	\$ 2,739	8,927
Consolidated statements of operations:		
Support for billing fees, clinical support, and occupancy	\$ (32,226)	(26,231)
Practice support costs	52,353	40,386
	\$ 20,127	14,155

(17) Defined-Contribution Plan

The Company offers defined-contribution retirement plans covering substantially all of their employees. Contributions and related retirement plan expense totaled \$10,697 and \$9,759 for the years ended December 31, 2018 and 2017, respectively. The contributions include a payroll match and a basic year-end contribution, as defined by the Plan.

(18) Commitments and Contingencies

(a) Laws and Regulations

The healthcare 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, government healthcare program participation requirements, reimbursements for patient services, and Medicare and Medicaid fraud and abuse. Violations of these laws and regulations could result in sanctions, including expulsion from government healthcare programs, imposition of significant fines and penalties, and significant repayments for patient services previously billed. Government activity has increased with respect to investigations and allegations concerning possible violations of fraud and abuse statutes and regulations by healthcare providers.

Management believes that the Company is in compliance with government laws and regulations as they apply to the areas of fraud and abuse. While no regulatory inquiries have been made that are

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expected to have a material effect on the Company's consolidated financial statements, compliance with such laws and regulations can be subject to future government review and interpretation, as well as regulatory actions unknown or unasserted at this time.

(b) Line of Credit

The Company has entered into an unsecured revolving line of credit in the amount of \$10,000. At December 31, 2018 or 2017, the Company had not borrowed on this line.

(19) Functional Classification of Expenses

The consolidated financial statements report certain categories of expenses that are attributable to one or more programs or supporting functions of the Company. Therefore, these expenses require allocation on a reasonable basis that is consistently applied. The expenses that are allocated include salaries and benefits, which are allocated on the basis of specific identification. Other expenses, due to their nature, are allocated in a similar fashion.

Expenses by functional classification for the years ended December 31, 2018 and 2017 consist of the following:

	2018			
	Healthcare services	Fundraising	General and administrative	Total
Operating expenses:				
Salaries, wages, and agency staffing	\$ 169,555	1,314	27,276	198,145
Employee benefits	38,643	304	8,212	47,159
Supplies and pharmaceuticals	59,106	7	600	59,713
Outside services and professional fees	30,288	382	13,525	44,195
Other operating expenses	16,090	1,016	6,247	23,353
Depreciation and amortization	18,459	8	2,908	21,375
Affiliation support	22,037	—	—	22,037
Occupancy	8,623	10	1,732	10,365
Interest	3,058	18	—	3,076
Total	\$ <u>365,859</u>	<u>3,059</u>	<u>60,500</u>	<u>429,418</u>

**CHILDREN'S HOSPITAL & MEDICAL CENTER AND
AFFILIATES**

Notes to Consolidated Financial Statements

December 31, 2018 and 2017

(Dollars in thousands)

	2017			
	Healthcare services	Fundraising	General and administrative	Total
Operating expenses:				
Salaries, wages, and agency staffing	\$ 155,744	1,285	23,008	180,037
Employee benefits	35,607	279	4,581	40,467
Supplies and pharmaceuticals	52,318	31	551	52,900
Outside services and professional fees	21,367	785	14,612	36,764
Other operating expenses	23,735	1,103	5,106	29,944
Depreciation and amortization	21,550	12	3,115	24,677
Affiliation support	14,154	—	—	14,154
Occupancy	9,287	39	1,594	10,920
Interest	3,787	21	—	3,808
Loss on sale	238	—	—	238
Total	\$ 337,787	3,555	52,567	393,909

(20) Fair Value Measurements

ASC Topic 820, *Fair Value Measurements and Disclosures*, establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives this highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to measurements involving significant unobservable inputs (Level 3 measurements). The level in the fair value hierarchy within which a fair value measurement in its entirety falls is based on the lowest-level input that is significant to the fair value measurement in its entirety. The following tables present assets and liabilities that are measured at fair value on a recurring basis (including items that are required to be measured at fair value and items for which the fair value option has been elected) at December 31, 2018 and 2017:

	Fair value measurements at December 31, 2018			
	Level 1	Level 2	Level 3	Total
Financial assets:				
Money market funds	\$ 71,686	—	—	71,686
Repurchase agreements	520	—	—	520
Fixed-income securities	—	241,237	—	241,237
Domestic mutual funds	65,461	—	—	65,461
International mutual funds	82,770	—	—	82,770
Domestic – individual stocks	30,907	—	—	30,907
Deferred compensation assets:				
Money market funds	172	—	—	172
Domestic equity funds	2,209	—	—	2,209

**CHILDREN'S HOSPITAL & MEDICAL CENTER AND
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Notes to Consolidated Financial Statements

December 31, 2018 and 2017

(Dollars in thousands)

Fair value measurements at December 31, 2018				
	Level 1	Level 2	Level 3	Total
International equity funds	\$ 208	—	—	208
Fixed-income funds	710	—	—	710
Investments measured at net asset value ¹				55,931
	<u>\$ 254,643</u>	<u>241,237</u>	<u>—</u>	<u>551,811</u>
Financial liabilities:				
Interest rate swap	\$ —	3,459	—	3,459
Deferred compensation	3,299	—	—	3,299
Total	<u>\$ 3,299</u>	<u>3,459</u>	<u>—</u>	<u>6,758</u>

Fair value measurements at December 31, 2017				
	Level 1	Level 2	Level 3	Total
Financial assets:				
Money market funds	\$ 78,872	—	—	78,872
Repurchase agreements	517	—	—	517
Fixed-income securities	—	267,085	—	267,085
Domestic mutual funds	62,794	—	—	62,794
International mutual funds	53,105	—	—	53,105
Domestic – individual stocks	28,879	—	—	28,879
Deferred compensation assets:				
Money market funds	224	—	—	224
Domestic equity funds	2,708	—	—	2,708
International equity funds	249	—	—	249
Fixed income funds	510	—	—	510
Investments measured at net asset value ¹				63,552
	<u>\$ 227,858</u>	<u>267,085</u>	<u>—</u>	<u>558,495</u>
Financial liabilities:				
Interest rate swap	\$ —	4,363	—	4,363
Deferred compensation	3,690	—	—	3,690
Total	<u>\$ 3,690</u>	<u>4,363</u>	<u>—</u>	<u>8,053</u>

¹ Certain investments that are measured at fair value using the net asset value per share (or its equivalent) practical expedient have not been categorized in the fair value hierarchy. The fair value amounts presented in this table are intended to permit reconciliation of the fair value hierarchy to the amounts presented in the consolidated balance sheets.

**CHILDREN'S HOSPITAL & MEDICAL CENTER AND
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Notes to Consolidated Financial Statements

December 31, 2018 and 2017

(Dollars in thousands)

(21) Subsequent Events

The Company has reviewed subsequent events through May 24, 2019, the date the consolidated financial statements were issued, noting no subsequent events to disclose.

**CHILDREN'S HOSPITAL & MEDICAL CENTER AND
AFFILIATES**

Consolidating Balance Sheet

December 31, 2018

(Dollars in thousands)

Assets	Children's Hospital	Children's Physicians	Children's Hospital Foundation	Children's Health Network	Eliminations	Consolidated
Current assets:						
Cash and cash equivalents	\$ 48,467	8,970	10,367	—	—	67,804
Patient accounts receivable	67,473	2,217	—	—	—	69,690
Current portion of pledges receivable	—	—	6,486	—	—	6,486
Affiliate receivables	3,928	622	—	—	(4,550)	—
Other receivables	3,597	318	2,938	—	—	6,853
Prepaid expenses and other assets	14,975	1,397	195	—	—	16,567
Estimated third-party payor settlements	10,295	—	—	—	—	10,295
Total current assets	148,735	13,524	19,986	—	(4,550)	177,695
Pledges receivable	—	—	9,051	—	—	9,051
Construction funds	57,303	—	—	—	—	57,303
Assets limited to use	41,584	—	42,896	—	—	84,480
Long-term investments	10,700	—	376,195	—	(9,040)	377,855
Property and equipment, net	286,394	2,464	33	—	—	288,891
Interest in Foundation	447,791	—	—	—	(447,791)	—
Other assets	5,821	—	699	—	—	6,520
Total assets	\$ 998,328	15,988	448,860	—	(461,381)	1,001,795

**CHILDREN'S HOSPITAL & MEDICAL CENTER AND
AFFILIATES**

Consolidating Balance Sheet

December 31, 2018

(Dollars in thousands)

Liabilities and Net Assets	Children's Hospital	Children's Physicians	Children's Hospital Foundation	Children's Health Network	Eliminations	Consolidated
Current liabilities:						
Current portion of long-term debt	\$ 5,039	—	—	—	—	5,039
Trade accounts payable	21,719	1,269	—	—	—	22,988
Construction payables	12,594	—	—	—	—	12,594
Affiliate payables	—	5,610	421	—	(4,550)	1,481
Accrued salaries	28,969	—	—	—	—	28,969
Other accrued expenses	11,875	69	435	—	—	12,379
Total current liabilities	80,196	6,948	856	—	(4,550)	83,450
Long-term debt and other obligations, net of current portion	176,017	—	—	—	—	176,017
Other liabilities	6,910	—	213	—	—	7,123
Total liabilities	263,123	6,948	1,069	—	(4,550)	266,590
Net assets:						
Without donor restrictions	680,746	9,040	398,865	—	(407,905)	680,746
Noncontrolling interest	3,013	—	—	—	—	3,013
Total net assets without donor restriction	683,759	9,040	398,865	—	(407,905)	683,759
With donor restrictions	51,446	—	48,926	—	(48,926)	51,446
Total net assets	735,205	9,040	447,791	—	(456,831)	735,205
Total liabilities and net assets	\$ 998,328	15,988	448,860	—	(461,381)	1,001,795

See accompanying independent auditors' report.

**CHILDREN'S HOSPITAL & MEDICAL CENTER AND
AFFILIATES**

Consolidating Statement of Operations

Year ended December 31, 2018

(Dollars in thousands)

	Children's Hospital	Children's Physicians	Children's Hospital Foundation	Children's Health Network	Eliminations	Consolidated
Unrestricted revenue, gains, and other support:						
Net patient service revenue	\$ 412,137	48,449	—	—	—	460,586
Contributions for use in operations	1,904	32	3,898	—	(1,936)	3,898
Other revenue	16,369	2,212	—	5	(5,014)	13,572
Equity in income of Children's Physicians	(1,337)	—	—	—	1,337	—
Equity in income of Children's Health Network	(499)	—	—	—	499	—
Total unrestricted revenue, gains, and other support	<u>428,574</u>	<u>50,693</u>	<u>3,898</u>	<u>5</u>	<u>(5,114)</u>	<u>478,056</u>
Operating expenses:						
Salaries, wages, and agency staffing	166,795	29,660	1,314	376	—	198,145
Employee benefits	41,079	5,735	304	41	—	47,159
Supplies and pharmaceuticals	50,132	9,575	6	—	—	59,713
Outside services and professional fees	42,255	5,936	808	79	(4,883)	44,195
Other operating expenses	20,678	1,304	3,299	8	(1,936)	23,353
Depreciation and amortization	20,989	378	8	—	—	21,375
Affiliation support	24,510	(2,473)	—	—	—	22,037
Occupancy	8,572	1,915	10	—	(131)	10,366
Interest	3,058	—	18	—	—	3,076
Beneficial interest in Foundation	1,869	—	—	—	(1,869)	—
Total operating expenses	<u>379,937</u>	<u>52,030</u>	<u>5,767</u>	<u>504</u>	<u>(8,819)</u>	<u>429,419</u>
Operating income (loss)	<u>48,637</u>	<u>(1,337)</u>	<u>(1,869)</u>	<u>(499)</u>	<u>3,705</u>	<u>48,637</u>
Other income:						
Net investment income	629	—	(9,748)	—	—	(9,119)
Change in fair value of swap transaction	903	—	—	—	—	903
Change in beneficial interest in net assets of Foundation	(9,748)	—	—	—	9,748	—
Total other income, net	<u>(8,216)</u>	<u>—</u>	<u>(9,748)</u>	<u>—</u>	<u>9,748</u>	<u>(8,216)</u>
Excess of revenue, gains, and other support over expenses	<u>40,421</u>	<u>(1,337)</u>	<u>(11,617)</u>	<u>(499)</u>	<u>13,453</u>	<u>40,421</u>
Other changes in unrestricted net assets:						
Net assets released from restrictions for use in operations	—	—	870	—	—	870
Net asset transfers	(46,612)	—	46,119	499	—	6
Change in beneficial interest in net assets of Foundation	47,488	—	—	—	(47,488)	—
Total other changes in unrestricted net assets	<u>876</u>	<u>—</u>	<u>46,989</u>	<u>499</u>	<u>(47,488)</u>	<u>876</u>
Increase (decrease) in unrestricted net assets	<u>\$ 41,297</u>	<u>(1,337)</u>	<u>35,372</u>	<u>—</u>	<u>(34,035)</u>	<u>41,297</u>

See accompanying independent auditors' report.

**CHILDREN'S HOSPITAL & MEDICAL CENTER AND
AFFILIATES**

Consolidating Statement of Changes in Net Assets

Year ended December 31, 2018

(Dollars in thousands)

	<u>Children's Hospital</u>	<u>Children's Physicians</u>	<u>Children's Hospital Foundation</u>	<u>Children's Health Network</u>	<u>Eliminations</u>	<u>Consolidated</u>
Changes in net assets without donor restrictions:						
Excess of revenue, gains, and other support over (under) expenses	\$ 40,421	(1,337)	(11,617)	(499)	13,453	40,421
Net assets released from restricted for property and equipment	—	—	870	—	—	870
Change in beneficial interest in net assets of Foundation	47,488	—	—	—	(47,488)	—
Net asset transfers	(46,618)	—	46,119	499	—	—
Increase (decrease) in net assets without donor restrictions	<u>41,291</u>	<u>(1,337)</u>	<u>35,372</u>	<u>—</u>	<u>(34,035)</u>	<u>41,291</u>
Changes in net assets with donor restrictions:						
Contributions restricted by donor	—	—	8,438	—	—	8,438
Investment income	—	—	220	—	—	220
Change in beneficial interest in net assets of Foundation	7,873	—	—	—	(7,873)	—
Change in value of split-interest agreements	(265)	—	(103)	—	—	(368)
Net assets released from restrictions	—	—	(682)	—	—	(682)
Increase (decrease) in net assets with donor restrictions	<u>7,608</u>	<u>—</u>	<u>7,873</u>	<u>—</u>	<u>(7,873)</u>	<u>7,608</u>
Increase (decrease) in net assets	48,899	(1,337)	43,245	—	(41,908)	48,899
Net assets, beginning of year	<u>686,306</u>	<u>10,377</u>	<u>404,546</u>	<u>—</u>	<u>(414,923)</u>	<u>686,306</u>
Net assets, end of year	<u>\$ 735,205</u>	<u>9,040</u>	<u>447,791</u>	<u>—</u>	<u>(456,831)</u>	<u>735,205</u>

See accompanying independent auditors' report.