

# **Children's National Medical Center and Subsidiaries**

**Consolidated Financial Statements and  
Supplementary Consolidating Information  
June 30, 2018 and 2017**

# Children’s National Medical Center and Subsidiaries

## Index

June 30, 2018 and 2017

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## Report of Independent Auditors

To the Board of Trustees of  
Children's National Medical Center and Subsidiaries

We have audited the accompanying consolidated financial statements of Children's National Medical Center and Subsidiaries ("Children's National"), which comprise the consolidated balance sheets as of June 30, 2018 and 2017, and the related consolidated statements of operations, changes in net assets and cash flows for the years then ended.

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

Management is responsible for the preparation and fair presentation of the consolidated 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 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 the 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 our 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, we consider internal control relevant to Children's National'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 Children's National'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 National Medical Center and Subsidiaries as of June 30, 2018 and 2017, and the results of their operations, their changes in net assets and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

A handwritten signature in black ink that reads "PricewaterhouseCoopers LLP". The signature is written in a cursive, flowing style.

October 5, 2018

**Children's National Medical Center and Subsidiaries**  
**Consolidated Balance Sheets**  
**June 30, 2018 and 2017**

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<i>(in thousands)</i>	<b>2018</b>	<b>2017</b>
<b>Assets</b>		
Current assets		
Cash and cash equivalents	\$ 111,213	\$ 138,850
Accounts receivable for patient services, net of allowance for uncollectible accounts of \$11,683 and \$11,228 as of June 30, 2018 and 2017, respectively	180,494	179,394
Settlements due from third-party payors	7,506	7,302
Contributions receivable, net	60,940	33,480
Grant receivable	22,191	21,170
Inventories of supplies	13,355	9,424
Prepaid expenses and other	29,162	26,489
Total current assets	<u>424,861</u>	<u>416,109</u>
Noncurrent assets		
Property and equipment, net	565,922	554,137
Assets whose use is limited by professional liability claims	23,735	26,226
Investments	746,962	676,729
Contributions receivable, net	59,873	33,754
Interest in beneficial trusts	8,357	8,184
Other	29,653	26,790
Total other noncurrent assets	<u>1,434,502</u>	<u>1,325,820</u>
Total assets	<u>\$ 1,859,363</u>	<u>\$ 1,741,929</u>

The accompanying notes are an integral part of these consolidated financial statements.

**Children's National Medical Center and Subsidiaries**  
**Consolidated Balance Sheets (continued)**  
**June 30, 2018 and 2017**

<i>(in thousands)</i>	<b>2018</b>	<b>2017</b>
<b>Liabilities and Net Assets</b>		
Current liabilities		
Accounts payable	\$ 38,351	\$ 37,630
Accrued salaries and other expenses	118,733	113,495
Current portion of reserve for claims	22,929	22,634
Settlements due to third-party payors	1,255	2,928
Deferred revenue	26,895	26,291
Current portion of long-term debt	5,911	5,866
Current portion of capital lease obligations	694	882
Total current liabilities	214,768	209,726
Noncurrent liabilities		
Long-term debt	460,653	466,444
Long-term capital lease obligations	5,058	5,201
Reserve for claims	65,676	67,025
Interest rate swaps	19,116	27,209
Other long-term liabilities	40,415	43,647
Total noncurrent liabilities	590,918	609,526
Total liabilities	805,686	819,252
<b>Net assets</b>		
Unrestricted	707,500	629,774
Temporarily restricted	199,281	155,115
Permanently restricted	146,896	137,788
Total net assets	1,053,677	922,677
Total liabilities and net assets	\$ 1,859,363	\$ 1,741,929

The accompanying notes are an integral part of these consolidated financial statements.

**Children's National Medical Center and Subsidiaries**  
**Consolidated Statements of Operations**  
**Years Ended June 30, 2018 and 2017**

<i>(in thousands)</i>	<b>2018</b>	<b>2017</b>
<b>Unrestricted revenues, gains, and other support</b>		
Patient service revenue (net of contractual allowances and discounts)	\$ 1,079,327	\$ 1,039,697
Provision for uncollectible accounts	<u>(29,749)</u>	<u>(34,533)</u>
Net patient service revenue less provision for uncollectible accounts	1,049,578	1,005,164
Grant revenue	83,339	69,254
Other operating revenue	50,260	56,618
Unrestricted contributions	32,045	26,461
Net assets released from restrictions used for operations	<u>31,645</u>	<u>34,497</u>
Total unrestricted revenues, gains, and other support	<u>1,246,867</u>	<u>1,191,994</u>
<b>Expenses</b>		
Salaries, wages, and benefits	759,596	698,500
Supplies and other	324,735	321,293
Depreciation and amortization	58,758	62,187
Provision for insurance	11,688	21,749
Interest and amortization	17,161	17,572
Development expense	<u>26,160</u>	<u>25,200</u>
Total expenses	<u>1,198,098</u>	<u>1,146,501</u>
Operating income	<u>48,769</u>	<u>45,493</u>
<b>Non-operating revenues and expenses</b>		
Investment income	5,961	2,960
Realized and change in unrealized fair value of interest rate swaps	4,502	8,255
Other non-operating income, net	<u>2,193</u>	<u>-</u>
Total non-operating revenues and expenses	<u>12,656</u>	<u>11,215</u>
Excess of revenues over expenses	61,425	56,708
Unrealized gain on investments	12,822	27,502
Property contribution	425	-
Conveyance of property	-	45,400
Released from restriction for property and equipment and other changes in net assets	<u>3,054</u>	<u>(6,125)</u>
Increase in unrestricted net assets	<u>\$ 77,726</u>	<u>\$ 123,485</u>

The accompanying notes are an integral part of these consolidated financial statements.

**Children's National Medical Center and Subsidiaries**  
**Consolidated Statements of Changes in Net Assets**  
**Years Ended June 30, 2018 and 2017**

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<i>(in thousands)</i>	<b>2018</b>	<b>2017</b>
<b>Unrestricted net assets</b>		
Excess of revenues over expenses	\$ 61,425	\$ 56,708
Unrealized gain on investments	12,822	27,502
Property contribution	425	-
Conveyance of property	-	45,400
Released from restrictions for property and equipment and other changes in net assets	3,054	(6,125)
Increase in unrestricted net assets	<u>77,726</u>	<u>123,485</u>
<b>Temporarily restricted net assets</b>		
Contributions	64,430	32,651
Investment gain	14,626	18,229
Released from restrictions and other changes in temporarily restricted net assets	(34,804)	(30,401)
Change in value of split interest agreements	(86)	(49)
Increase in temporarily restricted net assets	<u>44,166</u>	<u>20,430</u>
<b>Permanently restricted net assets</b>		
Contributions	8,450	1,973
Investment gain	214	182
Change in value of split interest agreements	259	455
Other changes in permanently restricted net assets	185	2,030
Increase in permanently restricted net assets	<u>9,108</u>	<u>4,640</u>
Change in net assets	131,000	148,555
<b>Net assets</b>		
Beginning of year	<u>922,677</u>	<u>774,122</u>
End of year	<u>\$ 1,053,677</u>	<u>\$ 922,677</u>

The accompanying notes are an integral part of these consolidated financial statements.

**Children's National Medical Center and Subsidiaries**  
**Consolidated Statements of Cash Flows**  
**Years Ended June 30, 2018 and 2017**

<i>(in thousands)</i>	<b>2018</b>	<b>2017</b>
<b>Cash flows from operating activities</b>		
Change in net assets	\$ 131,000	\$ 148,555
Adjustments to reconcile change in net assets to net cash and cash equivalents provided by operating activities		
Depreciation and amortization	58,758	62,187
Provision for uncollectible accounts	29,749	34,533
Provision for uncollectible contributions	2,706	1,407
Gain on sale of assets	(2,193)	-
Amortization of deferred financing costs	185	197
Amortization of bond premium	(2,666)	(2,842)
Conveyance of land and buildings	-	(45,400)
Loss in PSV equity investment	10,549	10,535
Net realized and change in unrealized gains on investments	(25,618)	(44,293)
Change in fair market value of interest rate swaps	(8,093)	(12,759)
Proceeds from restricted contributions	(6,557)	(8,346)
Change in assets and liabilities		
Accounts receivable for patient services	(30,849)	(69,121)
Settlements due from third-party payors	(204)	(794)
Other current assets and inventory of supplies	(6,604)	(809)
Contributions and grants receivable	(57,306)	9,535
Interest in beneficial trusts	(173)	(407)
Other noncurrent assets	(2,875)	(5,293)
Accounts payable	721	1,501
Accrued salaries and other expenses	4,946	(5,522)
Reserve for claims	(1,054)	14,336
Deferred revenue	604	1,079
Settlements due to third-party payors	(1,673)	2,085
Other noncurrent liabilities	(3,232)	7,486
Net cash and cash equivalents provided by operating activities	<u>90,121</u>	<u>97,850</u>
<b>Cash flows from investing activities</b>		
Purchases of property, plant and equipment	(72,555)	(61,696)
Proceeds from sales of property, plant and equipment	4,509	-
Purchases of investments	(199,816)	(108,386)
Sales of investments	157,637	95,314
Contribution to equity investment	(10,494)	(13,281)
Net cash and cash equivalents used in investing activities	<u>(120,719)</u>	<u>(88,049)</u>
<b>Cash flows from financing activities</b>		
Payments of long-term debt	(3,265)	(6,631)
Proceeds from restricted contributions	6,557	8,346
Payments on capital lease obligations	(331)	(967)
Net cash and cash equivalents provided by (used in) financing activities	<u>2,961</u>	<u>748</u>
(Decrease) increase in cash and cash equivalents	(27,637)	10,549
<b>Cash and cash equivalents</b>		
Beginning of year	<u>138,850</u>	<u>128,301</u>
End of year	<u>\$ 111,213</u>	<u>\$ 138,850</u>
<b>Supplemental disclosure of cash flow information</b>		
Cash paid for interest	\$ 23,662	\$ 24,868
Capital lease obligations for new equipment	-	521
Conveyance of land and buildings	-	45,400
Property, plant and equipment in accounts payable	4,908	4,616

The accompanying notes are an integral part of these consolidated financial statements.

# Children's National Medical Center and Subsidiaries

## Notes to Consolidated Financial Statements

### June 30, 2018 and 2017

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#### 1. Organization

The Children's National Medical Center's ("Children's National" or the "Medical Center") consolidated financial statements include the accounts of Children's Hospital (the "Hospital"); Children's Hospital Foundation (the "Foundation"); Children's National at Walter Reed, LLC ("CNWR"); Children's Research Institute ("CRI"); Safe Kids Worldwide ("Safe Kids"); Children's Pediatricians and Associates ("CP&A"); Children's National Health Network ("CNHN"); Children's National Advocacy and Public Policy, Inc. ("CNAPPI"); Children's School Services ("CSS"); and Bearacuda Reinsurance Company, Ltd. (the "Captive"); all referred to as the "Subsidiaries."

Children's National is a tax-exempt, nonstock corporation, which controls its subsidiary corporations through its authority to appoint the governing boards of the tax-exempt, nonstock subsidiaries or its stock ownership. Children's National and its subsidiaries provide health care services to infants, children, and youth in Washington, D.C., and the surrounding metropolitan area. The Hospital operates an acute care pediatric and teaching facility.

The Foundation supports and maintains the programs, services, and facilities of Children's National in part through solicitation, receipt, administration, and distribution of philanthropic gifts on behalf of its tax-exempt subsidiaries.

CNWR is a limited liability company organized for the purpose of holding certain real property conveyed by the United States Department of Defense to be used for public health purposes.

CRI is a research organization involved in providing services and support in connection with the delivery of health care services on behalf of the community.

Safe Kids is an organization involved in nonhospital pediatric health and safety activities.

CP&A is a limited liability corporation that operates for-profit physician practices. CP&A is owned 50% by Children's National and 50% by the Hospital.

CNHN is a for-profit physician hospital organization, of which Children's National is the sole shareholder.

CNAPPI is an organization involved in addressing the advocacy mission and community benefit activities of Children's National.

CSS is an organization that operates a school nurse program in the District of Columbia.

The Captive is a wholly owned captive insurance company established to assume general liability and malpractice risk for Children's National entities, effective August 1, 1997.

Children's National, Hospital, Foundation, CRI, Safe Kids, CNAPPI, and CSS are not-for-profit organizations that qualify under Section 501(c)(3) of the Internal Revenue Code, and are therefore, not subject to tax under current income tax regulations.

# Children's National Medical Center and Subsidiaries

## Notes to Consolidated Financial Statements

### June 30, 2018 and 2017

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## 2. Risk Factors

The Medical Center's ability to maintain or increase future revenues could be adversely impacted by: (1) future legislation, regulation, or other actions by federal, state, or District of Columbia agencies, which may impose requirements or continue the trend toward more restrictive limitations on reimbursement for hospital services; (2) future legislation or adverse trends affecting the costs related to professional liability coverage; (3) changes in general and local economic conditions including the financial condition of the District of Columbia, the State of Maryland and the State of Virginia; and (4) a potential shortage of qualified doctors and other skilled healthcare professionals in the local employment market.

## 3. Summary of Significant Accounting Policies

### Basis of Presentation

The accompanying consolidated financial statements have been prepared on the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America.

### Principles of Consolidation

The consolidated financial statements include the accounts of Children's National and all its subsidiaries after elimination of all significant intercompany accounts and transactions.

### Cash and Cash Equivalents

Cash equivalents include amounts invested in accounts with depository institutions which are readily convertible to cash, with original maturities of three months or less. Total deposits maintained at these institutions at times exceed the amount insured by federal agencies and therefore, bear a risk of loss. Children's National has not experienced such losses on these funds.

### Investments and Assets Whose Use is Limited

Children's National classifies investments as available for sale. Investments consist primarily of money market funds, government securities, equity securities (including common trust funds), and mutual funds that are considered other than trading securities and are reported at fair value. Investments that management does not consider necessary for current operations are classified as long-term.

Investments in companies in which Children's National does not have control, but has the ability to exercise significant influence over operating and financial policies are accounted for under the equity method of accounting and operating results are recorded within investment income on the Consolidated Statements of Operations. Dividends received are recorded as a reduction of the carrying amount of the investment.

Assets whose use is limited include resources restricted under professional liability arrangements.

### Investment Income

Investment income or loss (including interest and dividends, net of investment management fees; realized gains and losses on investments; and any provision for other-than-temporary losses on impairment of investments) is reported as non-operating revenue and is included in excess of revenue over expenses unless the income or loss is restricted by donor or law. Unrealized gains and losses on investments, if any, are excluded from excess of revenues over expenses, unless the losses are deemed to be other-than-temporary.

# Children's National Medical Center and Subsidiaries

## Notes to Consolidated Financial Statements

### June 30, 2018 and 2017

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The Medical Center periodically evaluates whether any declines in the fair value of investments are other-than-temporary. This evaluation consists of a review of several factors, including, but not limited to: length of time and extent that a security has been in an unrealized loss position, the existence of an event that would impair the issuer's future earnings potential, the near-term prospects for recovery of the market value of a security, and the intent and ability of the Medical Center to hold the security until the market value recovers. Declines in fair value below cost that are deemed to be other-than-temporary losses are included in non-operating revenues and expenses in the accompanying Consolidated Statements of Operations. Investments are principally uninsured and subject to normal credit risk.

#### **Income Taxes**

The Medical Center is a not-for-profit corporation as described in Section 501(c)(3) of the Internal Revenue Code and is exempt from federal income taxes on related income pursuant to Section 501(a) of the Code. On such basis, the exempt entities will not incur any liability for federal income taxes, except for possible unrelated business income.

The Financial Accounting Standards Board's ("FASB") guidance on accounting for uncertainty in income taxes clarifies the accounting for uncertainty of income tax positions. The guidance defines the threshold for recognizing tax return positions in the consolidated financial statements as "more likely than not" that the position is sustainable, based on technical merits.

The Medical Center evaluates uncertain tax positions using a two-step approach for recognizing and measuring tax benefits taken or expected to be taken in an unrelated business activity tax return and disclosures regarding uncertainties in tax positions. There was no impact on the Medical Center's consolidated financial statements during the years ended June 30, 2018 and 2017 as the Medical Center has no uncertain tax positions.

#### **Accounts Receivable**

Accounts receivable for patient services consist of amounts due directly from patients or patients' third-party payors such as insurance companies, managed care programs, and Medicaid programs for services rendered. Provision for uncollectible accounts in the accompanying Consolidated Statements of Operations is shown net of recoveries on amounts previously written off. The allowance for uncollectible accounts is estimated based on prior experience and management's judgment and is, therefore, susceptible to change.

The provision for bad debts is based upon a combination of the payor source, the aging of receivables and management's assessment of historical and expected net collections, trends in health insurance coverage, and other collection indicators.

Management continuously assesses the adequacy of the allowance for uncollectible accounts based upon historical write-off experience and payment trends by payor classification.

#### **Inventories of Supplies**

Inventories generally consist of medical and nonmedical supplies, and are stated at the lower of cost or market, using the first-in, first-out method. The total inventory balance was \$13.4 million and \$9.4 million at June 30, 2018 and 2017, respectively.

#### **Contributions Receivable**

Unconditional promises to give cash and other assets are reported at fair value as contributions receivable at the date the promise is received. Conditional promises to give and indications of intentions to give are reported at fair value at the date the promise becomes unconditional. As of

# Children's National Medical Center and Subsidiaries

## Notes to Consolidated Financial Statements

### June 30, 2018 and 2017

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June 30, 2018 and 2017, conditional promises to give amounted to \$4.5 million and \$5.0 million, respectively. These promises are subject to annual donor approved and are restricted. Amounts due are recorded at the net realizable value discounted using a rate of return that a market participant would expect to receive over the payment period at the date the pledge is received. An allowance for uncollectible pledges is recorded for pledges which may become uncollectible in future periods. Amounts deemed to be uncollectible have been written off. The contributions receivable balance is based on management's best estimate of the amounts expected to be collected. The amounts Children's National will ultimately realize could differ from the amounts assumed in arriving at the present value and allowance for doubtful accounts.

The gifts are reported as temporarily and permanently restricted support 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 when the purpose of the restriction is accomplished, temporarily restricted net assets are reclassified as unrestricted net assets and are reported in the Consolidated Statements of Operations as net assets released from restrictions used for operations or used for construction and purchase of property and equipment.

#### **New Accounting Pronouncements**

In May 2014, the FASB issued Accounting Standards Update ("ASU") 2014-09—*Revenue from Contracts with Customers*. This standard implements a single framework for recognition of all revenue earned from customers. This framework ensures that entities appropriately reflect the consideration to which they expect to be entitled in exchange for goods and services by allocating transaction price to identified performance obligations and recognizing revenue as performance obligations are satisfied. Qualitative and quantitative disclosures are required to enable users of financial statements to understand the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. The standard is effective for fiscal years beginning after December 15, 2017.

In January 2016, the FASB issued ASU 2016-01, *Financial Instruments-Overall: Recognition and Measurement of Financial Assets and Financial Liabilities*. ASU 2016-01 addresses accounting for equity investments, financial liabilities under the fair value option, and the presentation and disclosure requirements for financial instruments. Entities that are not considered public business entities will no longer be required to disclose the fair value of financial instruments carried at amortized cost. The amendments in ASU 2016-01 are effective for years beginning after December 15, 2018, and early adoption is permitted. Children's National early adopted the provisions of this standard for the fiscal year ended June 30, 2016 that no longer requires disclosure of the fair value of financial instruments carried at amortized cost. Children's National is evaluating the impact the remaining guidance will have on the consolidated financial statements beginning in fiscal year 2020.

In February 2016, the FASB issued ASU 2016-02, *Leases*. The new standard establishes a right-of-use ("ROU") model that requires a lessee to record a ROU asset and a lease liability on the balance sheet for all leases with terms longer than 12 months. Leases will be classified as either finance or operating, with classification affecting the pattern of expense recognition in the income statement. ASU 2016-02 is effective for annual periods beginning after December 15, 2018, including interim periods within those annual periods, with early adoption permitted. Children's National is evaluating the impact this standard will have on the consolidated financial statements and disclosures beginning in fiscal year 2020.

# Children's National Medical Center and Subsidiaries

## Notes to Consolidated Financial Statements

### June 30, 2018 and 2017

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In August 2016, the FASB issued ASU 2016-14, *Presentation of Financial Statements for Not-for-Profit Entities*. The new guidance requires improved presentation and disclosures to help not-for-profits provide more relevant information about their resources to donors, grantors, creditors and other users. The standard is effective for fiscal years beginning after December 15, 2017.

In August 2016, the FASB issued ASU 2016-15, *Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments*, which adds or clarifies guidance on the classification of certain cash receipts and payments in the statement of cash flows with the intent to alleviate diversity in practice. The update is effective for fiscal years beginning after December 15, 2018, with early adoption permitted. Children's National is currently evaluating the impact of this update on the Consolidated Statements of Cash Flows beginning in fiscal year 2020.

In November 2016, the FASB issued ASU 2016-18, *Statement of Cash Flows (Topic 230): Restricted Cash*, which clarifies the classification and presentation of changes in restricted cash in the statement of cash flows. The guidance requires reporting entities to explain the changes in the consolidated total of restricted and unrestricted cash and cash equivalent balances in the statement of cash flows. The update is effective for fiscal years beginning after December 15, 2018, with early adoption permitted. Children's National is currently evaluating the impact of this update on the Consolidated Statements of Cash Flows beginning in fiscal year 2020.

In June 2018, the FASB issued ASU 2018-08, "Not-for-Profit Entities (Topic 958), Clarifying the Scope and the Accounting Guidance for Contributions Received and Contributions Made". The new standard applies to all entities that receive or make contributions. The guidance clarifies the definition of transactions accounted for as an exchange transaction subject to ASU 2014-09 or other applicable guidance and transactions that should be accounted for as contributions (non-exchange) subject to the contribution accounting model. Further, the guidance provides criteria for evaluating whether contributions are unconditional or conditional. Conditional contributions must specify a barrier that the recipient must overcome and a right of return that releases the donor from its obligation if the barrier is not achieved, otherwise the contribution is unconditional. The update is effective for fiscal years beginning after June 15, 2018, with early adoption permitted.

#### **Property and Equipment**

Property and equipment acquisitions are recorded at cost. Depreciation expense on the Medical Center's property and equipment is recorded using the straight-line method, which allocates the cost of the tangible property equally over the estimated useful lives, beginning with the date the asset is placed in service:

Buildings	30 - 40 years
Building improvements	9 - 20 years
Fixed equipment	10 - 15 years
Movable equipment	3 - 20 years

Equipment under capital lease obligations is amortized on the straight-line method over the shorter period of the lease term or the estimated useful life of the asset. Such amortization is included in depreciation and amortization in the Consolidated Statements of Operations. 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, net of any income earned. Repairs and maintenance are expensed as incurred. When property, plant and equipment are retired, sold or otherwise disposed of, the asset's carrying amount and related accumulated depreciation are removed from the accounts and any gain or loss is included in non-operating revenues and expenses.

# Children's National Medical Center and Subsidiaries

## Notes to Consolidated Financial Statements

### June 30, 2018 and 2017

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#### **Deferred Financing Costs**

Financing costs incurred in connection with the issuance of long-term debt are deferred and amortized using the straight line method, which approximates the effective interest rate method, over the period of time the debt is outstanding. Deferred financing costs are recorded in long-term debt on the Consolidated Balance Sheets. The amortization expense was approximately \$185.4 thousand and \$202.0 thousand for the years ended June 30, 2018 and 2017, respectively.

#### **Impairment of Long-Lived Assets**

Long-lived assets are reviewed for impairment when events and circumstances indicate that the carrying amount of an asset may not be recoverable. Children's National's policy is to record an impairment loss when it is determined that the carrying amount of the asset exceeds the sum of the expected undiscounted future cash flows resulting from the use of the asset and its eventual disposition. Impairment losses are measured as the amount by which the carrying amount of the asset exceeds its fair value. Long-lived assets to be disposed of are reported at the lower of the carrying amount or fair value less cost to sell. There were no impairment of long-lived assets for the years ended June 30, 2018 and 2017.

#### **Interest in Beneficial Trusts**

The Medical Center also receives contributions in the form of irrevocable split-interest agreements. These agreements include charitable remainder trusts, charitable gift annuities and perpetual trusts. In all of these agreements, the Medical Center has an interest in the trust but is not the trustee. When the trust's obligations to all beneficiaries expire, the remaining assets revert to the Medical Center to be used according to the donor's wishes.

#### **Other Long-Term Liabilities**

The Medical Center entered into a favorable cash deferral contact with Cerner, Inc. ("Cerner") related to expenses associated with the Bear Institute in September 2013. The Bear Institute is a purchased services information technology agreement where Cerner manages IT functionality for operational services and capital equipment acquisitions. As an incentive, the cash flows for the agreement are significantly deferred towards the latter portion of the seven-year agreement. The liability due to Cerner under this arrangement was \$12.2 million and \$15.0 million as of June 30, 2018 and 2017, respectively and is recorded in other long-term liabilities.

#### **Deferred Compensation Plan**

The Medical Center maintains a deferred compensation plan for certain employees. As of June 30, 2018 and 2017, deferred compensation investments of \$22.8 million and \$20.8 million, respectively, included in other assets on the consolidated balance sheets, represent investments held by the Medical Center under these deferred compensation agreements. Such amounts approximate the Medical Center's related liability to the employees and are included in other long-term liabilities.

#### **Grants**

Children's National and its subsidiaries receive various grants from Federal agencies and District of Columbia agencies for the purpose of furthering its mission of providing acute pediatric care, research and education. Grants are recognized as revenue and the related project costs are recorded as expenses when services related to grants are incurred. Cash received where related costs have not been incurred are shown as deferred grant revenue and is included within deferred revenue on the Consolidated Balance Sheets.

**Children’s National Medical Center and Subsidiaries**  
**Notes to Consolidated Financial Statements**  
**June 30, 2018 and 2017**

**Interest Rate Swaps**

The value of the interest rate swap agreements entered into by Children’s National is adjusted to fair value monthly at the close of each accounting period based upon quotations from market makers. The change in fair value, if any, is recorded in the Consolidated Statements of Operations. Entering into interest rate swap agreements involves, to varying degrees, elements of credit, default, prepayment, market and documentation risk in excess of the amounts recognized on the Consolidated Balance Sheets. Such risks involve the possibility that there will be no liquid market for these agreements, the counterparty to these agreements may default on its obligation to perform and there may be unfavorable changes in interest rates.

**Temporarily and Permanently Restricted Net Assets**

Temporarily restricted net assets are those whose use by the Medical Center has been limited by donors to a specific time period or purpose, including federal appropriations restricted for capital improvements. Permanently restricted net assets have been restricted by donors to be maintained by the Medical Center in perpetuity.

**Net Patient Service Revenue**

The Medical Center has agreements with third-party payors that provide for payments to the Medical Center at amounts different from its established rates. Payment arrangements include prospectively determined rates per discharge, reimbursed cost, discounted charges, and per diem payments. Hospital physicians are paid principally on a contracted fee schedule. Contractual adjustments to patient service revenue were \$1.43 billion and \$1.33 billion for the years ended June 30, 2018 and 2017, respectively.

*(in thousands)*

	<b>June 30, 2018</b>		
	<b>Third-Party Payors</b>	<b>Self-Pay</b>	<b>Total All Payors</b>
Patient service revenue (net of contractual allowances and discounts)	<u>\$ 1,041,462</u>	<u>\$ 37,865</u>	<u>\$ 1,079,327</u>

*(in thousands)*

	<b>June 30, 2017</b>		
	<b>Third-Party Payors</b>	<b>Self-Pay</b>	<b>Total All Payors</b>
Patient service revenue (net of contractual allowances and discounts)	<u>\$ 1,000,649</u>	<u>\$ 39,048</u>	<u>\$ 1,039,697</u>

Approximately 54% of gross patient service revenues were from Medicaid and Medicaid managed care programs in 2018 and 2017. Total reimbursements received for Graduate Medical Education (“GME”) were \$12.8 million in 2018 and \$11.7 million in 2017. Federal GME is subject to appropriation each year.

Inpatient and outpatient services, defined capital and medical education costs related to beneficiaries are paid using a cost reimbursement methodology for Medicare and the Fee-for-Service Medicaid programs. These services are paid prospectively for DC Medicaid and Maryland Medicaid. For cost reimbursable items, Children’s National is reimbursed at a tentative rate with final settlement determined after submission of the annual cost reports by Children’s National and

# Children's National Medical Center and Subsidiaries

## Notes to Consolidated Financial Statements

### June 30, 2018 and 2017

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audits thereof by the fiscal intermediary. Children's National cost reports have been audited and settled by the Medicare intermediary through 2016 for all facilities. The Virginia Medicaid cost report is settled annually and is settled through 2017.

#### **Charity Care**

The Medical Center, in keeping with its mission and philosophy to extend quality care and compassionate service, recognizes that some patients are unable to compensate the Medical Center for their treatment either through third party coverage or their own resources. Accordingly, the Medical Center extends charity or free care to those patients who do not have the ability to meet their obligations. The Medical Center provides free care based on federal poverty income guidelines or when it is determined that the patients are unable to fulfill their obligations to the Medical Center. The Medical Center also provides assistance in helping patients obtain third party coverage through state Medicaid programs. Because the Medical Center does not pursue collections of amounts determined to qualify as charity care, they are not reported as revenue. Direct and indirect costs for these services amounted to \$5.8 million and \$8.7 million for the years ended June 30, 2018 and 2017, respectively. The costs of providing charity care services are based on a calculation which applies a ratio of costs to charges to the gross uncompensated charges associated with providing care to charity patients. The ratio of cost to charge is calculated based on the Medical Center's total operating expenses divided by gross patient service revenue.

In addition to direct charity care, the Medical Center is committed to improving the health and well-being of children in the Washington, D.C., metropolitan area. Through programs of clinical intervention, community awareness, education and advocacy, the Medical Center strives to address the many challenges facing children and families today. Examples of programs addressing these challenges are the Community Pediatric Health Care Centers, school nursing services for District of Columbia Public Schools and District of Columbia Public Chartered Schools, Division of Child Protection, Children's Healthy Schools/President's Challenge Program, and services provided to children with AIDS.

#### **Excess of Revenues Over Expenses**

The Consolidated Statements of Operations include excess of revenues over expenses. Changes in unrestricted net assets which are excluded from excess of revenues over expenses, consistent with industry practice, include, among other items, the change in unrealized gains on investments on other than trading securities and contributions released from restrictions for property and equipment.

#### **Use of Estimates**

The preparation of financial statements in accordance 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 disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during reporting period. Actual results could differ from these estimates. These significant estimates include, among others, the accounts receivable allowance for doubtful accounts, contractual allowances, estimated third-party payor settlements, investments, and accrued insurance costs.

#### **Accrued Vacation**

The Medical Center records a liability for amounts due to employees for future absences which are attributable to services performed in the current and prior period.

# Children's National Medical Center and Subsidiaries

## Notes to Consolidated Financial Statements

### June 30, 2018 and 2017

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#### **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.

#### **Medical Claims Reserve**

The Medical Center's medical claims reserve is an estimate of payments to be made for reported claims losses incurred but not reported. The estimate was developed using actuarial methods based upon historical data for payment patterns, cost trends, and other relevant factors.

The estimate is continually reviewed and adjusted as necessary as experience develops or new information becomes known; such adjustments are included in current operations.

#### **4. Fair Value Measurements**

The Medical Center follows the FASB's guidance on fair value measurements, which defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date, establishes a framework for measuring fair value, and expands disclosures about such fair value measurements. This guidance applies to other accounting pronouncements that require or permit fair value measurements and, accordingly, this guidance does not require any new fair value measurements.

The guidance discusses valuation techniques such as the market approach, cost approach and income approach. This guidance establishes a three-tier level hierarchy for fair value measurements based upon the transparency of inputs used to value an asset or liability as of the measurement date.

The three-tier hierarchy prioritizes the inputs used in measuring fair value as follows:

- Level 1      Observable inputs such as quoted market prices for identical assets or liabilities in active markets;
- Level 2      Observable inputs for similar assets or liabilities in an active market, or other than quoted prices in an active market that are observable either directly or indirectly; and
- Level 3      Unobservable inputs in which there is little or no market data that require the reporting entity to develop its own assumptions.

The financial instrument's categorization within the hierarchy is based upon the lowest level of input that is significant to the fair value measurement. Each of the financial instruments below has been valued utilizing the market approach.

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The following tables present the financial instruments carried at fair value grouped by hierarchy level (in thousands):

	<b>June 30, 2018</b>		
	<b>Quoted In Active Markets (Level 1)</b>	<b>Significant Other Observable Inputs (Level 2)</b>	<b>Total Fair Value</b>
<b>Assets</b>			
Investments			
Cash and cash equivalents	\$ 58,353	\$ -	\$ 58,353
Fixed income securities	257,691	40,228	297,919
Equity securities	394,172	8,028	402,200
Real estate investments	-	6,125	6,125
Total investments	<u>710,216</u>	<u>54,381</u>	<u>764,597</u>
Deferred compensation money market funds	1,255	-	1,255
Deferred compensation mutual funds	20,828	-	20,828
Beneficial interests held by 3rd party	-	830	830
Perpetual trusts held by 3rd party	-	7,527	7,527
Total assets at fair value	<u>\$ 732,299</u>	<u>\$ 62,738</u>	<u>\$ 795,037</u>
<b>Liabilities</b>			
Deferred compensation liability	\$ -	\$ 22,083	\$ 22,083
Interest rate swaps	-	19,116	19,116
Total liabilities at fair value	<u>\$ -</u>	<u>\$ 41,199</u>	<u>\$ 41,199</u>
	<b>June 30, 2017</b>		
	<b>Quoted Prices In Active Markets (Level 1)</b>	<b>Significant Other Observable Inputs (Level 2)</b>	<b>Total Fair Value</b>
<b>Assets</b>			
Investments			
Cash and cash equivalents	\$ 85,822	\$ -	\$ 85,822
Fixed income securities	235,721	13,377	249,098
Equity securities	355,714	41	355,755
Real estate investments	-	6,125	6,125
Total investments	<u>677,257</u>	<u>19,543</u>	<u>696,800</u>
Deferred compensation money market funds	1,147	-	1,147
Deferred compensation mutual funds	19,679	-	19,679
Beneficial interests held by 3rd party	-	916	916
Perpetual trusts held by 3rd party	-	7,268	7,268
Total assets at fair value	<u>\$ 698,083</u>	<u>\$ 27,727</u>	<u>\$ 725,810</u>
<b>Liabilities</b>			
Deferred compensation liability	\$ -	\$ 20,826	\$ 20,826
Interest rate swaps	-	27,209	27,209
Total liabilities at fair value	<u>\$ -</u>	<u>\$ 48,035</u>	<u>\$ 48,035</u>

# Children's National Medical Center and Subsidiaries

## Notes to Consolidated Financial Statements

### June 30, 2018 and 2017

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During 2018 and 2017, there were no transfers between Levels 1 and 2.

Following is a description of the Children's National valuation methodologies for assets and liabilities measured at fair value.

Fair value for Level 1 is based upon quoted prices in active markets that Children's National has the ability to access for identical assets and liabilities. Market price data is generally obtained from exchange or dealer markets. Children's National does not adjust the quoted price for such assets and liabilities. Level 1 investments include cash and cash equivalents including money market accounts, fixed income and equity securities and mutual funds that are traded in an active exchange market.

Fair value for Level 2 is based on quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active and model-based valuation techniques for which all significant assumptions are observable in the market or can be corroborated by observable market data for substantially the full term of the assets. Inputs are obtained from various sources including market participants, dealers, and brokers. Level 2 investments include certain equity mutual funds, real estate investments, corporate bond funds, US government obligations, and federal agency obligations.

Interest rate swaps are valued using both observable and unobservable inputs, such as quotations received from the counterparty, dealers or brokers, whenever available and considered reliable. In instances where models are used, the value of the interest rate swap depends upon the contractual terms of, and specific risks inherent in, the instrument as well as the availability and reliability of observable inputs. Such inputs include market prices for reference securities, yield curves, credit curves, measures of volatility, prepayment rates, assumptions for nonperformance risk, and correlations of such inputs. The interest rate swap arrangements have inputs which can generally be corroborated by market data and are therefore classified within Level 2.

The fair value of the obligations under deferred compensation agreements approximates the fair value of the other investment assets, which are determined using quoted market prices. These assets are comprised of mutual funds and money market funds.

The methods described above may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, while Children's National believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different estimate of fair value at the reporting date.

**Children’s National Medical Center and Subsidiaries**  
**Notes to Consolidated Financial Statements**  
**June 30, 2018 and 2017**

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**5. Property and Equipment**

The components of property and equipment as of June 30 are summarized below:

<i>(in thousands)</i>	<b>2018</b>	<b>2017</b>
Land	\$ 12,042	\$ 13,341
Buildings and building improvements	948,848	901,690
Fixed and movable equipment	<u>254,363</u>	<u>226,212</u>
	1,215,253	1,141,243
Less: Accumulated depreciation	<u>(738,457)</u>	<u>(687,248)</u>
	476,796	453,995
Construction in progress	<u>89,126</u>	<u>100,142</u>
Property and equipment, net	<u>\$ 565,922</u>	<u>\$ 554,137</u>

Depreciation expense for the years ended June 30, 2018 and 2017 amounted to \$58.8 million and \$62.2 million, respectively.

In November 2016, the federal government conveyed through quitclaim deed, certain land and buildings to CNWR to be used for the protection of public health, including research. The property, which was recorded as Conveyance of Property within the Consolidated Statement of Changes in Net Assets at fair market value during the year ended June 30, 2017, consisted of land and buildings valued at \$11.9 million and \$33.5 million, respectively. The buildings are recorded in construction in progress at June 30, 2017. In connection with this transaction, CNWR recorded an environmental retirement obligation of \$4.8 million.

During the year ended June 30, 2018, Children’s National retired \$7.6 million of fully depreciated long-lived assets determined to have no future value. Additionally, during 2018 Children’s National sold land and property with a net book value of \$2.2 million for cash proceeds of \$4.5 million, resulting in a gain on sale of \$2.3 million. There were no retirements in 2017.

**Children's National Medical Center and Subsidiaries**  
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**June 30, 2018 and 2017**

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**6. Contributions Receivable**

Unconditional promises to give as of June 30 were as follows:

<i>(in thousands)</i>	<b>2018</b>	<b>2017</b>
Less than one year	\$ 61,662	\$ 33,959
One to five years	44,628	27,319
More than five years	<u>22,640</u>	<u>11,280</u>
	128,930	72,558
Less: Discount	(6,406)	(4,277)
Allowance for uncollectible contributions	<u>(1,711)</u>	<u>(1,047)</u>
Contribution receivable, net	<u>\$ 120,813</u>	<u>\$ 67,234</u>

Contributions receivable greater than one year in time are discounted using a rate of return that a market participant would expect to receive over the period at the date the pledge is received. The discount rate used is commensurate with the risk involved and ranges from 0.5% and 6.75% based on the date the pledge is made.

**Children's National Medical Center and Subsidiaries**  
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**7. Investments and Assets Whose Use is Limited**

The composition and fair values of investments and assets whose use is limited, as reported on the accompanying Consolidated Balance Sheets, at June 30 is as follows:

<i>(in thousands)</i>	<b>2018</b>		<b>2017</b>	
	<b>Cost</b>	<b>Carrying Value</b>	<b>Cost</b>	<b>Carrying Value</b>
Limited for professional liability claims				
Cash and cash equivalents	\$ 397	\$ 397	\$ -	\$ -
Fixed income securities	14,520	14,083	16,135	17,035
Equity securities	9,053	9,255	7,733	9,191
Total funded professional liability	<u>\$ 23,970</u>	<u>\$ 23,735</u>	<u>\$ 23,868</u>	<u>\$ 26,226</u>
Investments				
Cash and cash equivalents	\$ 57,956	\$ 57,956	\$ 85,823	\$ 85,822
Fixed income securities	290,328	283,836	229,986	232,063
Equity securities	249,143	392,945	227,279	346,564
Equity method investments	53,262	6,100	42,768	6,155
Real Estate Investments	-	6,125	-	6,125
Total Investments	<u>\$ 650,689</u>	<u>\$ 746,962</u>	<u>\$ 585,856</u>	<u>\$ 676,729</u>
Interest in Beneficial Trusts				
Beneficial interests held by 3rd party	\$ -	\$ 830	\$ -	\$ 916
Perpetual trusts held by 3rd party	-	7,527	-	7,268
Total interest and beneficial trusts	<u>\$ -</u>	<u>\$ 8,357</u>	<u>\$ -</u>	<u>\$ 8,184</u>

Investments included approximately \$223.7 million and \$222.3 million at June 30, 2018 and 2017, respectively, which is restricted by donors for specific programs or for capital improvements.

Investment returns consisted of the following:

<i>(in thousands)</i>	<b>June 30, 2018</b>			
	<b>Unrestricted</b>	<b>Temporarily Restricted</b>	<b>Permanently Restricted</b>	<b>Total</b>
Dividends and interest income	\$ 14,056	\$ 4,458	\$ 40	\$ 18,554
Loss on equity method investments	(10,549)	-	-	(10,549)
Realized gains	2,454	3,693	-	6,147
Investment income	5,961	8,151	40	14,152
Change in net unrealized gains on investments	12,822	6,475	174	19,471
Total investment returns	<u>\$ 18,783</u>	<u>\$ 14,626</u>	<u>\$ 214</u>	<u>\$ 33,623</u>

**Children's National Medical Center and Subsidiaries**  
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(in thousands)

	June 30, 2017			
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Dividends and interest income	\$ 11,200	\$ 3,347	\$ 506	\$ 15,053
Loss on equity method investments	(10,535)	-	-	(10,535)
Realized gains (losses)	<u>2,295</u>	<u>28</u>	<u>(28)</u>	<u>2,295</u>
Investment income	2,960	3,375	478	6,813
Change in net unrealized gains/(loss) on investments	<u>27,503</u>	<u>14,854</u>	<u>(296)</u>	<u>42,061</u>
Total investment returns	<u>\$ 30,463</u>	<u>\$ 18,229</u>	<u>\$ 182</u>	<u>\$ 48,874</u>

Realized gains and losses are calculated by comparing proceeds upon sale of an investment to its original cost, or its cost less any adjustment recorded for other-than-temporary loss on investments where applicable. The change in unrealized gains or losses on investments reflects the increase or decrease during the period in the difference between the fair value and the carrying amount of securities.

The following tables show the gross unrealized losses and fair values of Children's National's investments and assets whose use is limited with unrealized losses that are not deemed to be other-than-temporarily impaired, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position:

(in thousands)

As of June 30, 2018	Less Than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Fixed Income	\$ 8,397	\$ (365)	\$ 249,293	\$ (5,315)	\$ 257,690	\$ (5,680)
Equities	-	-	-	-	-	-
	<u>\$ 8,397</u>	<u>\$ (365)</u>	<u>\$ 249,293</u>	<u>\$ (5,315)</u>	<u>\$ 257,690</u>	<u>\$ (5,680)</u>

(in thousands)

As of June 30, 2017	Less Than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Fixed Income	\$ 208,830	\$ (1,676)	\$ 97	\$ (1)	\$ 208,927	\$ (1,677)
Equities	-	-	-	-	-	-
	<u>\$ 208,830</u>	<u>\$ (1,676)</u>	<u>\$ 97</u>	<u>\$ (1)</u>	<u>\$ 208,927</u>	<u>\$ (1,677)</u>

**Children’s National Medical Center and Subsidiaries**  
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There were 11 and 7 investment positions in an unrealized loss position as of June 30, 2018 and 2017, respectively. The contractual terms of those investments do not permit the issuer to settle the securities at a price less than the amortized cost of the investment. For the debt securities in an unrealized loss position, Children’s National does not consider these investments to be other-than-temporarily impaired as of June 30, 2018 and 2017. The equities are invested in broad based index funds and have fluctuated from an unrealized gain and loss position since the acquisition and based on management’s impairment policy, Children’s National does not consider these investments to be other-than-temporarily impaired as of June 30, 2018 and 2017.

In October of 2013, Children’s National and Inova Health Care Services (“Inova”) partnered in a joint venture to create Pediatric Specialists of Virginia (“PSV”). PSV is a Virginia limited liability company which provides high-quality pediatric specialty care to the children of Northern Virginia through clinical excellence, innovation, education, research, and family-centered care. Children’s National has a 50% investment in PSV, and it is accounted for under the equity method. Inova owns the remaining 50% of PSV.

PSV is governed by an eight-member Management Committee of which Children’s National has four members. Any action by the Management Committee must be approved by a majority of the members, provided that it includes an affirmative vote by both one Inova representative and one Children’s National representative.

Children’s National’s investment in PSV was \$6.1 million and \$6.2 million as of June 30, 2018 and 2017, respectively. Children’s National’s contributions to PSV during fiscal year 2018 included \$10.5 million of cash contributions while fiscal year 2017 included \$13.3 million of cash contributions. Children’s National’s share of losses from PSV as of June 30, 2018 and 2017, were \$10.5 million and are included within investment income in the Consolidated Statements of Operations.

The total assets, liabilities, and members’ equity as of June 30, 2018 and 2017 and the total revenue, total expenses and net loss for the years then ended for PSV are as follows:

<i>(in thousands)</i>	<b>2018</b>	<b>2017</b>
Total assets	\$ 20,604	\$ 21,117
Total liabilities	8,466	8,809
Members’ equity	12,138	12,308
Total revenue	32,663	26,027
Total expenses	54,114	47,661
Net loss	(21,451)	(21,634)

**8. Derivative Instruments**

In October 2002, the Hospital entered into interest rate swap agreements in conjunction with the restructuring of its Series A tax-exempt bonds. The swaps were intended to protect the Hospital from increased debt service costs resulting from anticipated future increases in market interest rates.

The Medical Center recognizes their derivatives instruments as either assets or liabilities in the Consolidated Balance Sheets at fair value in accordance with relevant accounting guidance. The total notional amount of the 2002 interest rate swap agreement was \$7.6 million and \$11.1 million, respectively, as of June 30, 2018 and 2017. As of June 30, 2018 and 2017, the fair value of the

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2002 swap was \$57.0 thousand and \$0.2 million, respectively, and is included with other noncurrent liabilities in the accompanying Consolidated Balance Sheets. In 2018 and 2017, the change in fair value of the 2002 swap was \$0.2 million and \$0.4 million, respectively, and is recorded as part of non-operating revenues and expenses in the accompanying Consolidated Statements of Operations.

In October 2005, the Hospital entered into an interest rate swap agreement (the 2005 swap) in conjunction with the issuance of \$150 million in Series 2005-1, 2005-2 and 2005-3 tax-exempt bonds. The swap agreement hedged the variability of cash flows related to changes in market interest rates on the underlying variable-rate debt, effectively converting the variable-rate debt to a fixed rate issuance for the life of the debt outstanding. On April 9, 2008, the Hospital exercised its option to convert the interest rate on the Series 2005 bonds from the auction rate to a fixed rate of 5.45%. The Hospital continues to hold the 2005 swap. The total notional amount of the 2005 interest rate swap agreement was \$135.6 million and \$137.5 million as of June 30, 2018 and 2017. As of June 30, 2018 and 2017, the fair value of the 2005 swap was \$19.0 million and \$27.0 million, respectively, and is included in other noncurrent liabilities in the accompanying Consolidated Balance Sheets. The change in fair value on the 2005 swap was \$7.9 million and \$12.4 million for the years ended June 30, 2018 and 2017 respectively, and is recorded as part of non-operating revenues and expenses in the accompanying Consolidated Statements of Operations.

The total derivative interest expense was \$3.6 million and \$4.5 million for the years ended June 30, 2018 and 2017, respectively.

**9. Debt**

As of June 30, long-term debt consisted of the following:

<i>(in thousands)</i>	<b>2018</b>	<b>2017</b>
Series 2015 bonds maturity between July 15, 2017 and July 15, 2044, interest rates ranging from 4.00% to 5.00%	\$ 364,280	\$ 367,480
Loan payable to Bank of America	75,000	75,000
Loan payable to Cerner	40	105
Total debt	439,320	442,585
Add/Less: Unamortized premiums and debt issuance costs	27,244	29,725
	466,564	472,310
Less: Current portion	(5,911)	(5,866)
Total long-term debt	\$ 460,653	\$ 466,444

**Series 2015 Bonds**

In September 2015, the Children’s National Obligated Group (“Obligated Group”) borrowed from the District of Columbia (the “District”) the proceeds of a series of tax exempt revenue refunding bonds (“Series 2015 Bonds”) issued by the District in the principal amount of \$374.0 million. The Obligated Group consists of Children’s Hospital, CNWR (joined September 2016), and the Foundation. The Series 2015 Bonds were sold at a premium of \$39.8 million which is being amortized using the effective interest method. The proceeds were used to advance refund the outstanding Series 2008 and Series 2005 Bonds and pay the cost of issuance associated with the

# Children's National Medical Center and Subsidiaries

## Notes to Consolidated Financial Statements

### June 30, 2018 and 2017

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Series 2015 Bonds. The Series 2005 Bonds and the Series 2008 Bonds (\$139.5 million and \$248.6 million outstanding as of the advance refunding date, respectively) were issued or refinanced as tax-exempt revenue bonds with fixed interest rates and a final maturity date of July 2035 and July 2044, respectively. The Series 2005 Bonds and the Series 2008 Bonds each had a call provision where the bonds could not be redeemed until July 2018. On July 15, 2018 the bonds were redeemed for \$394.2 million, including interest.

The Series 2015 Bonds are comprised of four tranches:

- \$195,030,000 5.00% Serial Bonds due July 15, 2016 through July 15, 2035
- \$40,315,000 4.00% Term Bonds due July 15, 2040
- \$50,000,000 5.00% Term Bonds due July 15, 2040
- \$88,615,000 5.00% Term Bonds due July 15, 2044

The most restrictive covenants for the Series 2015 Bonds require the Obligated Group to maintain a minimum debt service coverage ratio of 1.5, days cash on hand of at least 90 days, and a debt to capitalization ratio of less than 60% at June 30, 2018.

#### **Series 2008 Bonds**

In April 2008, the District of Columbia issued \$250 million of Hospital Revenue bonds ("the Series 2008 Bonds"). The Obligated Group under the Series 2008 Bonds included the Hospital and the Foundation.

The proceeds of the sale of the Series 2008 Bonds were loaned by the District of Columbia to the Obligated Group pursuant to a loan agreement dated as of April 1, 2008. The proceeds, together with other available money, are being used in the aggregate to: (1) finance the cost of construction, renovation, equipping and furnishing certain health facilities owned by the Hospital, including, but not limited to (i) the completion of the East Wing Inpatient Tower; (ii) the expansion of Surgical Services into newly constructed space above the emergency and ambulance drive; (iii) the expansion, redesign and upgrade of the Diagnostic Imaging and Radiology Services Departments (iv) expansion of the Cardiology Outpatient Services, Gastroenterology Clinic and the Otolaryngology Clinic; (v) certain infrastructure upgrades at the Hospital, including parking enhancements; and (vi) certain related improvements to the Hospital; (2) funding, if necessary of any working capital costs, (3) funding any required debt service reserve fund or capitalized interest, and (4) paying certain costs of issuance, including any bond insurance or credit enhancement.

The Series 2008 Bonds were comprised of five tranches:

- \$3,680,000 5.25% Term Bonds due July 15, 2018
- \$3,990,000 4.75% Term Bonds due July 15, 2022
- \$11,315,000 5.00% Term Bonds due July 15, 2028
- \$76,250,000 5.25% Term Bonds due July 15, 2038
- \$154,765,000 5.25% Term Bonds due July 15, 2045

# Children's National Medical Center and Subsidiaries

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The Series 2008 Bonds were secured pursuant to an indenture of trust (the Indenture) between the District of Columbia and the Bank of New York. The bondholder held the security interest in gross receipts of the Obligated Group.

The Series 2008 Bonds were insured by Assured Guaranty Municipal Corporation. In September of 2015, the Series 2008 Bonds were advance refunded with the proceeds from the Series 2015 Bonds.

#### **Series 2005 Bonds**

In October 2005, the District of Columbia issued \$150 million of Hospital Revenue bonds in three Sub-Series 2005-1, 2005-2 and 2005-3 Bonds (collectively, "the Series 2005 Bonds"). The Obligated Group under the Series 2005 Bonds included the Hospital and the Foundation.

The proceeds of the sale of the Series 2005 Bonds were loaned by the District of Columbia to the Obligated Group pursuant to a loan agreement dated as of October 1, 2005. The proceeds, together with other available money, were being used in the aggregate to: (1) finance the cost of construction, renovation and equipping of improvements to the Hospital's facilities, (2) pay a portion of the interest accruing on the Series 2005 Bonds during construction, renovation and equipping of the project, (3) fund a debt service reserve fund for the Series 2005 Bonds, and (4) pay costs of issuing the Series 2005 Bonds, including the payment of the premium for the bond insurance policy.

The Series 2005 Bonds were comprised of three tranches:

- \$50,000,000 5.45% Bonds due July 15, 2035
- \$50,000,000 5.45% Bonds due July 15, 2035
- \$50,000,000 5.45% Bonds due July 15, 2035

The project consisted of financing and reimbursing the costs of the construction, renovation, and equipping of improvements to the Hospital's facilities including the completion of the East Addition Patient Care Tower and Main Hospital renovations (including renovation of the perioperative suite), erecting steel and shell for the sixth floor research addition, updating clinical information systems and information systems infrastructure, replacing and improving diagnostic imaging equipment, and purchasing other miscellaneous equipment.

The Series 2005 Bonds were secured pursuant to an indenture of trust (the Indenture) between the District of Columbia and the Bank of New York. The bondholder held the security interest in gross receipts of the Obligated Group.

The Series 2005 Bonds were insured by Assured Guaranty Municipal Corporation. In September of 2015, the Series 2005 Bonds were advance refunded with the proceeds from the Series 2015 Bonds.

**Children’s National Medical Center and Subsidiaries**  
**Notes to Consolidated Financial Statements**  
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**Bank of America Loan**

On March 15, 2013, the Hospital entered into a loan agreement with Bank of America (“BoA”) to borrow \$75 million. The Medical Center paid debt issuance cost of \$50 thousand in connection with the borrowing, which will be amortized to interest expense over the term of the loan. The proceeds from the borrowing will be used for general business purposes including increasing its cash reserve. In conjunction with the master borrowing agreement, BoA requires compliance with predetermined debt coverage ratios and minimum cash balance.

On June 26, 2017, the Hospital entered into an amended loan agreement with BoA and extended the maturity date of the loan to June 1, 2020. Interest payments of Libor plus 44 basis points are due on the first of each month and the principle must be repaid on the maturity date.

Maturities and sinking fund requirements of long-term debt outstanding for the next 5 years and thereafter as of June 30, 2018 were as follows:

*(in thousands)*

2019	\$ 3,290
2020	78,295
2021	7,505
2022	7,880
2023	8,275
Thereafter	<u>334,075</u>
	<u>\$ 439,320</u>

Total interest expense was \$20.8 million and \$22.1 million for the years ended June 30, 2018 and 2017, respectively. Cash paid for interest was \$23.7 million and \$24.9 million for the years ended June 30, 2018 and 2017, respectively, and includes capitalized interest for construction projects of \$0.4 million, net of investment income for the year ended June 30, 2018.

**10. Endowments**

Children’s National endowment consists of 126 individual donor restricted endowment funds and one board-designated endowment fund for a variety of purposes. In addition, contributions receivables, split interest agreements, and other net assets have been designated for Children’s National endowment.

**Children’s National Medical Center and Subsidiaries**  
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The Board of Trustees of Children’s National has interpreted the “Uniform Prudent Management of Institutional Funds Act” (“UPMIFA”) as requiring the preservation 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, Children’s National classifies as permanently restricted net assets, (a) the original value of 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. The remaining portion of the donor-restricted endowment fund that is not classified in permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by Children’s National in a manner consistent with the standard of prudence prescribed by UPMIFA. In accordance with UPMIFA, Children’s National considers the following factors in making a determination to appropriate or accumulate endowment funds:

- (1) The duration and preservation of the fund
- (2) The purposes of Children’s National and the donor restricted endowment fund
- (3) General economic conditions
- (4) The possible effect of inflation and deflation
- (5) The expected total return from income and the appreciation of investments
- (6) Other resources of Children’s National
- (7) The investment policies of Children’s National

Endowment net asset composition by type of fund as of June 30, 2018 and 2017:

*(in thousands)*

	<b>2018</b>			
	<b>Unrestricted</b>	<b>Temporarily Restricted</b>	<b>Permanently Restricted</b>	<b>Total</b>
Donor-restricted endowment funds	\$ -	\$ 42,382	\$ 146,896	\$ 189,278
Board-designated endowment funds	4	-	-	4
Total endowment funds	<u>\$ 4</u>	<u>\$ 42,382</u>	<u>\$ 146,896</u>	<u>\$ 189,282</u>

*(in thousands)*

	<b>2017</b>			
	<b>Unrestricted</b>	<b>Temporarily Restricted</b>	<b>Permanently Restricted</b>	<b>Total</b>
Donor-restricted endowment funds	\$ -	\$ 34,559	\$ 137,788	\$ 172,347
Board-designated endowment funds	4	-	-	4
Total endowment funds	<u>\$ 4</u>	<u>\$ 34,559</u>	<u>\$ 137,788</u>	<u>\$ 172,351</u>

**Children's National Medical Center and Subsidiaries**  
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Changes in endowment net assets for the years ended June 30 (in thousands) were as follows:

	<b>2018</b>			<b>Total</b>
	<b>Unrestricted</b>	<b>Temporarily Restricted</b>	<b>Permanently Restricted</b>	
<b>Endowment net assets, beginning of year</b>	\$ 4	\$ 34,559	\$ 137,788	\$ 172,351
Investment income	-	4,503	40	4,543
Net appreciation (realized and unrealized)	-	10,167	174	10,341
Total investment return	-	14,670	214	14,884
Redesignation of net assets	-	-	185	185
Gifts	-	-	8,709	8,709
Appropriation for expenditure	-	(6,847)	-	(6,847)
<b>Endowment net assets, end of year</b>	<b>\$ 4</b>	<b>\$ 42,382</b>	<b>\$ 146,896</b>	<b>\$ 189,282</b>

	<b>2017</b>			<b>Total</b>
	<b>Unrestricted</b>	<b>Temporarily Restricted</b>	<b>Permanently Restricted</b>	
<b>Endowment net assets, beginning of year</b>	\$ 4	\$ 22,794	\$ 133,148	\$ 155,946
Investment income	-	3,392	506	3,898
Net appreciation (realized and unrealized)	-	14,881	(324)	14,557
Total investment return	-	18,273	182	18,455
Redesignation and other changes in net assets	-	(147)	2,030	1,883
Gifts	-	-	2,428	2,428
Appropriation for expenditure	-	(6,361)	-	(6,361)
<b>Endowment net assets, end of year</b>	<b>\$ 4</b>	<b>\$ 34,559</b>	<b>\$ 137,788</b>	<b>\$ 172,351</b>

**Permanently Restricted Net Assets (Endowments Only)**

The portion of perpetual endowment funds that is required to be retained permanently either by explicit donor stipulation or by UPMIFA as of June 30:

<i>(in thousands)</i>	<b>2018</b>	<b>2017</b>
Patient care	\$ 53,630	\$ 48,393
Health-related education	6,346	5,561
Research	86,920	83,834
	<b>\$ 146,896</b>	<b>\$ 137,788</b>

**Children’s National Medical Center and Subsidiaries**  
**Notes to Consolidated Financial Statements**  
**June 30, 2018 and 2017**

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**Endowment Funds With Deficits**

From time to time, the fair value of assets associated with individual donor-restricted endowment funds may fall below the value of the initial and subsequent donor gift amounts (deficit). When donor endowment deficits exist, they are classified as a reduction of unrestricted net assets. There were no deficits in donor gift amounts as of June 30, 2018 and 2017.

**Return Objectives and Risk Parameters**

Children’s National has adopted endowment investment and spending policies that attempt to provide a predictable stream of funding to programs supported by its endowment while seeking to maintain the purchasing power of endowment assets. Under this policy, the return objective for the endowment assets, measured over a full market cycle, shall be to maximize the return against a blended index, based on the endowment’s target allocation applied to the appropriate individual benchmarks. Children’s National expects its endowment funds over time, to provide an average rate of return of approximately 5% annually. Actual returns in any given year may vary from this amount.

**Strategies Employed for Achieving Investment Objectives**

To achieve its long-term rate of return objectives, Children’s National relies on a total return strategy in which investment returns are achieved through both capital appreciation (realized and unrealized gains) and current yield (interest and dividends). Children’s National targets a diversified asset allocation that places greater emphasis on equity-based investments to achieve its long-term objectives within prudent risk constraints.

**Endowment Spending Allocation and Relationship of Spending Policy to Investment Objectives**

The Board of Trustees of Children’s National determines the method to be used to appropriate endowment funds for expenditure. Calculations were performed for individual endowment funds at a rate of 5% of the three-year rolling average using a monthly average over the most recent 36 months ending June 30<sup>th</sup>. The corresponding calculated spending allocations were distributed annually on the first day of the fiscal year from the current net total or accumulated net total investment returns for individual endowment funds. In establishing this policy, the Board considered the expected long term rate of return on its endowment. Accordingly, over the long term, Children’s National expects the current spending policy to allow its endowment to grow at between 3-8% annually, consistent with its intention to maintain the purchasing power of the endowment assets as well as to provide additional real growth through new gifts.

**11. Temporarily Restricted Net Assets**

Temporarily restricted net assets, consisting of cash, investments, and contributions receivable, were available for the following purposes at June 30:

<i>(in thousands)</i>	<b>2018</b>	<b>2017</b>
Patient care	\$ 141,733	\$ 104,183
Building expansion and equipment	2,776	7,591
Health-related education	6,497	8,157
Research	47,445	34,268
Charitable remainder trusts	830	916
	<u>\$ 199,281</u>	<u>\$ 155,115</u>

# Children's National Medical Center and Subsidiaries

## Notes to Consolidated Financial Statements

### June 30, 2018 and 2017

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#### 12. Insurance

The Medical Center self-insures for malpractice and general liability claims up to a retention limit and carries excess coverage above that limit. On August 1, 1997, the Medical Center established the Captive as a wholly owned captive insurance company to assume the retained portion of medical malpractice, employment, and general liability claims of the Medical Center arising on or after August 1, 1997. Cash transfers to the Captive are based on premium levels established by the Captive's management, as well as Cayman Islands statutory capital requirements.

The reserve for claims shown in the accompanying Consolidated Balance Sheets represent the reserve for asserted and unasserted malpractice and comprehensive general liability claims against the Medical Center and its affiliated physicians. The reserve for claims is estimated by management using information supplied by legal counsel and an independent actuarial firm. Malpractice and other claims in excess of the reserve for claims have been asserted against the Medical Center, and it is possible that actual claim liabilities could differ from estimated amounts in the near term. However, management and legal counsel do not believe that the ultimate cost of resolving asserted and unasserted claims related to events having occurred through June 30, 2018 are materially in excess of the reserve for claims and malpractice insurance coverage.

The Medical Center also self-insures for employee health and dental claims. In addition, the Medical Center has a deductible of \$500 thousand per occurrence for workers' compensation. Amounts accrued in the accompanying Consolidated Balance Sheets for the estimated cost of health and dental care claims incurred, including estimates for incurred but not reported amounts, was approximately \$4.5 million and \$4.3 million as of June 30, 2018 and 2017, respectively. Amounts accrued for workers compensation claims were approximately \$2.3 million and \$2.4 million as of June 30, 2018 and 2017, respectively.

#### 13. Benefit Plans

The Medical Center sponsors a defined contribution retirement plan that is available to substantially all employees. The Medical Center makes contributions to the plan on behalf of each participant based on the employee's level of contribution. The cost of the plan to the Medical Center was approximately \$22.4 million and \$20.3 million as of June 30, 2018 and 2017, respectively.

The Medical Center also has incentive compensation plans, based on achievement of organizational and individual goals, and deferred compensation arrangements. Assets and liabilities related to the deferred compensation arrangements are included in other noncurrent assets and other noncurrent liabilities in the accompanying Consolidated Balance Sheets in the amount of approximately \$27.4 million and \$25.9 million as of June 30, 2018 and 2017, respectively.

#### 14. Leases

The Medical Center operates certain property and equipment under capital leases and is obligated under several operating leases. The operating leases are primarily for the rental of space at auxiliary locations and for the use of certain office and lab equipment. Several of these leases contain escalation clauses, with fixed-rate increases ranging from 2% – 4%. The Medical Center has recorded a deferred rent liability of approximately \$6.0 million and \$5.5 million as of June 30, 2018 and 2017, respectively, which is included in deferred revenue in the accompanying Consolidated Balance Sheets.

**Children's National Medical Center and Subsidiaries**  
**Notes to Consolidated Financial Statements**  
**June 30, 2018 and 2017**

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Future minimum payments for the years ending June 30 are as follows:

<i>(in thousands)</i>	<b>Operating Leases</b>	<b>Capital Leases</b>
2019	\$18,869	\$1,171
2020	20,605	719
2021	21,448	749
2022	18,137	783
2023	15,598	806
2024 and thereafter	<u>134,450</u>	<u>5,872</u>
Total future minimum payments	229,107	10,100
Less: Amount representing interest	<u>-</u>	<u>(4,348)</u>
Present value of net minimum lease payments	<u>\$ 229,107</u>	<u>\$ 5,752</u>

As of June 30, 2018, the amount representing short term and long term interest is \$0.5 million and \$3.8 million, respectively.

Rent expense was \$21.5 million and \$17.8 million for the years ended June 30, 2018 and 2017, respectively.

Fixed assets under capital leases as of June 30 are as follows:

<i>(in thousands)</i>	<b>2018</b>	<b>2017</b>
Property and equipment under capital lease	\$ 30,956	\$ 30,361
Less: Accumulated depreciation	<u>(26,172)</u>	<u>(25,049)</u>
Property and equipment under capital leases, net	<u>\$ 4,784</u>	<u>\$ 5,312</u>

**15. Concentrations of Credit Risk**

The Medical Center grants credit without collateral to its patients, most of whom are local residents insured under third-party payor agreements. The mix of receivables was as follows:

	<b>2018</b>	<b>2017</b>
Managed Care/Commercial	46 %	47 %
Maryland Medicaid	24	26
District of Columbia Medicaid	12	14
Virginia Medicaid and other	17	12
Self-pay	<u>1</u>	<u>1</u>
	<u>100 %</u>	<u>100 %</u>

# Children's National Medical Center and Subsidiaries

## Notes to Consolidated Financial Statements

### June 30, 2018 and 2017

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#### 16. Functional Expenses

The Medical Center provides health care services to children both within and outside its geographical service area. Expenses related to providing these services for the years ending June 30 were as follows:

<i>(in thousands)</i>	<b>2018</b>	<b>2017</b>
Patient care	\$ 738,760	\$ 711,342
Research	63,827	56,323
Management and general	368,103	354,474
Fundraising	<u>27,408</u>	<u>24,362</u>
	<u>\$ 1,198,098</u>	<u>\$ 1,146,501</u>

#### 17. Commitments and Contingencies

The Medical Center is involved in litigation and regulatory investigations arising in the ordinary course of business. After consulting with legal counsel, management estimates that these matters will be resolved without material adverse effect on the Medical Center's future financial position or results from operations.

#### 18. Subsequent Events

Subsequent events have been evaluated by management through October 5, 2018 which is the date the consolidated financial statements were issued.

## **Supplementary Consolidating Information**



## Report of Independent Auditors

To the Board of Trustees of  
Children's National Medical Center and Subsidiaries:

We have audited the consolidated financial statements of Children's National Medical Center and Subsidiaries ("Children's National") as of June 30, 2018 and for the year then ended and our report thereon appears on page 1 of this document. That audit was conducted for the purpose of forming an opinion on the consolidated financial statements taken as a whole. The consolidating information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The consolidating information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves and other additional procedures, in accordance with auditing standards generally accepted in the United States of America. In our opinion, the consolidating information is fairly stated, in all material respects, in relation to the consolidated financial statements taken as a whole. The consolidating information is presented for purposes of additional analysis of the consolidated financial statements rather than to present the financial position, results of operations, changes in net assets and cash flows of the individual companies and is not a required part of the consolidated financial statements. Accordingly, we do not express an opinion on the financial position, results of operations, changes in net assets and cash flows of the individual companies.

A handwritten signature in black ink that reads "PricewaterhouseCoopers US". The signature is written in a cursive, flowing style.

October 5, 2018

**Children's National Medical Center and Subsidiaries**  
**Supplementary Consolidating Statement of Operations**  
**Year Ended June 30, 2018**

(in thousands)	Obligated group											Consolidated Total		
	Hospital	CNWR	Foundation	Eliminations	Obligated Group Total	CRI	Safekids	CP&A	CNHN	CNAPPI	CSS		Captive	Eliminations
<b>Assets</b>														
<b>Current assets</b>														
Cash and cash equivalents	\$ 109,276	\$ -	\$ 1,577	\$ -	\$ 110,853	\$ -	\$ (62)	\$ (274)	\$ -	\$ -	\$ 2	\$ 694	\$ -	\$ 111,213
Accounts receivable for patient services, net	179,204	-	-	-	179,204	-	-	1,290	-	-	-	-	-	180,494
Settlements due from third-party payors	7,506	-	-	-	7,506	-	-	-	-	-	-	-	-	7,506
Contributions receivable, net	-	-	58,323	-	58,323	-	2,567	-	-	-	-	-	-	60,890
Grant receivables	2,718	-	-	-	2,718	15,000	61	-	-	-	4,412	-	-	22,191
Inventory of supplies	12,723	-	-	-	12,723	-	-	632	-	-	-	-	-	13,355
Prepaid expenses and other	45,492	-	-	-	45,492	1	108	571	846	-	-	683	(18,539)	29,162
Total current assets	356,919	-	59,900	-	416,819	15,001	2,674	2,219	846	-	4,414	1,377	(18,539)	424,811
Property and equipment, net	488,011	53,273	-	-	541,284	19,436	1,095	4,107	-	-	-	-	-	565,922
Assets whose use is limited by professional liability claims	398	-	-	-	398	-	-	-	-	-	-	23,337	-	23,735
Investments	706,329	-	532,528	(536,490)	702,367	44,855	1,270	-	-	-	-	43,326	(44,856)	746,962
Contributions receivable, net	-	-	59,873	-	59,873	-	-	-	-	-	-	-	-	59,873
Interest in beneficial trusts	-	-	8,357	-	8,357	-	-	-	-	-	-	-	-	8,357
Due from affiliates	393,101	-	-	(87,522)	305,579	-	1,364	-	970	-	-	-	(307,913)	-
Other	33,342	-	-	-	33,342	-	-	1,109	-	-	-	-	(4,798)	29,653
Total noncurrent assets	1,621,181	53,273	600,758	(624,012)	1,651,200	64,291	3,729	5,216	970	-	-	66,663	(357,567)	1,434,502
Total assets	\$ 1,978,100	\$ 53,273	\$ 660,658	\$ (624,012)	\$ 2,068,019	\$ 79,292	\$ 6,403	\$ 7,435	\$ 1,816	\$ -	\$ 4,414	\$ 68,040	\$ (376,106)	\$ 1,859,313
<b>Liabilities and Net Assets</b>														
<b>Current liabilities</b>														
Accounts payable	\$ 36,742	\$ -	\$ -	\$ -	\$ 36,742	\$ -	\$ 105	\$ 826	\$ -	\$ -	\$ -	\$ 678	\$ -	\$ 38,351
Accrued salaries and other expenses	112,017	10	810	-	112,837	2,457	271	1,926	-	-	1,242	-	-	118,733
Current portion of reserve for claims	22,929	-	-	-	22,929	-	-	-	-	-	-	18,539	(18,539)	22,929
Settlements due to third-party payors	1,255	-	-	-	1,255	-	-	-	-	-	-	-	-	1,255
Deferred revenue	12,792	-	179	-	12,971	10,182	1,860	1,882	-	-	-	-	-	26,895
Current portion of long-term debt	5,911	-	-	-	5,911	-	-	-	-	-	-	-	-	5,911
Current portion of capital lease obligations	555	-	-	-	555	-	-	139	-	-	-	-	-	694
Total current liabilities	192,201	10	989	-	193,200	12,639	2,236	4,773	-	-	1,242	19,217	(18,539)	214,768
<b>Noncurrent liabilities</b>														
Long-term debt	460,653	-	-	-	460,653	-	-	-	-	-	-	-	-	460,653
Long-term capital lease obligations	4,123	-	-	-	4,123	-	-	935	-	-	-	-	-	5,058
Reserve for claims	65,676	-	-	-	65,676	-	-	-	-	-	-	4,798	(4,798)	65,676
Due to affiliates	-	9,555	77,967	(87,522)	-	283,245	-	19,947	-	405	4,316	-	(307,913)	-
Interest rate swaps	19,116	-	-	-	19,116	-	-	-	-	-	-	-	-	19,116
Other long-term liabilities	34,484	4,465	357	-	39,306	-	-	1,109	-	-	-	-	-	40,415
Total noncurrent liabilities	584,052	14,020	78,324	(87,522)	588,874	283,245	-	21,991	-	405	4,316	4,798	(312,711)	590,918
Total liabilities	776,253	14,030	79,313	(87,522)	782,074	295,884	2,236	26,764	-	405	5,558	24,015	(331,250)	805,686
<b>Net assets (deficit)</b>														
Unrestricted	904,522	39,243	239,165	(239,165)	943,765	(261,447)	220	(19,329)	1,816	(405)	(1,144)	44,025	(1)	707,500
Temporarily restricted	174,008	-	195,284	(174,008)	195,284	21,276	3,947	-	-	-	-	-	(21,276)	199,231
Permanently restricted	123,317	-	146,896	(123,317)	146,896	23,579	-	-	-	-	-	-	(23,579)	146,896
Total net assets (deficit)	1,201,847	39,243	581,345	(536,490)	1,285,945	(216,592)	4,167	(19,329)	1,816	(405)	(1,144)	44,025	(44,856)	1,053,627
Total liabilities and net assets	\$ 1,978,100	\$ 53,273	\$ 660,658	\$ (624,012)	\$ 2,068,019	\$ 79,292	\$ 6,403	\$ 7,435	\$ 1,816	\$ -	\$ 4,414	\$ 68,040	\$ (376,106)	\$ 1,859,313

**Children's National Medical Center and Subsidiaries**  
**Supplementary Consolidating Statement of Operations**  
**Year Ended June 30, 2018**

(in thousands)	Obligated Group				Obligated Group Total	CRI	Safekids	CP&A	CNHN	CNAPPI	CSS	Captive	Eliminations	Consolidated Total
	Hospital	CNWR	Foundation	Eliminations										
<b>Unrestricted revenues, gains, and other support</b>														
Patient service revenue (net of contractual allowances and discounts)	\$ 1,052,324	\$ -	\$ -	\$ -	\$ 1,052,324	\$ -	\$ -	\$ 27,003	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 1,079,327
Provision for uncollectible accounts	(29,731)	-	-	-	(29,731)	-	(18)	-	-	-	-	-	-	(29,749)
Net patient service revenue	1,022,593	-	-	-	1,022,593	-	(18)	27,003	-	-	-	-	-	1,049,578
Grant revenue	16,176	-	-	-	16,176	50,763	239	-	-	-	16,161	-	-	83,339
Other operating revenue	73,190	-	23	(3,995)	69,218	867	1,616	1,535	1,195	-	-	10,047	(34,218)	50,260
Unrestricted contributions	521	-	29,868	-	30,389	-	1,656	-	-	-	-	-	-	32,045
Net assets released from restrictions used for operations	13,735	-	388	-	14,123	10,327	7,195	-	-	-	-	-	-	31,645
Total unrestricted revenues, gains, and other support	1,126,215	-	30,279	(3,995)	1,152,499	61,957	10,688	28,538	1,195	-	16,161	10,047	(34,218)	1,246,867
<b>Expenses</b>														
Salaries, wages, and benefits	673,857	85	-	-	673,942	48,254	4,140	17,386	948	-	14,926	-	-	759,596
Supplies and other	284,094	2,952	-	(3,995)	283,051	42,879	6,435	12,455	214	-	2,379	1,493	(24,171)	324,735
Depreciation and amortization	56,164	-	-	-	56,164	2,144	107	343	-	-	-	-	-	58,758
Provision for insurance	15,270	-	-	-	15,270	70	-	216	-	-	-	6,179	(10,047)	11,688
Interest and amortization	16,966	159	-	-	17,125	-	-	36	-	-	-	-	-	17,161
Development expense	-	-	26,160	-	26,160	-	-	-	-	-	-	-	-	26,160
Total expenses	1,046,351	3,196	26,160	(3,995)	1,071,712	93,347	10,682	30,436	1,162	-	17,305	7,672	(34,218)	1,198,098
Operating income (loss)	79,864	(3,196)	4,119	-	80,787	(31,390)	6	(1,898)	33	-	(1,144)	2,375	-	48,769
<b>Non-operating revenues and expenses</b>														
Investment income (loss)	(7,182)	-	11,472	-	4,290	-	-	-	-	-	-	1,671	-	5,961
Realized and change in unrealized fair value of interest rate swaps	4,502	-	-	-	4,502	-	-	-	-	-	-	-	-	4,502
Gain (loss) on sale of assets, net	2,204	-	-	-	2,204	(11)	-	-	-	-	-	-	-	2,193
Total non-operating revenues and expenses	(476)	-	11,472	-	10,996	(11)	-	-	-	-	-	1,671	-	12,656
Excess (deficiency) of revenues over expenses	\$ 79,388	\$ (3,196)	\$ 15,591	\$ -	\$ 91,783	\$ (31,401)	\$ 6	\$ (1,898)	\$ 33	\$ -	\$ (1,144)	\$ 4,046	\$ -	\$ 61,425

**Children’s National Medical Center and Subsidiaries**  
**Notes to Consolidating Supplementary Information**  
**Year Ended June 30, 2018**

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**1. Basis of Presentation—Consolidating Supplementary Information**

The consolidating supplementary information (“consolidating information”) presented on pages 34-35 was derived from and relates to the underlying accounting and other records used to prepare the consolidated financial statements. The consolidating information is presented for purposes of additional analysis of the consolidated financial statements rather than to present the financial position and results of operations, changes in net assets and cash flows of the individual companies within the Medical Center and is not a required part of the consolidated financial statements. The individual companies within the Medical Center as presented within the consolidating information are disclosed within Note 1 to the consolidated financial statements.