



**Texas Children's<sup>®</sup>**

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Fiscal 2019 Annual Report

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# who we are

Texas Children's is a not-for-profit organization based in the Texas Medical Center in Houston, Texas. It is comprised of several entities ranging from general pediatric care to obstetric and gynecological services. It also includes the country's first pediatric health maintenance organization, as well as a foundation which is the holder of investments administered for the sole benefit of Texas Children's Hospital. Through the combination of these entities, we create a healthier future for children and women throughout our global community by leading in patient care, education, and research.



# what we do

We drive innovation and focus relentlessly on positive outcomes. We believe in leading tirelessly every day so that we can extend our reach around the globe to find new and improved ways to help children and women get the care they deserve. We are never restricted by what has been done before, and we embrace the freedom to discover better methods. We create medical breakthroughs not just for today, but for years to come. We succeed when faced even with the most difficult cases through cross-disciplinary expertise and collaboration to improve outcomes and overall quality of life for our patients. We invest millions in education to ensure we have the best team to bring our mission to life. At Texas Children's, our patients and their families are at the heart of everything we do.

# where we're going

We opened the doors to our hospital in 1954 and have grown tremendously. We started with a three-story pediatric hospital which has grown to be a multi-building pediatric campus in the Texas Medical Center. In addition, Texas Children's has expanded its line of service to provide obstetrics and gynecological (OB/GYN) care, as well as pediatric facilities in west Houston and The Woodlands. In 2017, Texas Children's announced plans to expand its pediatric health care offerings into the Austin community. As of 2019, Texas Children's has opened five pediatric primary care clinics, one urgent care clinic and one pediatric specialty care clinic.



Texas Children's, 1954



Texas Children's, 2019

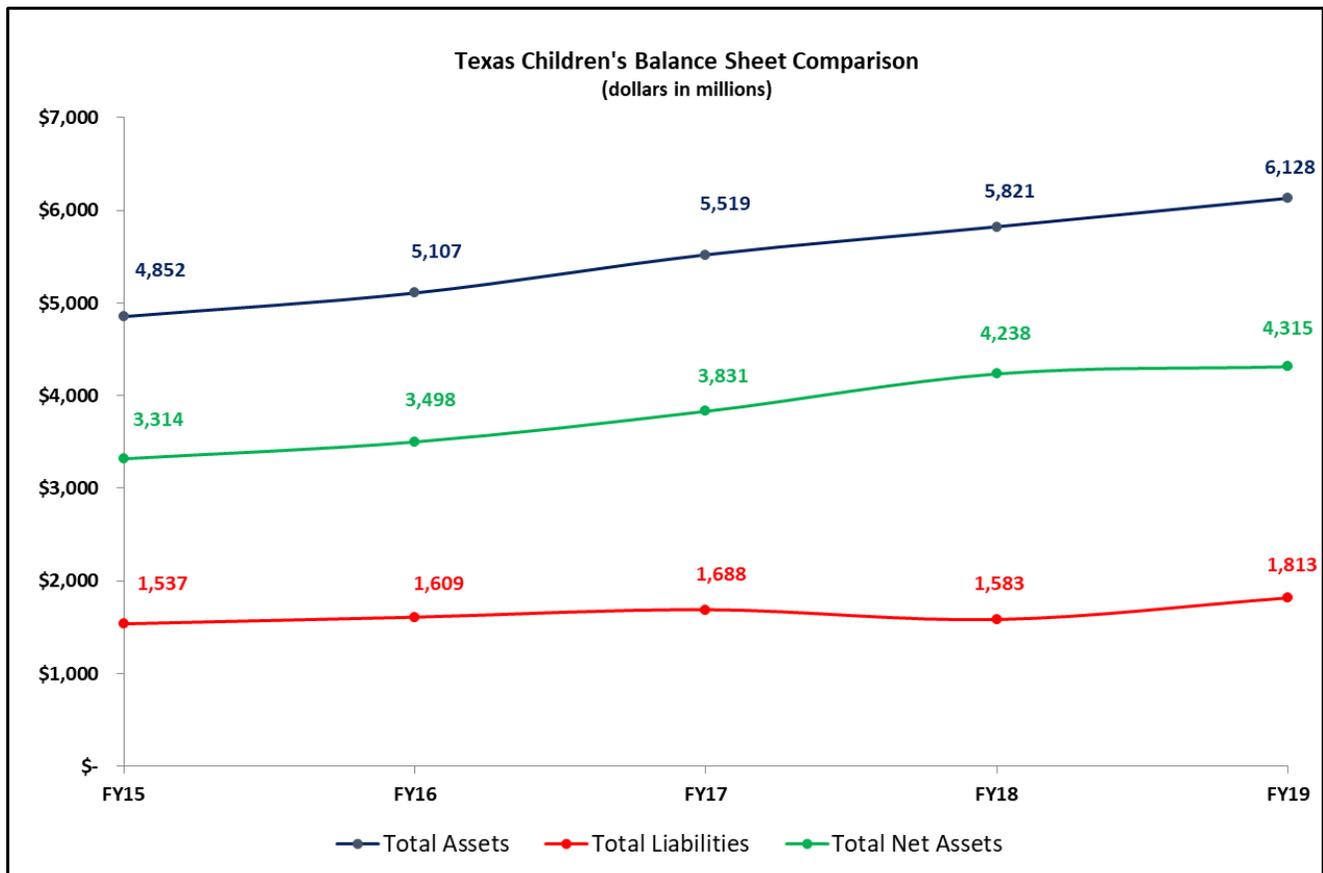
## U.S. News & World Report



The 2019-20 edition of Best Children’s Hospitals by *U.S. News & World Report* ranked Texas Children’s Hospital third in the country among nearly 200 pediatric centers. For the eleventh straight year, Texas Children’s Hospital placed on the Best Children’s Hospital Honor Roll of best pediatric institutions. Texas Children’s is one of only 10 children’s hospitals across the country to achieve the Honor Roll designation, and the only hospital in Texas – and the southern U.S. – awarded this distinction. Over the last decade, no other pediatric hospital in the state has ever achieved an overall ranking as high as Texas Children’s. Each year, in addition to ranking pediatric hospitals overall, *U.S. News & World Report* also ranks the top 50 pediatric hospitals across 10 major subspecialties. For the third straight year, Texas Children’s Heart Center ranked as the best cardiology and heart surgery service in the country. The pulmonology care program also achieved best in the country ranking, along with four additional subspecialties that are among the top five programs nationally.

## Financial Results – Texas Children’s

Texas Children’s consolidated balance sheet remains strong. As of September 30, 2019, total assets were \$6.1 billion and debt to capitalization was 17.7%. Days cash on hand was 227 as of September 30, 2019, a five day decrease from prior year end. The decrease in days cash on hand was partially driven by the decrease in Texas Children’s Health Plan operating cash flow that was the result of an increase in medical claim payments.

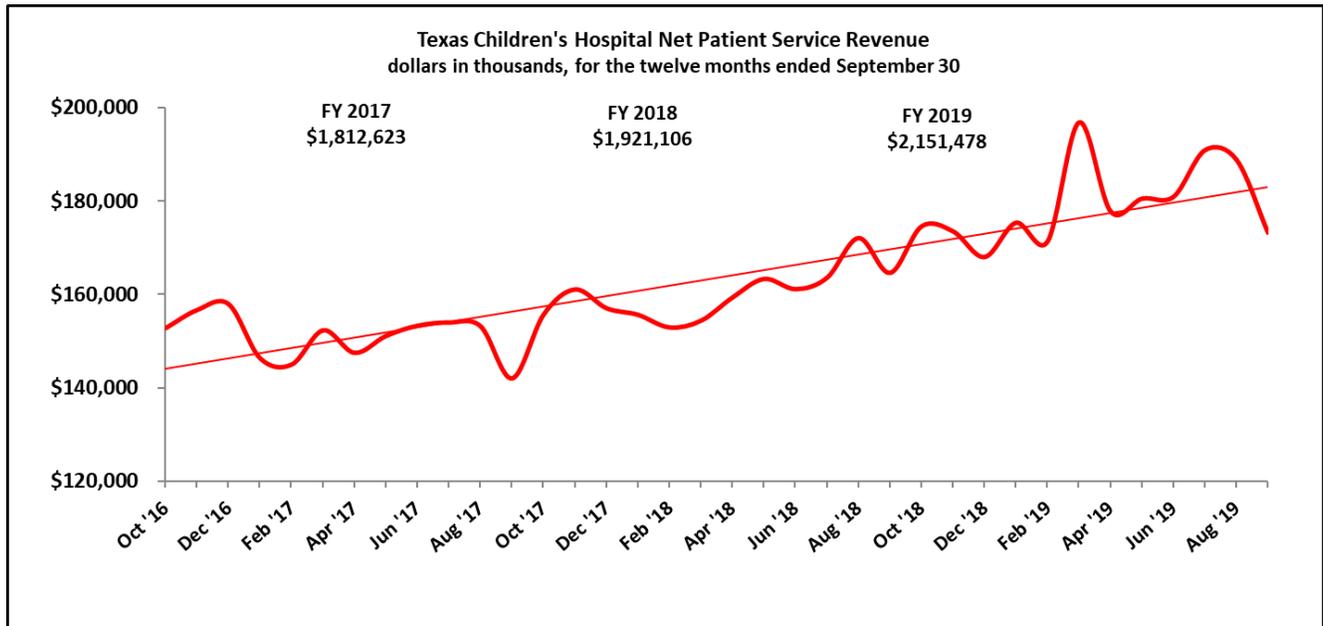


For the twelve months ended September 30, 2019, Texas Children’s operating income was \$106.2 million, which was a decrease of \$7.0 million from prior year. During September 2019 Texas Children’s Hospital recorded a reserve of \$71.4 million for DSH revenue received in 2018 and 2019. After removing the impact of this one-time entry, Texas Children’s operating income was \$177.6 million. Additional disclosure related to this reserve is discussed in Footnote 16 of the audit report. Texas Children’s operating cash flow, which is calculated by adding back interest, depreciation, and amortization costs to operating income, was \$333.2 million for the twelve months ended September 30, 2019, an increase of \$26.5 million from prior year.

### Financial Results – Texas Children’s Hospital

Texas Children’s Hospital’s (TCH) operating income was \$173.0 million for the twelve months ended September 30, 2019, an increase of \$40.4 million from prior year. TCH’s strong performance was primarily driven by growth in patient activity and strong collection performance.

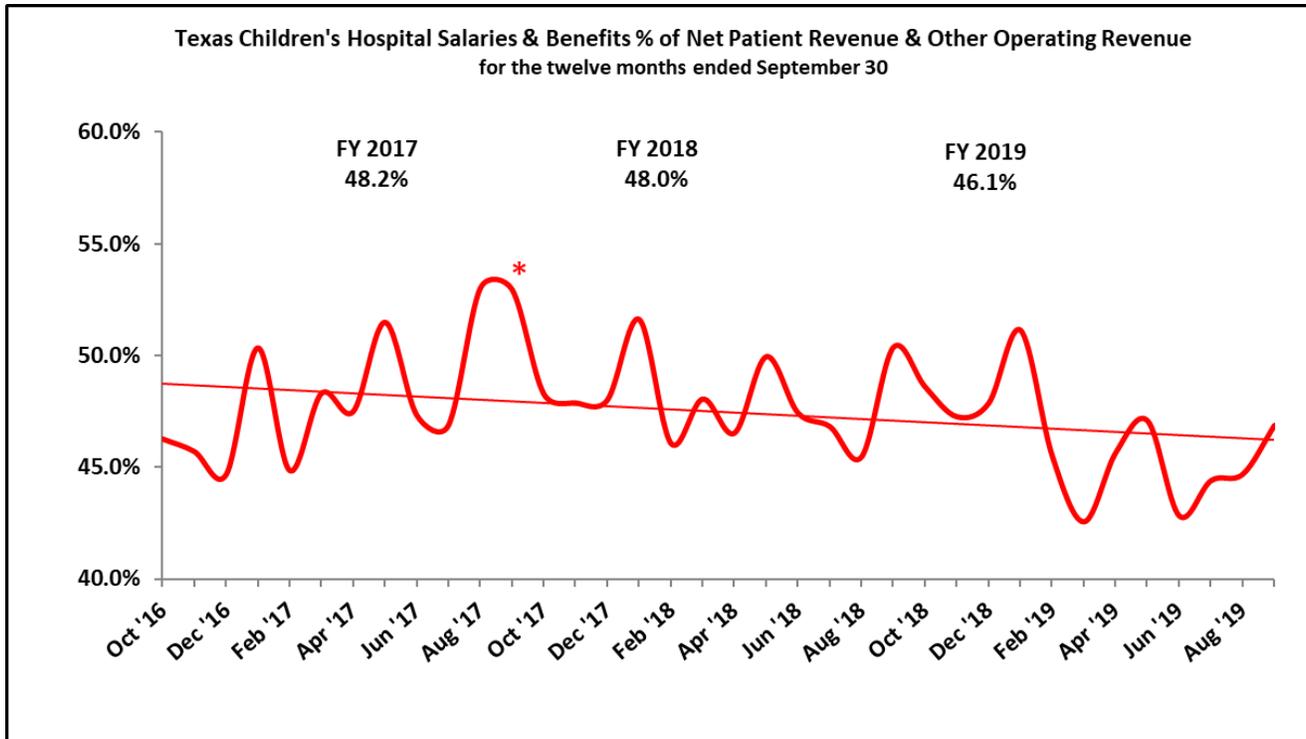
For the twelve months ended September 30, 2019, net patient service revenue increased \$230.4 million, or 12.0%, compared to prior year. Net patient service revenue at the Medical Center campus, including Legacy Tower, increased \$180.8 million or 13.7%, compared to prior year, accounting for the majority of the increase. During fiscal year 2019, total equivalent patient days increased 13,584 or 5.7%. Equivalent patient days at the Medical Center campus increased 11,305 or 7.0% compared to prior year.



<b>Texas Children's Hospital Statistical Summary for the twelve months ended September 30</b>				
	<u>2019</u>	<u>2018</u>	<u>Increase (Decrease)</u>	<u>% Increase (Decrease)</u>
<b>Admissions</b>	<b>36,372</b>	<b>34,455</b>	<b>1,917</b>	<b>5.6%</b>
<b>Average Daily Census</b>	<b>688</b>	<b>650</b>	<b>38</b>	<b>5.8%</b>
<b>Surgery Cases</b>	<b>40,134</b>	<b>37,447</b>	<b>2,687</b>	<b>7.2%</b>
<b>Surgery Hours</b>	<b>61,264</b>	<b>58,095</b>	<b>3,169</b>	<b>5.5%</b>
<b>Emergency Room Visits</b>	<b>157,084</b>	<b>152,316</b>	<b>4,768</b>	<b>3.1%</b>
<b>Urgent Care Encounters *</b>	<b>169,627</b>	<b>123,326</b>	<b>46,301</b>	<b>37.5%</b>
<b>Births</b>	<b>6,706</b>	<b>6,401</b>	<b>305</b>	<b>4.8%</b>

\*Urgent Care Encounters are within the Texas Children's Pediatrics entity

For the twelve months ended September 30, 2019, salaries and benefits as a percentage of net patient service revenue and other revenue was 46.1% compared to 48.0% in the same period of the prior year. Texas Children's Hospital had full-time equivalents of 10,986 and 10,243 for the twelve months ended September 30, 2019 and 2018, respectively. Premium labor as a percentage of net patient service revenue and other revenue of 1.7% remained consistent with prior year.



\* The increase during the fourth quarter of fiscal year 2017 was due to additional expenses associated with Hurricane Harvey.

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## *Financial Results and Membership – Texas Children’s Health Plan*

Texas Children’s Health Plan (TCHP) had an operating loss of \$46.9 million for the twelve months ended September 30, 2019. TCHP operating loss has been primarily driven by a decrease in membership and an increase in medical claims expense.

Membership of 424,853 at September 30, 2019, decreased by 3.0% compared to the prior year membership of 438,072. Medicaid membership has declined across the state, but TCHP market share of 45.8% has remained consistent with prior year. Significant efforts are underway by TCHP leadership to retain and increase membership to improve premium revenue, and enhance care coordination activities to improve medical expense.



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## Report of Independent Auditors

The Board of Trustees  
Texas Children's

We have audited the accompanying consolidated financial statements of Texas Children's, which comprise the consolidated balance sheets as of September 30, 2019 and 2018, and the related consolidated statements of operations and changes in net assets, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

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

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

### **Auditor's Responsibility**

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

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

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

## **Opinion**

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Texas Children's at September 30, 2019 and 2018, and the consolidated results of its operations and its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

## **Supplementary Information**

Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The accompanying consolidating information is presented for purposes of additional analysis and is not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audits 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 financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States. In our opinion, the information is fairly stated, in all material respects, in relation to the financial statements as a whole.

*Ernst + Young LLP*

December 12, 2019

**Texas Children's  
Consolidated Balance Sheets**

(Dollars in thousands)

	<u>September 30, 2019</u>	<u>September 30, 2018</u>
Assets:		
Current assets		
Cash and cash equivalents	\$ 221,113	\$ 198,359
Patient accounts receivable	409,064	353,670
Receivable for Medicaid and other supplemental reimbursements	73,620	409
Assets limited as to use, current portion	46,418	37,571
Other current assets	203,734	183,189
Investment-related receivables	<u>173,875</u>	<u>88,934</u>
Total current assets	1,127,824	862,132
Assets limited as to use	101,434	100,868
Investments	2,522,614	2,400,641
Property and equipment, net	2,247,714	2,315,020
Other assets	<u>128,651</u>	<u>142,774</u>
Total assets	<u>\$ 6,128,237</u>	<u>\$ 5,821,435</u>
Liabilities and net assets:		
Current liabilities		
Accounts payable and accrued expenses	\$ 531,131	\$ 459,325
Investment-related accrued expenses	180,922	89,872
Current portion of long-term debt	19,640	18,600
Line of credit	-	5,000
Long-term debt subject to remarketing agreements	<u>160,000</u>	<u>141,500</u>
Total current liabilities	891,693	714,297
Long-term debt	724,270	759,825
Loss reserves for self-insurance program	36,101	40,297
Retirement plan liability	85,117	22,255
Other long-term liabilities	<u>76,142</u>	<u>46,822</u>
Total liabilities	<u>1,813,323</u>	<u>1,583,496</u>
Net assets:		
Without donor restrictions	3,918,704	3,826,121
With donor restrictions	<u>396,210</u>	<u>411,818</u>
Total net assets	<u>4,314,914</u>	<u>4,237,939</u>
Total liabilities and net assets	<u>\$ 6,128,237</u>	<u>\$ 5,821,435</u>

See accompanying notes to consolidated financial statements.

**Texas Children's**  
**Consolidated Statements of Operations and Changes in Net Assets**

(Dollars in thousands)

	Year Ended September 30,	
	2019	2018
Changes in net assets without donor restrictions:		
Operating revenues:		
Net patient service revenue	\$ 2,151,792	1,945,029
Premium revenue	1,724,628	1,666,796
Medicaid and other supplemental reimbursements	119,692	116,283
Grants	14,607	29,345
Other	145,428	96,085
Net assets released from restrictions for operations	46,848	44,018
Total operating revenues	<u>4,202,995</u>	<u>3,897,556</u>
Operating expenses:		
Salaries and benefits	1,399,272	1,288,672
Medical claims	1,039,287	1,031,650
Professional fees	552,124	515,493
Supplies and pharmaceuticals	368,204	314,563
Outside purchased services	188,996	180,096
Depreciation and amortization	197,898	171,610
Operation of plant	136,565	118,784
General and administrative	132,908	119,025
Enhanced mission support	52,407	22,601
Interest	29,118	21,843
Total operating expenses	<u>4,096,779</u>	<u>3,784,337</u>
Operating income	<u>106,216</u>	<u>113,219</u>
Nonoperating gains (losses):		
Investment return, net	65,453	163,261
Change in interest rate swap valuation	(29,377)	14,709
Other	(7,440)	(115)
Net nonoperating gains	<u>28,636</u>	<u>177,855</u>
Revenues and gains in excess of expenses and losses	<u>\$ 134,852</u>	<u>\$ 291,074</u>

See accompanying notes to consolidated financial statements.

**Texas Children's**  
**Consolidated Statements of Operations and Changes in Net Assets, continued**

(Dollars in thousands)

	Year Ended	
	2019	September 30, 2018
Changes in net assets without donor restrictions:		
Revenues and gains in excess of expenses and losses brought forward	\$ 134,852	\$ 291,074
Net assets released from restrictions for purchases of property, equipment and other	33,664	38,568
Change in pension liabilities	(75,933)	34,020
Change in net assets without donor restrictions	<u>92,583</u>	<u>363,662</u>
Changes in net assets with donor restrictions:		
Donor-restricted contributions	47,419	106,364
Net assets released from restrictions	(83,453)	(57,844)
Investment return and other, net	20,426	(5,265)
Change in net assets with donor restrictions	<u>(15,608)</u>	<u>43,255</u>
Change in net assets	76,975	406,917
Net assets at beginning of year	<u>4,237,939</u>	<u>3,831,022</u>
Net assets at end of year	\$ <u>4,314,914</u>	\$ <u>4,237,939</u>

See accompanying notes to consolidated financial statements.

**Texas Children's  
Consolidated Statements of Cash Flows**

(Dollars in thousands)

	Year Ended	
	September 30,	
	2019	2018
Operating activities:		
Change in net assets	\$ 76,975	\$ 406,917
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Change in beneficial interest in net assets of donor-restricted foundations	(8)	1,546
Increase (decrease) in pension liabilities	75,933	(34,020)
Net realized and unrealized gains on investments	(65,357)	(169,563)
Depreciation and amortization	197,898	171,610
Increase (decrease) in interest rate swap valuation	29,377	(14,709)
Loss on early extinguishment of debt	4,667	-
Restricted contributions received	(64,049)	(41,927)
Changes in assets and liabilities		
Increase in patient accounts receivable	(55,394)	(49,886)
(Increase) decrease in receivable for Medicaid and other supplemental reimbursements	(73,211)	29,612
Increase in other assets	(8,880)	(88,161)
Increase in accounts payable and accrued expenses	84,057	16,020
Decrease in other liabilities	(19,457)	(5,828)
Total adjustments	105,576	(185,306)
Net cash provided by operating activities	182,551	221,611
Investing activities:		
(Purchases) sales of investments, net	(68,882)	80,454
Purchases of property and equipment	(139,663)	(325,721)
Net cash used in investing activities	(208,545)	(245,267)
Financing activities:		
Repayments on line-of-credit, net	(5,000)	(16,200)
Principal payment on long-term debt	(18,600)	(17,415)
Proceeds from issuance of long-term debt	271,812	-
Deferred financing costs	(2,164)	-
Redemption of long-term debt	(267,397)	-
Principal payment on capital lease obligation	(2,922)	(9,242)
Restricted contributions received	57,859	34,959
Proceeds from sale of donated securities with restrictions	6,190	6,968
Restricted investment return	8,970	6,710
Net cash provided by financing activities	48,748	5,780
Net increase (decrease) in cash and cash equivalents	22,754	(17,876)
Cash and cash equivalents at beginning of year	198,359	216,235
Cash and cash equivalents at end of year	\$ 221,113	\$ 198,359
Supplemental Disclosures:		
Cash paid for interest	\$ 35,919	\$ 33,139
Capital in accounts payable and accrued expenses	\$ 21,364	\$ 30,717

See accompanying notes to consolidated financial statements.

## 1. ORGANIZATION AND BASIS OF PRESENTATION

The consolidated financial statements of Texas Children's include the entities described below. Intercompany balances and transactions have been eliminated in consolidation.

Texas Children's Hospital (TCH) primarily provides direct patient care and conducts educational and research activities within Houston and its surrounding communities. It is comprised of a 692 licensed-bed comprehensive tertiary care pediatric facility and a 119 licensed-bed facility, providing obstetrics and gynecological care, both located in Houston's Texas Medical Center (Medical Center), an 86 licensed-bed full-service pediatric facility located in west Houston, and a 74 licensed-bed full-service pediatric facility located in The Woodlands.

Texas Children's Pediatrics (TCP) is a group of pediatric practices that provide primary care services and conduct educational activities. It acquires, manages, and affiliates with pediatric practices primarily in Houston and its surrounding counties, and has expanded into Austin.

Texas Children's Urgent Care (TCUC) is a group of clinics that provides pediatric urgent care primarily in Houston, and has expanded into Austin.

Texas Children's Health Plan, Inc. (TCHP) operates a health maintenance organization (HMO), the first of its kind for pediatrics in the nation, and has a Certificate of Authority from the Texas Department of Insurance. It improves the quality, cost, and access of pediatric and obstetrical services delivered to health plan members in its service area.

Texas Children's Health Plan, Inc. – The Center for Women and Children (the Centers) operates two patient and family-centered primary care medical homes for TCHP's members. The Centers are designed to address the shortage of primary care for the Medicaid and Children's Health Insurance Program (CHIP) populations.

TCH Insurance Company, Ltd. (TCHICO), a Cayman Islands company, provides primary and excess professional and general liability coverage, as well as property coverage, by issuing insurance policies covering Texas Children's and its affiliates. TCHICO has been issued a Class B(i) license as an insurer and is regulated by the Insurance Division of the Cayman Islands Monetary Authority.

Texas Children's Hospital Foundation (TCHF) is operated for charitable, scientific, and educational purposes and, in accomplishment of such purposes, is administered solely for the benefit of TCH.

Texas Children's Women's Specialists (TCWS) provides administrative and staffing services to support the provision of obstetric and gynecological services by Texas Children's Physician Group (TCPG).

TCPG provides services in support of Texas Children's for Baylor College of Medicine (Baylor) faculty and other affiliated health care professionals who provide services at Texas Children's or participate in Texas Children's programs.

The Gordon and Mary Cain Pediatric Neurology Research Foundation (Cain Foundation) supports scientific and educational purposes with respect to pediatric neurological disorders, solely for the benefit of TCH.

Texas Children's is the sole corporate member of TCH, TCP, TCHP, TCHF, TCWS, and TCPG, and Cain Foundation and is the sole shareholder of TCHICO. TCP is the sole corporate member of TCUC, and TCHP is the sole corporate member of the Centers.

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

### USE OF ESTIMATES

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the consolidated financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

### CASH EQUIVALENTS

Texas Children's considers all highly liquid investments with a maturity of three months or less to be cash equivalents, except those subject to restrictions, which are reported as assets limited as to use in the consolidated balance sheets.

### PATIENT ACCOUNTS RECEIVABLE AND ACCRUED THIRD-PARTY PAYOR LIABILITIES

Patient accounts receivable include reductions for explicit contractual agreements, discounts provided to uninsured and underinsured patients, implicit price concessions, and charity adjustments and are recorded on an accrual basis at net realizable value in the consolidated balance sheets. The estimate of patient accounts receivable is based primarily on Texas Children's historical collection and write-off experience and the aging of patient accounts receivables. Changes in business and economic conditions, trends in federal, state and private employer health care coverage, and other collection indicators are also taken into consideration when estimating price concessions each quarter.

In assessing collectability, Texas Children's has elected the portfolio approach due to the large volume of similar contracts with similar classes of customers. Texas Children's reasonably expects that the effect of applying a portfolio approach to a group of contracts would not differ materially from considering each contract separately. The portfolios consist of particular payors and major payor classes by inpatient and outpatient service lines. As a result, aggregating all of the contracts (which are at the patient level) by the particular payor or group of payors, will result in the recognition of materially the same amount of revenue as applying the analysis at the individual patient level.

Amounts receivable or payable under TCH reimbursement agreements with the Medicaid and Medicare programs are subject to examination and retroactive adjustment. TCH's third-party payor balances are impacted by changes in previous estimates as a result of tentative and final settlements, closure on years that are no longer subject to audits, resolution of reviews and investigations, and prior-year retroactive adjustments. Provisions for estimated retroactive adjustments under such programs are provided in the period the related services are rendered, adjusted in future periods as final settlements are determined, and are included in other current assets in the consolidated balance sheets. It is reasonably possible that the recorded estimates may change in the near term. Final settlement has been made for Medicaid and Medicare claims through fiscal year ended September 30, 2017.

## INVESTMENTS AND INVESTMENT RETURN

Investments consist of fixed income securities, marketable equity securities, interests in mutual funds, common trust funds, and exchange-traded funds that, in turn, invest in marketable securities. Additionally, TCH and TCHF hold ownership interests in certain limited liability partnerships and corporations that hold investments in hedge funds, private equity, real estate, managed futures, natural resources, and other investment categories (alternative investments). Investments are reflected in the consolidated balance sheets as investments or assets limited as to use. Assets limited as to use represent investments limited for specific purposes. Investments and assets limited as to use are classified as noncurrent assets, except for those required for current obligations, which are classified as current assets in the consolidated balance sheets.

Investments in marketable securities, fixed income securities, certain mutual funds, and exchange-traded funds with readily determinable fair values are reported at fair value. Investments in common trust funds and limited liability partnerships and corporations that do not have readily determinable fair values are recorded based on Texas Children's share of the underlying value of portfolio securities held by these funds, as reported to Texas Children's. Alternative investment positions are recorded at amounts as reported by the related investment managers. Alternative investments are accounted for under the equity method of accounting. Under this method, the equity in earnings includes changes in reported values in the underlying investments. Generally, the underlying investments are not readily marketable and the alternative investments may not be redeemable except in certain circumstances, and there can be no assurance that reported amounts will be ultimately realized.

Investment return includes interest and dividend income, realized and unrealized investment gains and losses, and earnings from investments accounted for under the equity method. Investment income on assets held for TCHICO is included in other operating revenues. All other investment return is recorded as nonoperating gains (losses) and is included in revenues and gains in excess of expenses and losses, unless investment return is restricted by donor or law. Investment return is initially recorded as net assets without donor restrictions or net assets with donor restrictions based on donor-imposed restrictions, if any. Restricted amounts are reflected as net assets released from restrictions in the consolidated statements of operations and changes in net assets to the extent they become available for use during the period.

Investment-related receivables primarily include receivables from brokers for unsettled trades and receivables from counterparties for forward and spot exchange contracts. Investment-related accrued expenses primarily include payables to brokers for unsettled trades and payables to counterparties for forward and spot exchange contracts.

## PROPERTY AND EQUIPMENT

Property and equipment are stated at cost. Donated property and equipment are recorded at fair value at the date of donation, which is then treated as cost. Depreciation of property and equipment is calculated using the straight-line method over the estimated useful lives of the assets. Property and equipment under capital lease obligations are amortized using the straight-line method over the shorter period of either the lease term or the asset's estimated useful life.

## IMPAIRMENT OF LONG-LIVED ASSETS

When events or changes in circumstances indicate the carrying amount of property and equipment and intangible or other long-lived assets related to specifically acquired assets may not be recoverable, an evaluation of the recoverability of currently recorded costs is performed. When an evaluation is performed, the estimated value of undiscounted future net cash flows associated with the asset is compared to the asset's carrying value to determine whether a write-down to fair value is required. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. Texas Children's did not recognize any material impairment of long-lived assets for the twelve months ended September 30, 2019 and 2018.

**OTHER ASSETS**

Other assets primarily include prepaid expenses, pledges, and inventory.

Pledges, less a provision for uncollectible amounts, are recorded as other assets in the year made. Unrestricted pledges are recorded as contributions within other operating revenues and restricted pledges are recorded as increases in net assets with donor restrictions depending on the donor restrictions received with the pledge. Pledges receivable represent unconditional promises to give and are primarily restricted for specific capital campaigns. Noncurrent pledges receivable have been discounted to their present value. Pledges receivable, net of discounts and allowances, are included in other current or noncurrent assets in the consolidated balance sheets.

Inventories are stated at the lower of cost or net realizable value utilizing the first-in, first-out valuation method, and are included in other current assets in the consolidated balance sheets. As of September 30, 2019 and 2018, Texas Children's had inventory of \$29,647 and \$26,031, respectively.

**INSURANCE PROGRAM**

Texas Children's is self-insured for professional and general liability insurance and maintains excess liability insurance coverage at varying levels. A provision is made for estimated losses and related expenses for risks not covered by insurance. This provision includes estimated amounts for asserted claims, reported incidents for which a claim has not been asserted, and claims incurred but not reported. The provision is based on specific claim loss estimates by management and on estimates of total annual losses by an independent actuary taking into consideration the estimated future rate of inflation, using Texas Children's experience and similar industry experience.

**PREMIUM REVENUES**

TCHP earns premium revenue from the state-funded Medicaid State of Texas Access Reform (STAR), Medicaid STAR Kids and CHIP programs. Premium revenue was derived from the various programs as follows:

	<b>Year Ended September 30,</b>	
	<b>2019</b>	<b>2018</b>
Medicaid STAR	53%	55%
Medicaid STAR Kids	39%	36%
CHIP	8%	9%
Total	100%	100%

TCHP recognizes revenue during the coverage period of the member agreement. Under these agreements, TCHP receives monthly payments based on the number of members regardless of actual medical claims incurred.

TCHP is subject to an experience rebate if operating income, as a percentage of revenue, is greater than the percentage set forth by the state. As of September 30, 2019 and 2018, TCHP had no estimated experience rebate liability.

## CONTRIBUTIONS

Texas Children's records unconditional contributions, including promises to contribute, as revenue when the commitment is received. Conditional contributions are recognized as revenue when the conditions on which they depend have been substantially met. Texas Children's reports gifts of cash and other assets as restricted support if they are received with donor restrictions that limit the use of the donated assets. When a donor restriction expires, that is, when a time restriction ends or purpose restriction is accomplished, net assets with donor restrictions are reclassified to net assets without donor restrictions and reported in the consolidated statements of operations and changes in net assets as net assets released from restrictions.

## MEDICAL CLAIMS EXPENSES

TCHP contracts with various health care providers for the provision of medical care to its members. TCHP compensates hospitals on either a payment methodology utilizing the All Patient Refined Diagnosis Related Group (APR-DRG) classification system, discounted fee-for-service or per diem basis. TCHP compensates physicians and other health care providers on a capitated basis or a discounted fee-for-service basis.

The cost to TCHP for health care services provided by contracted providers is accrued in the period in which it is provided to a member, based in part on estimates, including accruals for medical services provided but not billed, and estimates of claims incurred but not yet reported to TCHP, based on actuarial valuations. The methods utilized in determining estimates are continually reviewed, and any changes in estimates are reflected prospectively. As of September 30, 2019 and 2018, recorded IBNR accruals were \$67,319 and \$70,499, respectively, and are included in accounts payable and accrued expenses in the consolidated balance sheets.

## INTEREST EXPENSE

Interest expense includes the interest associated with Texas Children's debt, outstanding line of credit, net cash settlement activity related to interest rate swaps, and interest related to capital leases.

## INCOME TAXES

All Texas Children's entities are exempt from federal taxes under Section 501(c)(3) of the Internal Revenue Code, except for TCHICO, which is a taxable for-profit entity domiciled in the Cayman Islands. Management annually reviews its tax positions and has determined that there are no material uncertain tax positions that require recognition in the accompanying consolidated balance sheets as of September 30, 2019 and 2018. The Tax Cuts and Jobs Act (the Act) was enacted on December 22, 2017. The Act includes several provisions that impact Texas Children's, including new excise taxes on executive compensation, increases to unrelated business taxable income (UBTI) by the amount of certain fringe benefits for which a deduction is not allowed, and the computation of UBTI separately for each unrelated trade or business. Further, the Act reduces the US federal corporate tax rate from a maximum of 35% to 21%. Texas Children's has evaluated the impact of the Act which does not have a material impact to Texas Children's consolidated financial statements.

## NEW ACCOUNTING PRONOUNCEMENTS

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2014-09, *Revenue from Contracts with Customers* which provides for a single comprehensive principles-based standard for the recognition of revenue across all industries through the application of a five-step framework. The core principle of 2014-09 is that an entity recognizes revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services.

In addition, the standard requires expanded disclosures in regards to the nature, amount, timing and uncertainty of revenue, as well as certain additional quantitative and qualitative disclosures. Texas Children's has adopted ASU 2014-09 by applying the full retrospective method. As of September 30, 2019, the primary impact of adopting ASU 2014-09 is \$74,333 previously classified as the provision for doubtful accounts is now reflected as an implicit price concession within net patient service revenue. These amounts are no longer separately stated as a reduction to net patient service revenue in the consolidated statements of operations and changes in net assets. Texas Children's will consider certain changes in the financial status of a third-party payor not assessed at the date of service, for example, a bankruptcy, as bad debt expense within general and administrative expense. Except for the adjustment to the presentation of the provision for doubtful accounts, the adoption of ASU 2014-09 did not have a material impact on the consolidated financial statements. Refer to Footnote 12 and 16.

In August 2016, the FASB issued ASU 2016-14, *Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities*. This guidance is intended to improve the net asset classification requirements and the information presented in the financial statements and footnote disclosures about a not-for-profit entity's liquidity, financial performance, and cash flows. Main provisions of the guidance include: presentation of two classes of net assets versus the previously required three; recognition of capital gifts for construction as a net asset without donor restrictions when the associated long-lived asset is placed in service; and recognition of underwater endowment funds as a reduction in net assets with donor restrictions. The guidance also enhance disclosures for Board-designated amounts, composition of net assets without donor restrictions, liquidity, and expenses by both their natural and functional classification. At September 30, 2018, Texas Children's reported temporarily restricted net assets and permanently restricted net assets of \$226,817 and \$185,001, respectively. At September 30, 2019, those amounts have been reclassified as net assets with donor restrictions in the accompanying consolidated balance sheet. Texas Children's has adopted ASU 2016-14 by applying the retrospective method effective October 1, 2018. The liquidity and availability of resources and functional classification disclosures has been presented for the current year only, as allowed by the ASU. Refer to Footnote 3, 11 and 15.

## PENDING ACCOUNTING PRONOUNCEMENTS

In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 842)*, which calls for the reporting of assets and liabilities arising from leases in a more transparent manner. Topic 842 was subsequently amended by ASU 2018-01, *Land Easement Practical Expedient for Transition to Topic 842*; ASU 2018-10, *Codification Improvements to Topic 842, Leases*; ASU 2018-11, *Targeted Improvements*; ASU No. 2018-20, *Leases (Topic 842): Narrow-Scope Improvements for Lessors*, and ASU No. 2019-01, *Leases (Topic 842): Codification Improvements*. The new standard requires companies that lease assets to recognize a right-of-use asset and a lease liability, initially measured at the present value of the lease payments, in its balance sheet.

ASU 2016-02 requires lessees to classify leases as finance, or operating leases, and lessors to classify leases as sales-type, direct financing, or operating leases. The pronouncement also requires enhanced disclosures on the amount, timing, and uncertainty of cash flows arising from leases.

Texas Children's will adopt ASU 2016-02 effective October 1, 2019, applying a modified retrospective approach in which comparable prior period information and disclosures will not be adjusted. Certain practical expedients will be utilized in adoption of the new standard, including "the package" of practical expedients and the practical expedient on existing land easements. Upon electing "the package", Texas Children's will not be required to reassess whether a contract is or contains a lease, the lease classification and initial direct costs of all existing contracts.

Texas Children's has also adopted practical expedients that will be utilized prospectively, after the date of adoption, including the short-term lease recognition exemption for all leases that have a lease term of 12 month or less and electing to separate lease and non-lease components for all leases. For those leases that qualify for the short-term exemption, right-of-use assets and lease liabilities will not be recognized.

The primary impact of adopting the new standard will be the recognition of additional lease liabilities, and corresponding right-of-use assets for leases currently classified as operating leases. The approximate amount of additional liability and corresponding assets is \$127 million. Texas Children's will have approximately \$127 million of right-of-use assets, and \$147 million of lease liabilities recorded for leases classified as operating leases. Texas Children's does not anticipate the results of ASU 2016-02 related to lessor activity will have a material impact on the financial statements. Additionally, the results of ASU 2016-02 will not have an impact on compliance with debt covenants.

In November 2016, the FASB issued ASU 2016-18, *Statement of Cash Flows (Topic 230): Restricted Cash* which requires a statement of cash flows to explain the change during the period in the total of cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents. Entities are required to disclose the nature of the restrictions, as well as reconcile the totals in the statement of cash flows to cash, cash equivalents, restricted cash, and restricted cash equivalents on the balance sheet when these are shown in more than one line item. ASU 2016-18 is effective for fiscal years beginning after December 15, 2018, and interim periods within fiscal years beginning after December 15, 2019. The amendments in ASU 2016-18 should be applied retrospectively. Texas Children's will adopt this standard within the consolidated financial statements beginning October 1, 2019, and anticipates ASU 2016-18 will not have a material impact on the consolidated statements of cash flows.

In March 2017, the FASB issued ASU No. 2017-07 "*Compensation – Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost.*" The ASU is intended to improve the presentation of net periodic pension cost and net periodic postretirement benefit cost. The amendment applies to all entities offering a defined benefit pension plan, other postretirement benefit plans, or other types of benefits accounted for under Topic 715. The amendments in the ASU require an employer to report the service cost component in the same line item or items as other compensation costs arising from services rendered by the pertinent employees during the period. The other components of net benefit cost are required to be presented in the income statement separately from the service cost component and outside a subtotal of income from operations. The amendments in this ASU are effective for annual periods beginning after December 15, 2018, and interim periods within fiscal years beginning after December 15, 2019. The amendments in this ASU should be applied retrospectively for the presentation of the service cost component and the other components of net periodic pension cost and net periodic postretirement benefit cost in the income statement. Texas Children's will adopt ASU 2017-07 effective October 1, 2019 and does not anticipate a material impact on the consolidated statements.

In June 2016, the FASB issued ASU 2016-13, *Financial Instruments-Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*. The amendments in the ASU requires financial assets measured at amortized cost basis to be presented as the net amount expected to be collected, which includes a reduction for any expected credit losses. Expected credit losses are to be estimated based on relevant information about past events and reasonable and supportable forecasts. ASU 2016-13 is effective for fiscal years beginning after December 15, 2022, including interim periods thereafter. Texas Children's does not plan to adopt the guidance early and is currently evaluating the impact on its consolidated financial statements.

**3. LIQUIDITY AND AVAILABILITY OF FINANCIAL ASSETS**

Texas Children's has a practice of structuring its financial assets to be available as its general expenditures, liabilities, and other obligations come due. In addition, as part of its liquidity management practices, Texas Children's invests cash in excess of daily requirements in various short-term highly liquid investments. To assist with working capital liquidity, TCH also has a committed line of credit in the amount of \$100,000. Refer to Footnote 7.

Texas Children's endowment funds consist of donor-restricted endowments and Board-designated quasi-endowments. Income from donor-restricted endowments is restricted for specific purposes. Therefore, it is not available for general expenditure and is not included in total financial assets available to meet cash needs. Although Texas Children's does not intend to spend from its quasi-endowments, other than amounts distributed, quasi-endowment funds could be made available, if necessary and therefore included in total financial assets available to meet cash needs.

Texas Children's financial assets available within one year of the consolidated balance sheet date available for general expenditure are as follows:

	<b>September 30, 2019</b>
Cash and cash equivalents	\$ 221,113
Patient accounts receivable	409,064
Receivable for Medicaid and other supplemental reimbursements	73,620
Other receivables	64,226
Investments	2,522,614
Total financial assets	<u>3,290,637</u>
Less: restricted financial assets	
Investments with liquidity more than a year	1,510,667
Funds restricted by donor	294,743
Total restricted financial assets	<u>1,805,410</u>
Financials assets available to meet cash needs for general expenditures within one year	<u>\$ 1,485,227</u>

#### 4. INVESTMENTS AND INVESTMENT RETURN

Investments are included in the consolidated balance sheets as follows:

	September 30, 2019	September 30, 2018
Investments	\$ 2,522,614	\$ 2,400,641
Assets limited as to use:		
Assets held by bond trustee	36,813	37,571
Assets held for insurance program	92,968	92,752
Assets restricted under statutory requirements	4,862	4,525
Beneficial interest in supporting foundations	3,599	3,591
Total assets limited as to use (1)	138,242	138,439
Total investments and assets limited as to use	\$ 2,660,856	\$ 2,539,080

(1) Total assets limited as to use excludes the collateral on the interest rate swaps of \$9,610 and \$0 as of September 30, 2019 and 2018 respectively. See Note 8 for more information on the interest rate swaps.

Investments, including assets limited as to use, include the following:

	September 30, 2019	September 30, 2018
Cash and cash equivalents	\$ 36,813	\$ 37,571
U.S. government fixed income securities	126,601	76,420
U.S. government agency securities	100,661	83,736
Municipal government securities	2,817	990
Foreign government fixed income securities	18,874	9,385
Corporate fixed income securities	367,069	275,755
Domestic equity securities	319,659	485,804
International equity securities	174,096	88,173
Alternative investments	1,510,630	1,477,405
Other	3,636	3,841
	\$ 2,660,856	\$ 2,539,080

#### INVESTMENT RISKS

Texas Children's investments are subject to various types of risks, as described below:

##### FIXED INCOME SECURITIES

This investment class includes investments in various fixed income instruments that include investment-grade and high-yield domestic and international bonds, preferred stocks, mortgage pools, and bonds issued by U.S. government agencies. This investment class also includes investments in common trust funds, mutual funds, and exchange-traded funds that hold investments in fixed income securities. The fixed income investments are exposed to various kinds and levels of risk, including interest rate risk, credit risk, foreign exchange risk, and liquidity risk.

##### EQUITY SECURITIES

This investment class consists primarily of common equity securities of domestic and international companies. These securities trade through the major public domestic and international exchanges. This investment class also includes investments in common trust funds, mutual funds, and exchange-traded funds that hold investments in equity securities. The equity securities investments are exposed to various kinds and levels of risk, including market risk, individual security risk, and foreign exchange risk and, for common equity of companies with a small market capitalization, liquidity risk.

#### **ALTERNATIVE INVESTMENTS**

Alternative investments are domestic and international in nature and are invested with external investment managers who invest primarily in various alternative categories including real estate, long and short equity positions, natural resources, private equity, managed futures, emerging markets, distressed enterprises, and arbitrage positions. This investment class is subject to numerous risks that could lead to a greater likelihood of invested capital loss. Such risks include the following:

- **NON-REGULATION RISK** – These funds are not required to register with the U.S. Securities and Exchange Commission (SEC) and are not subject to regulatory controls. However, many of the alternative investment fund managers through which Texas Children's invest are SEC registered investment advisers.
- **LIMITED TRANSPARENCY** – As unregistered investment vehicles, funds are not required to disclose the holdings in their portfolios to investors.
- **INVESTMENT STRATEGY RISK** – The funds often employ sophisticated, complex investment strategies and may include speculative strategies or strategies that use leverage, which could result in volatile returns.
- **MINIMAL LIQUIDITY** – Many funds impose lock-up periods that prevent investors from redeeming their shares or impose penalties to redeem. The lock-up provisions of each investment vary but, when applicable, generally range from twelve months to three years. Notice requirements typically vary from fifteen to ninety days prior to the redemption date. In addition, private equity investments (a category of alternative investments) are self-funding and self-liquidating entities that typically endure for ten years or more.

#### **FAIR VALUE OF FINANCIAL INSTRUMENTS**

Texas Children's uses various inputs in determining the fair value of its investments and measures these assets on a quarterly basis. Financial assets and liabilities recorded at fair value in the consolidated balance sheets are categorized by the level of objectivity associated with the inputs used to measure their fair value. Authoritative guidance establishes a three-level hierarchy for disclosure of fair value measurements. The valuation hierarchy is based on the transparency of inputs to the valuation of an asset or liability as of the measurement date.

The three levels are defined as follows:

- **LEVEL 1** – Inputs to the valuation methodology are quoted prices (unadjusted) in active markets for identical assets or liabilities at the measurement date.
- **LEVEL 2** – Inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.
- **LEVEL 3** – Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

The inputs or methodology used for valuing securities are not necessarily an indication of the credit risk associated with investing in those securities. The following tables present the financial instruments carried at fair value as of September 30, 2019 and 2018, by the valuation hierarchy (as described above). The following tables do not include alternative investments and other investments as they are accounted for using the equity method of accounting.

Money market mutual funds that are included in cash and cash equivalents in the consolidated balance sheets are included in cash and cash equivalents in the tables. As of September 30, 2019 and 2018, Texas Children's had \$113,983 and \$112,700, respectively, in money market mutual funds. Derivative financial instruments that are included in investment-related receivables and investment-related accrued expenses in the consolidated balance sheets are included in the tables.

**FINANCIAL ASSETS AND LIABILITIES AT FAIR VALUE**  
as of September 30, 2019

	Level 1	Level 2	Level 3	Total
<b>ASSETS</b>				
Investments:				
Cash and cash equivalents	\$ 150,796	\$ -	\$ -	\$ 150,796
Derivative financial instruments	-	100,415	-	100,415
U.S. government fixed income securities	11,235	115,366	-	126,601
U.S. government agency securities	-	100,661	-	100,661
Municipal government securities	-	2,817	-	2,817
Foreign government fixed income securities	-	18,874	-	18,874
Corporate fixed income securities	-	367,069	-	367,069
Domestic equity securities	319,659	-	-	319,659
International equity securities	174,096	-	-	174,096
Total assets at fair value	\$ 655,786	\$ 705,202	\$ -	\$ 1,360,988
<b>LIABILITIES</b>				
Derivative financial instruments	\$ -	\$ 99,774	\$ -	\$ 99,774
Interest rate swap agreement	-	47,971	-	47,971
Total liabilities at fair value	\$ -	\$ 147,745	\$ -	\$ 147,745

**FINANCIAL ASSETS AND LIABILITIES AT FAIR VALUE**  
as of September 30, 2018

	Level 1	Level 2	Level 3	Total
<b>ASSETS</b>				
Investments:				
Cash and cash equivalents	\$ 150,271	\$ -	\$ -	\$ 150,271
Derivative financial instruments	-	71,304	-	71,304
U.S. government fixed income securities	13,416	63,004	-	76,420
U.S. government agency securities	-	83,736	-	83,736
Municipal government securities	-	990	-	990
Foreign government fixed income securities	-	9,385	-	9,385
Corporate fixed income securities	-	275,755	-	275,755
Domestic equity securities	485,804	-	-	485,804
International equity securities	88,173	-	-	88,173
Interest rate swap agreement	-	2,424	-	2,424
Total assets at fair value	\$ 737,664	\$ 506,598	\$ -	\$ 1,244,262
<b>LIABILITIES</b>				
Derivative financial instruments	\$ -	\$ 71,249	\$ -	\$ 71,249
Interest rate swap agreement	-	21,018	-	21,018
Total liabilities at fair value	\$ -	\$ 92,267	\$ -	\$ 92,267

**INSTRUMENTS NOT MEASURED AT FAIR VALUE**

As of September 30, 2019 and 2018, Texas Children's financial instruments included cash and cash equivalents, accounts receivable, assets limited as to use, accounts payable and accrued expenses, estimated third-party payor settlements, and long-term debt. The carrying amounts reported in the consolidated balance sheets for these financial instruments, except for long-term debt, approximate their fair values.

The fair value of TCH's long-term debt is estimated based on the quoted market prices for the same issues. Expenses that would be incurred in an actual settlement are not taken into consideration. The estimated fair value of long-term debt is \$925,141 and \$934,305 as of September 30, 2019 and 2018, respectively. Settlement at the reported fair value may not be possible or may not be a prudent business decision.

Alternative investments are accounted for under the equity method of accounting. As of September 30, 2019 and 2018, Texas Children's had \$1,514,266 and \$1,481,246, respectively, in alternative investments and other investments, and had committed approximately \$253,800 of future funding to various alternative investments as of September 30, 2019.

**SUMMARY OF INVESTMENT RETURNS**

	Year Ended	
	September 30, 2019	September 30, 2018
Without donor restrictions:		
Dividends and interest, net of investment expenses	\$ 22,450	\$ 18,889
Net unrealized (losses) gains	(19,301)	25,343
Net realized gains	11,323	27,427
Equity in gains of alternative investments, not measured at fair value:		
Net unrealized (losses) gains	(300)	30,821
Net realized gains	57,618	66,647
Total without donor restrictions investment return	<u>\$ 71,790</u>	<u>\$ 169,127</u>
With donor restrictions:		
Dividends and interest, net of investment expenses	\$ 8,971	\$ 6,710
Net unrealized gains	1,591	5,498
Net realized gains	5,055	7,117
Total with donor restrictions investment return	<u>\$ 15,617</u>	<u>\$ 19,325</u>

## 5. PROPERTY AND EQUIPMENT

Property and equipment, by major category, are as follows:

	September 30, 2019	September 30, 2018
Land and land improvements	\$ 139,468	\$ 139,800
Improvements to leased facilities	130,273	122,550
Buildings	1,604,677	1,678,536
Building and movable equipment under capital lease obligation	43,009	43,351
Fixed equipment	925,659	819,892
Movable equipment	814,425	725,351
Software	191,062	194,610
	<u>3,848,573</u>	<u>3,724,090</u>
Less accumulated depreciation	(1,668,459)	(1,484,369)
	<u>2,180,114</u>	<u>2,239,721</u>
Construction in progress	67,600	75,299
Net property and equipment	<u>\$ 2,247,714</u>	<u>\$ 2,315,020</u>

TCH had remaining commitments of \$88,788 and \$97,159 on open construction and equipment contracts as of September 30, 2019 and 2018, respectively.

## 6. PLEDGES AND CONTRIBUTIONS

Pledges receivable are expected to be realized as follows:

	September 30, 2019	September 30, 2018
In one year or less	\$ 38,100	\$ 37,603
Between one year and five years	57,225	75,287
More than five years	61,631	60,832
Total pledges	<u>156,956</u>	<u>173,722</u>
Less present value discount	(28,407)	(34,257)
Less allowance for doubtful pledges	(2,536)	(3,474)
Net pledges receivable	<u>\$ 126,013</u>	<u>\$ 135,991</u>

As of September 30, 2019, net assets with restrictions included \$18,535 restricted for capital expansion, of which \$17,879 relates to pledges that had not yet been received.

**7. Borrowings**

**DEBT**

Debt and capital lease obligations are as follows:

	<b>September 30, 2019</b>	<b>September 30, 2018</b>
TCH Revenue Bonds:		
Series 2008	\$ 191,450	\$ 284,700
Series 2009	-	126,615
Series 2010	-	55,251
Series 2015-1	190,004	201,063
Series 2015-2	50,000	50,000
Series 2015-3	110,000	110,000
Series 2015-4	97,425	98,300
Series 2019A	178,805	-
Series 2019B	91,637	-
Capital lease obligation	944	3,866
	<u>910,265</u>	<u>929,795</u>
Less current portion of long-term debt	(19,640)	(18,600)
Less current portion of capital lease obligation	(98)	(2,996)
Less long-term debt subject to remarketing agreements	(160,000)	(141,500)
Net of bond issuance cost	(5,411)	(6,004)
Total long-term debt and capital lease obligations	<u>\$ 725,116</u>	<u>\$ 760,695</u>

As of September 30, 2019, the aggregate annual maturities based on the scheduled maturities of long-term debt for the next five fiscal years are as follows:

<b>YEAR</b>	<b>AMOUNT</b>
2020	\$ 19,640
2021	19,475
2022	20,445
2023	21,625
2024	22,820

In 1995, 2008, 2009, 2010, 2015, and 2019, TCH Revenue Bonds were issued in several series by Harris County Health Facilities Development Corporation and the Harris County Cultural Education Facilities Finance Corporation under loan agreements with TCH. TCH and TCHF are currently the only members of the Obligated Group (each member of the Obligated Group is jointly and severally obligated to pay the debt). In 2014, TCH issued its Special Obligation Taxable Refunding Bond Series 2014.

**Texas Children's**  
**Notes to the Consolidated Financial Statements** (Dollars in thousands)  
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On July 10, 2019, the Harris County Cultural Education Facilities Finance Corporation issued Hospital Revenue Bonds Series 2019A ("Series 2019A") in the aggregate principal amount of \$157,255 and Hospital Revenue Bonds Series 2019B ("Series 2019B") in the aggregate principal amount of \$78,910 (collectively, "Series 2019 Bonds") under loan agreements with TCH. A portion of the Series 2019 Bonds was used to pay the cost of refunding the Series 2009 Bonds with an outstanding principal amount of \$122,770 and the Series 2010 Bonds with an outstanding principal amount of \$51,670. Such funds were deposited in an irrevocable escrow fund to which the Series 2009 Bonds and the Series 2010 Bonds were irrevocably called for early redemption on October 1, 2019. Upon the deposit of the proceeds in to the escrow fund on July 10, 2019, the Series 2009 Bonds and the Series 2010 Bonds were legally defeased. A portion of the Series 2019 Bonds was also used to pay the cost of refunding and redeeming the Series 2008-3 Bonds, which were irrevocably called for early redemption on July 10, 2019 for the outstanding principal amount of \$91,500.

The following bond series are defeased. They are no longer the obligation of TCH and are not included in the consolidated financial statements at September 30, 2019. Series 2009 and Series 2010 were included in the consolidated financial statements at September 30, 2018.

**LEGALLY DEFEASED BONDS**

	<b>SERIES 1995</b>	<b>SERIES 2009</b>	<b>SERIES 2010</b>	<b>SERIES 2014</b>
Issued Amount	\$69,225	\$200,000	\$78,210	\$91,985
Fiscal Year Defeased	1999	2019	2019	2015
Final Maturity Date	October 1, 2019	October 1, 2039	October 1, 2029	October 1, 2029
Outstanding Balance	\$4,980	\$122,770	\$51,670	\$66,570

The following bond series are outstanding:

**VARIABLE RATE BANK DIRECT PURCHASES**

	<b>SERIES 2008-1</b>	<b>SERIES 2008-2</b>	<b>SERIES 2015-4</b>
Issued Amount	\$100,000	\$100,000	\$100,000
Average Interest Rate 2019	2.39%	2.49%	2.61%
Average Interest Rate 2018	1.85%	1.87%	2.00%
Mandatory Tender Date	April 3, 2028	September 30, 2022	July 16, 2025
Final Maturity Date	October 1, 2041	October 1, 2041	October 1, 2042

**OTHER VARIABLE RATE BONDS**

	<b>SERIES 2015-2</b>	<b>SERIES 2015-3</b>
Issued Amount	\$50,000	\$110,000
Type	Windows Variable Rate	Floating Rate
Average Interest Rate 2019	1.76%	2.46%
Average Interest Rate 2018	1.46%	2.04%
Mandatory Tender Date	-	June 1, 2020
Final Maturity Date	October 1, 2045	October 1, 2045

The interest rate for the Series 2015-2 Bonds excludes fees related to a remarketing agent. The Series 2015-2 Bonds are subject to mandatory tender purchase 210 days after a tender notice from bondholders. Within the 210 day period, TCH can remarket the bonds, convert the bonds to a different mode or pay off the bonds. As such, the entire amount of the Series 2015-2 Bonds is classified as a current liability and is included in long-term debt subject to remarketing agreements in the consolidated balance sheets. As of September 30, 2019, no bonds have been tendered.

Texas Children's  
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September 30, 2019

The Series 2015-3 Bonds are subject to mandatory tender on June 1, 2020, the mandatory purchase date. The Series 2015-3 Bonds are not subject to optional tender prior to the mandatory tender date.

**FIXED RATE BOND**

	<b>SERIES 2015-1</b>	<b>Series 2019A</b>	<b>SERIES 2019B</b>
Issued Amount	\$195,720	\$157,255	\$78,910
Original Premium	\$30,013	\$22,381	\$13,266
Interest Rate	3.00% - 5.00%	3.00% - 5.00%	5.00%
Interest Payment Frequency	Semiannually	Semiannually	Semiannually
Mandatory Tender Date	-	-	October 1, 2024
Final Maturity Date	October 1, 2034	October 1, 2039	October 1, 2041

TCH may redeem the Series 2015-1 Bonds with a stated maturity on and after October 1, 2026, in whole or in part on any date after October 1, 2025, at par plus accrued and unpaid interest.

TCH may redeem the Series 2019A Bonds with a stated maturity on and after October 1, 2035, in whole or in part on any date after October 1, 2029, at par plus accrued and unpaid interest.

**LINE OF CREDIT**

TCH has a working capital line-of-credit agreement with a commercial bank that permits TCH to borrow up to \$100,000 bearing interest at the thirty-day daily London Interbank Offered Rate (LIBOR) plus a spread. TCH must pay an annual commitment fee on the unused portion of the commitment. Borrowings under the working capital agreement are taken as needed and repaid as operating funds become available. As of September 30, 2019 and 2018, Texas Children's had \$0 and \$5,000, respectively, outstanding.

**8. DERIVATIVE FINANCIAL INSTRUMENTS**

**INTEREST RATE SWAPS**

Texas Children's utilizes interest rate swap agreements to manage its interest rate exposure on its 2008-1 and 2008-2 Series bonds. As of September 30, 2019 and 2018, the fair value of the 2008-1 swap agreement was a liability of \$37,791 and \$21,018, respectively, and is included in other long-term liabilities in the consolidated balance sheets. As of September 30, 2019 and 2018, the fair value of the 2008-2 swap agreement was a liability of \$10,181 and an asset of \$2,424, and is included in other long-term liabilities and other assets in the consolidated balance sheets, respectively. Changes in the fair value of Texas Children's swaps are recorded as nonoperating gains (losses) and included in revenues and gains in excess of expenses and losses. For the twelve months ended September 30, 2019 and 2018, the change in fair value resulted in a loss of \$29,377 and a gain of \$14,709, respectively.

TCH has the option to terminate both swap transactions in whole or in part with cash settlement. TCH may be required to post collateral to secure obligations that would be owed to the counterparty under such transaction if terminated, regardless of whether such transaction is actually terminated. TCH has complied with these provisions as required. TCH does not offset the fair value of the derivative financial instrument and fair value of any collateral posted. The collateral is reflected on the consolidated balance sheets within assets limited as to use, current portion.

The following table summarizes the agreements:

	<u>Series 2008-1</u>	<u>Series 2008-2</u>
Notional amount	\$100,000	\$91,450
Expiration date	October 1, 2041	October 1, 2041
Fixed rate TCH pays to counterparty	3.657% of the notional amount	1.834% of the notional amount
Variable rate TCH receives from counterparty	67% of the U.S. dollar one-month LIBOR	67% of the U.S. dollar one-month LIBOR
Collateral threshold	\$30,000	\$50,000
Collateral posted as of September 30, 2019	\$9,610	-
Collateral posted as of September 30, 2018	-	-

The interest rate swap contracts between TCH and third parties (counterparties) provide for the periodic exchange of payments between the parties based on changes in a defined index and a fixed rate and exposes TCH to market risk and credit risk. Market risk is the adverse effect on the value of a financial instrument that results from a change in interest rates. The market risk associated with interest rate changes is managed by establishing and monitoring parameters that limit the types and degrees of market risk that may be undertaken. Management also mitigates risk through periodic reviews of its derivative position in the context of its blended cost of capital. Credit risk is the risk that contractual obligations of the counterparties will not be fulfilled. Counterparty credit risk is managed by requiring high credit standards for TCH's counterparties. The counterparties to the contracts are financial institutions that carry an investment-grade credit rating. TCH does not anticipate nonperformance by its counterparties.

## OTHER DERIVATIVES

Texas Children's utilizes forward and spot exchange contracts on foreign currencies as investment vehicles, which are included in investment-related receivables and investment-related accrued expenses in the consolidated balance sheets. Changes in the fair value of the contracts are recorded as nonoperating gains (losses) and included in revenues and gains in excess of expenses and losses.

## 9. EMPLOYEE BENEFIT PLANS

Texas Children's has a noncontributory cash balance pension plan covering substantially all employees. Under the plan, employees' annual pension benefits are a combination of a pay credit, which is equal to a percentage of their base pay, and an interest credit, which is equal to a percentage of their accumulated cash balance. Texas Children's funding policy is to contribute an amount at least equal to the minimum amount required under the Employee Retirement Income Security Act of 1974 (ERISA) and subsequent law changes amending ERISA.

The assumptions used in calculating the pension amounts recognized in Texas Children's consolidated financial statements include discount rates, interest crediting rates, expected return on plan assets, retirement and mortality rates, inflation rates, salary growth, and other factors. While Texas Children's believes the assumptions used are appropriate, differences in actual experience or changes in assumptions may affect future pension obligations and expenses.

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The plan's funded status, amounts included in the consolidated financial statements, and the assumptions used are as follows:

	<b>September 30, 2019</b>	<b>September 30, 2018</b>
<b>CHANGE IN PROJECTED BENEFIT OBLIGATION</b>		
Projected benefit obligation, beginning of year	\$ 402,219	\$ 396,620
Service cost	32,178	32,697
Interest cost	16,106	14,008
Actuarial losses (gains)	62,252	(28,283)
Benefits paid	(13,001)	(12,823)
Projected benefit obligation (including \$468,944 and \$380,038 in 2019 and 2018, respectively, in accumulated benefit obligation), end of year	<u>\$ 499,754</u>	<u>\$ 402,219</u>
<b>CHANGE IN PLAN ASSETS</b>		
Fair value of plan assets, beginning of year	\$ 379,964	\$ 341,590
Actual return on plan assets	9,694	25,117
Employer contributions	37,980	26,080
Benefits paid	(13,001)	(12,823)
Fair value of plan assets, end of year	<u>\$ 414,637</u>	<u>\$ 379,964</u>
<b>FUNDED STATUS</b>		
Projected benefit obligation	\$ (499,754)	\$ (402,219)
Fair value of plan assets	414,637	379,964
Funded status recorded in retirement plan liability in the consolidated financial statements	<u>\$ (85,117)</u>	<u>\$ (22,255)</u>
<b>COMPONENTS OF NET PERIODIC COST</b>		
Service cost	\$ 32,178	\$ 32,697
Interest cost	16,106	14,008
Expected return on plan assets	(23,279)	(21,263)
Prior service cost amortization	(95)	(95)
Recognized net actuarial loss	-	1,977
Net periodic cost included in salaries and benefits in the consolidated financial statements	<u>\$ 24,910</u>	<u>\$ 27,324</u>
<b>WEIGHTED-AVERAGE ASSUMPTIONS USED TO DETERMINE BENEFIT OBLIGATIONS AT MEASUREMENT DATE</b>		
Discount rate	3.09%	4.21%
Compensation projection rate	4.06	4.06
<b>WEIGHTED-AVERAGE ASSUMPTIONS USED TO DETERMINE NET PERIODIC PENSION COST</b>		
Discount rate	4.21%	3.77%
Expected long-term rate of return on plan assets	6.10	6.25
Compensation projection rate	4.06	4.06

Texas Children's  
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As of September 30, 2019, net assets without donor restrictions decreased by \$75,933 due to amounts arising from Texas Children's noncontributory cash balance pension plan that have not yet been recognized in net periodic benefit cost.

The weighted-average asset allocation categories, target, and actual percentages for September 30 are as follows:

	TARGET	2019	2018
Global equity	55 %	56 %	58 %
Fixed income and cash	30	35	30
Absolute return	15	9	12
	100 %	100 %	100 %

The primary investment objective of the plan investments is to earn the actuarial average annual nominal rate of return assumption (inclusive of inflation), net of management fees, over long time periods (rolling ten- and fifteen-year periods). The plan investments will seek to outperform a composite of market indices reflecting the plan's asset allocation policies and perform on par with other long-term pools with broadly similar investment objectives and policies.

	ESTIMATED
Expected contributions for fiscal year 2020	\$ 34,610
Expected benefit payments for fiscal years:	
2020	51,001
2021	20,670
2022	22,585
2023	23,046
2024	23,782
Subsequent five years consolidated	150,633

The value of the plan assets measured at fair value on a recurring basis was determined using the inputs as described in Note 4 as of September 30. The tables for fiscal years 2019 and 2018 do not include alternative investments of \$169,201 and \$154,670, respectively, which are measured at fair value using net asset value as a practical expedient.

	LEVEL 1	LEVEL 2	LEVEL 3	TOTAL
<b>FISCAL YEAR 2019</b>				
Investments:				
Cash and cash equivalents	\$ 8,015	\$ -	\$ -	\$ 8,015
Domestic equity securities	108,530	-	-	108,530
International equity securities	8,967	-	-	8,967
U.S. government fixed income securities	-	18,584	-	18,584
U.S. agency securities	-	71,087	-	71,087
Corporate fixed income securities	-	30,253	-	30,253
Total assets at fair value	\$ 125,512	\$ 119,924	\$ -	\$ 245,436
<b>FISCAL YEAR 2018</b>				
Investments:				
Cash and cash equivalents	\$ 5,131	\$ -	\$ -	\$ 5,131
Domestic equity securities	100,649	-	-	100,649
International equity securities	21,832	-	-	21,832
U.S. government fixed income securities	-	9,977	-	9,977
U.S. agency securities	-	72,586	-	72,586
Corporate fixed income securities	-	15,119	-	15,119
Total assets at fair value	\$ 127,612	\$ 97,682	\$ -	\$ 225,294

Additionally, Texas Children's maintains a tax-sheltered annuity plan that allows employees to defer a portion of their compensation through salary deductions. Texas Children's matches employee contributions to the plan, equal to 50% of an employee's elective deferral, up to a maximum of 3% of the employee's compensation on a per paycheck basis. Texas Children's expense for the matching contributions was \$23,811 and \$22,247 for the twelve months ended September 30, 2019 and 2018, respectively.

## 10. COMMITMENTS AND CONTINGENCIES

### INSURANCE PROGRAM

TCHICO is a captive insurance company that provides primary coverage for professional and general liability exposures of Texas Children's under a retrospectively rated policy whereby the premiums are accrued based on the experience of Texas Children's. The policy also provides excess liability coverage for amounts in excess of the primary policy limits. TCH funds TCHICO's required insurance reserves. Funding amounts are based on actuarial recommendations.

Beginning in fiscal year 2019, Texas Children's changed its accounting policy to record TCHICO's loss reserves at the expected level, and on an undiscounted basis. As of September 30, 2019 and 2018, TCH recorded a liability of \$36,101 and \$40,297, based on a discount rate of 3.4% for the prior year. This liability is presented as loss reserves for self-insurance program in the consolidated balance sheets. Investment income from the assets and the provision for estimated self-funded losses and administrative costs are reported in the consolidated statements of operations and changes in net assets.

Texas Children's has certain pending and threatened litigation and claims incurred in the ordinary course of business; however, management believes that the probable resolution of such contingencies will not exceed insurance coverage and self-insurance reserves and will not materially affect the consolidated financial position of Texas Children's or the results of its operations.

### REGULATORY COMPLIANCE

Laws and regulations governing the Medicare and Medicaid programs and certain other third-party programs are complex and subject to interpretation. The United States Department of Justice and other federal agencies are increasing resources dedicated to regulatory investigations and compliance audits of health care providers. Texas Children's is subject to these regulatory efforts and monitors and responds to regulatory changes and any issues that may arise. Texas Children's intent is to be in compliance with all applicable laws and regulations, and it is not aware of any significant pending or threatened investigations involving allegations of potential wrongdoing.

**LEASE COMMITMENTS**

TCH, TCHP and TCP lease certain warehouse space, office equipment, and office space under operating leases expiring at various times through 2032. Certain leases include options for renewal. The following schedule presents future minimum rental payments required under operating leases that have initial or remaining non-cancelable lease terms in excess of one year as of September 30, 2019:

Year ending September 30:	
2020	\$ 24,938
2021	22,975
2022	22,247
2023	20,852
2024	15,692
Thereafter	36,281
	<u>\$ 142,985</u>

Rental expense for the twelve months ended September 30, 2019 and 2018 was \$23,381 and \$24,856, respectively, and is included in outside purchased services in the consolidated statements of operations and changes in net assets.

**11. NET ASSETS WITH AND WITHOUT DONOR RESTRICTION**

Texas Children's funding sources include donors that have placed specific restriction on the use of donated assets and, in certain instances, the use of the income derived from those assets. In addition, the TCH Board of Directors has designated funds for specific purposes to function as quasi-endowments. Funds held as net assets and revenues, expenses, gains, and losses are classified based on the existence or absence of donor-imposed restrictions.

Accordingly, net assets of Texas Children's and changes therein are classified and reported as follows:

- **NET ASSETS WITHOUT DONOR RESTRICTIONS** – Net assets that arise as a result of the operations of Texas Children's for its stated purposes and reported as revenues and gains in excess of expenses and losses, donations that are not subject to donor imposed restrictions, Board-designated funds held as quasi-endowments, and unrealized gains and losses on investments.
- **NET ASSETS WITH DONOR RESTRICTIONS** – Net assets that are subject to donor-imposed restrictions based on the passage of time or the occurrence of a specific event. Net assets required to be maintained in perpetuity, with only the income to be used for Texas Children's activities, due to donor-imposed restrictions. Net assets with donor restrictions also include accumulated appreciation on endowment funds.

Texas Children's net assets are as follows:

	<u>September 30, 2019</u>
Net assets:	
Without donor restrictions:	
Undesignated	\$ 3,883,774
Designated	34,930
Total net assets without donor restrictions	<u>3,918,704</u>
With donor restrictions:	
Purpose restricted	210,222
Perpetual in nature	185,988
Total net assets with donor restrictions	<u>396,210</u>
Total net assets	<u>\$ 4,314,914</u>

## **INTERPRETATION OF RELEVANT LAW**

Texas Children's follows the requirements of the Uniform Prudent Management of Institutional Funds Act (UPMIFA) as they relate to its permanently restricted endowments.

## **RETURN OBJECTIVES AND RISK PARAMETERS**

Texas Children's has adopted investment and spending policies for endowment assets that attempt to provide a predictable stream of funding to programs supported by its endowment, while seeking to maintain purchasing power of the endowment assets. Endowment assets include those assets of donor-restricted funds that Texas Children's must hold in perpetuity or for a donor-specific period, as well as Board-designated endowed funds.

To satisfy its long-term rate-of-return objectives, Texas Children's relies on a total return strategy in which investment returns are achieved through both capital appreciation (realized and unrealized), and current yield (interest and dividends). Texas Children's targets a diversified asset allocation that consists of equities and fixed income securities.

## **SPENDING POLICY**

Texas Children's policy, unless otherwise specified by the donor, of appropriating for distribution each year 5% of a three-year rolling average of the endowment market value, so long as the distribution does not decrease an endowed fund below its historical dollar value. In establishing this policy, Texas Children's considered the long-term expected return on its endowments. Accordingly, over the long term, Texas Children's expects the current spending policy to allow endowments to grow at an average of the long-term rate of inflation. This is consistent with Texas Children's objective to maintain the purchasing power of the endowment assets held in perpetuity or for a specific term, as well as to provide additional real growth through new gifts and investment return.

From time to time, the fair value of assets associated with individual donor restricted endowment funds may fall below the level that the donor requires Texas Children's to retain as a fund of perpetual duration. This could be a result of unfavorable market fluctuations that have occurred shortly after the investment of new restricted contributions and continued appropriation for certain programs that was deemed prudent by the Board of Trustees. These endowment funds are considered underwater endowment funds. As of September 30, 2019, there were no material underwater endowment funds.

## 12. NET PATIENT SERVICE REVENUE

Amounts reimbursed for services rendered to patients covered under the Medicaid and Medicare programs are generally less than the established billing rates. Texas Children's also provides services to beneficiaries of certain other third-party payor programs at amounts less than their established billing rates based on contractual arrangements. Differences between the established billing rates and amounts reimbursed are contractual adjustments.

Net patient service revenue is recognized as goods and services are provided at the transaction price estimated by Texas Children's to reflect the total consideration due from patients and third-party payors. The transaction price, which involves significant estimates, is determined based on Texas Children's standard charges for the goods and services provided with a reduction recorded for price concessions, which include discounts based on third party contractual arrangements and patient discounts, as well as implicit price concessions based on historical collection rates. As performance obligations are met (i.e.: room, board, ancillary services, level of care, etc.), net patient service revenue is recognized based upon an allocated transaction price as goods and services are provided to the patient. In instances where performance obligations are across multiple periods, the transaction price is allocated by applying an estimated implicit and explicit rate to gross charges based on the separate performance obligations or the patient's length of stay. Substantially all performance obligations have a duration of less than one year. Texas Children's has elected to apply the optional exemption provided in Accounting Standards Codification 606-10-50-14(a) and is not required to disclose the aggregate amount of the transaction price allocated to performance obligations that are unsatisfied or partially satisfied at the end of the reporting period, which are primarily related to inpatient acute care services.

A summary of the payment arrangements with major third-party payors is as follows:

- **COMMERCIAL** – TCH, TCP, and TCPG have entered into payment agreements with certain commercial insurance carriers, HMOs, and preferred provider organizations. The basis for payment under these agreements includes discounts from established charges, agreed-upon fees per procedure, prospectively determined per diem rates, and case rates.
- **MEDICAID PROGRAMS** – TCH reimbursement rates for inpatient Medicaid enrollees are determined using the APR-DRG classification system. The remaining hospital services and all TCP and TCPG services rendered to Medicaid beneficiaries are reimbursed under prospectively determined rates according to a patient classification system that is based on clinical, diagnostic, and other factors.
- **MEDICAID MANAGED CARE PROGRAMS** – Certain Medicaid recipients are required to enroll in selected HMOs that contract with the Medicaid program to provide primary and acute care services to enrolled Medicaid recipients. TCH has contracted with these HMOs to provide services to pediatric Medicaid recipients. TCH reimbursement rates for inpatient Medicaid Managed Care STAR, CHIP, and other programs are determined using the APR-DRG classification system. Outpatient services are primarily reimbursed at a discount from established charges.

Net patient service revenue by payor was as follows:

	Year Ended			
	September 30, 2019		September 30, 2018	
Commercial	\$ 1,515,551	70%	\$ 1,398,689	72%
Medicaid	123,072	6%	112,938	6%
Medicaid managed care	404,283	19%	341,811	17%
Self-pay and other	108,886	5%	91,591	5%
Total All Payors	\$ 2,151,792	100%	\$ 1,945,029	100%

### 13. CONCENTRATIONS OF CREDIT RISK

TCH, TCP, and TCPG grant credit without collateral to their patients, most of whom are local residents of the geographies of the various health care centers and are insured under third-party payor agreements. The mix of net accounts receivable from patients and third-party payors is as follows:

	September 30, 2019	September 30, 2018
	Commercial	64 %
Medicaid	6	7
Medicaid Managed Care	18	18
Self-pay and Other	12	8
Total All Payors	100 %	100 %

### 14. CHARITY CARE AND COMMUNITY BENEFIT

In accordance with its vision and mission, Texas Children's commits significant resources to promote the health and well-being of women and children. In support of this endeavor, Texas Children's recognizes that some of its most fragile constituents are women and children whose families are financially or medically indigent. To that end, Texas Children's provides medical treatment to patients unable to pay for treatment from their own resources or whose family or custodians are unable to pay for such treatment. Texas Children's ensures that charity care, indigent care, education, research and other sponsored community programs are available to all children and women, regardless of economic status. Therefore, Texas Children's maintains charity and community benefits programs, within limits, that are available to the entire community with equal consideration for those who are poor and underserved.

The categories included as programs and services for the poor and the underserved are as follows:

- **CHARITY CARE** – Represents the unreimbursed cost of providing, funding, or otherwise financially supporting health care services to a patient classified as financially indigent or medically indigent and who has not been insured or partially insured by one of the available government-sponsored means-tested indigent care programs. Because the vast majority of financially or medically indigent pediatric and obstetrical patients qualify for government sponsored indigent care programs, the amounts of charity care are much less than the unreimbursed cost of government-sponsored indigent care programs. In accordance with Texas Children's established policy and procedure, a patient classified as medically indigent or financially indigent will not be required to pay for the designated portion of the care received. Services designated as charity and provided to these patients are not reported as net patient service revenue in the consolidated statements of operations and changes in net assets. Texas Children's financial assistance policy and procedures are in compliance with internal revenue code section 501(r).

The cost of charity care includes both direct and indirect costs calculated based on the ratio of cost to charges. Texas Children's total cost of charity care was \$19,450 and \$24,844 for the years ended September 30, 2019 and 2018, respectively. Funds received to offset or subsidize charity services were \$2,486 and \$2,892 for the years ended September 30, 2019 and 2018, respectively.

- **UNREIMBURSED COST OF GOVERNMENT SPONSORED INDIGENT HEALTH CARE** – Represents the cost of providing services to beneficiaries of public programs, including state Medicaid and indigent care programs, in excess of any payments received from all sources.
- **COMMUNITY BENEFITS** – Represents the unreimbursed cost of providing services for the benefit of the entire community. These benefits include philanthropy, education, research and various other community-based health care programs. The majority of these benefits are for graduate medical education and academic research. Other benefits for the community target the poor and underserved and include Project Medical Home, immunizations for children, and various community-based health educational resources. These programs are not intended to be financially self-supporting.

TCH makes other public disclosures regarding the estimated cost of its charity and community benefit activities in various reports to the state of Texas, as well as in its federal tax return.

## 15. CLASSIFICATION OF FUNCTIONAL EXPENSES

Expenses of Texas Children's by major functional category for the twelve months ended September 30, 2019 are as follows:

	<b>Twelve Months Ended September 30, 2019</b>		
	<b>Program</b>	<b>Administration</b>	<b>Total</b>
Salaries and benefits	\$ 1,335,973	\$ 63,299	\$ 1,399,272
Medical claims	1,039,287	-	1,039,287
Professional fees	548,886	3,238	552,124
Supplies and pharmaceuticals	368,204	-	368,204
Outside purchased services	181,398	7,598	188,996
Depreciation & amortization	196,334	1,564	197,898
Operation of plant	134,294	2,271	136,565
General & administrative	107,433	25,475	132,908
Enhanced mission support	52,407	-	52,407
Interest expense	28,573	545	29,118
Total operating expenses	<u>\$ 3,992,789</u>	<u>\$ 103,990</u>	<u>\$ 4,096,779</u>

Operating expenses are allocated to each functional category based on relevant underlying drivers, such as square footage or full-time equivalents.

## 16. MEDICAID SUPPLEMENTAL PAYMENTS

TCH participates in the Medicaid disproportionate share hospital (DSH) funding program, established by the state of Texas and administered by Texas Health and Human Services Commission (HHSC). Funds are distributed to hospitals that provide a high volume of services to Medicaid and uninsured patients. DSH funds are subject to audit and recovery by HHSC in accordance with the federal rule 73 CFR 777904, December 19, 2008 (the DSH Audit Rule).

TCH recognizes revenue related to its share of the DSH pool on an accrual basis utilizing the submitted application and estimated payment. The DSH performance obligation is the rendering of patient care. TCH allocates the transaction price based on the rendering of patient care over time. TCH considers historical DSH adjustments and changes in program calculations and funding methodologies when estimating the expected final payment.

On December 5, 2014, TCH and Seattle Children's Hospital filed a lawsuit (the FAQ Case) in the United States District Court for the District of Columbia (the District Court) against the United States Department of Health and Human Service's Centers for Medicare and Medicaid Services (CMS) seeking a temporary restraining order and eventual injunction to prohibit CMS from enforcing a change to the Hospital Specific Limit (HSL) calculation that would limit TCH's potential reimbursement for serving indigent patients. CMS first stated in its response to a frequently asked question (FAQ No. 33) that costs and payments from private insurers are to be included in the HSL calculation when Medicaid made no payment on the claim.

On April 3, 2017, CMS published amendments to its DSH Audit Rule at 42 CFR 447.299 (the Final Rule) to make explicit that in determining the total costs of inpatient and outpatient hospital services for purposes of calculating the HSL, costs must take into account third-party payments, including private insurance payments. CMS asserted that the policy of including private insurance payments in the calculation of HSL was contained in the 2008 Rule and therefore, the Final Rule had retroactive application. The Final Rule became effective on June 2, 2017.

On May 8, 2017, the Children's Hospital Association of Texas (CHAT), Children's Hospital and Clinics of Minnesota, Gillette Children's Specialty Healthcare, Children's Hospital of the King's Daughters and Seattle Children's Hospital filed a second lawsuit (the CHAT Case) in the District Court against CMS seeking a temporary and eventual permanent injunction to prohibit CMS from enforcing, applying, and implementing the Final Rule. TCH, along with 7 other children's hospitals in Texas, are members of CHAT. On March 2, 2018, the District Court issued an order in the CHAT Case granting the hospitals' motion for summary judgment and vacating the Final Rule, which effectively nullified the policy set forth in FAQ No. 33. On May 4, 2018, CMS appealed the ruling.

On June 1, 2018, the District Court issued an order in the FAQ Case in favor of TCH and Seattle Children's Hospital granting their motion for summary judgment. The District Court concluded that CMS' policy set forth in FAQ No. 33 was "promulgated without appropriate notice-and-comment procedures in violation of the Administrative Procedures Act." Further, the District Court found that the policy embodied in FAQ No. 33 was not supported by the Medicaid Act. On August 3, 2018, CMS appealed the ruling. As of December 31, 2018, CMS removed FAQ No. 33 from DSH guidance and withdrew its appeal of the FAQ Case ruling.

On August 13, 2019, the U.S. Court of Appeals issued an opinion (the Opinion) reversing the District Court's March 2, 2018 decision, reinstating the Final Rule and remanding the case back to the District Court for further proceedings in accordance with the Opinion. On September 27, 2019, CHAT and the other claimants (the Appellees) filed a Petition (the Petition) for Rehearing with the Court of Appeals. On November 8, 2019, the Court of Appeals denied the Petition. The final rule cannot be reinstated until after the District Court finalizes the remand proceedings.

The U.S. Court of Appeals made clear in the Opinion that it agreed with four other U.S. appellate courts that the policy embodied in FAQ No. 33 had not been legally promulgated, meaning that the HSL calculation would take into account third party payments only after the effective date of the Final Rule, whenever it is ultimately reinstated. Management believes that CMS will likely take the position that reinstatement of the Final Rule should be effective on June 2, 2017. However, during the remand proceedings, the Appellees will argue that the rule should be effective prospectively from the date of the Opinion or a later date determined by the District Court.

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As of September 30, 2019, TCH recorded a liability of \$71,446 to reserve for DSH revenue recognized in 2019 and 2018 of \$37,766 and \$33,680, respectively, that may be subject to recoupment if the Opinion is upheld and effective on June 2, 2017.

For DSH funding earned in prior years but not yet received pending the result of the litigation (The FAQ Case), HHSC has performed the calculation to determine the allocation of funds based on the Court's ruling and has made the first payment for fiscal year 2014, which TCH received on August 19, 2019. Based on communication from HHSC, TCH expects to receive total remaining funds by May 31, 2020. As such, the gain contingency is considered to be resolved and realization is assured beyond a reasonable doubt. For the twelve months ended September 30, 2019, TCH recognized \$60,899 in DSH revenue related to fiscal years 2014 through 2017. As of September 30, 2019, a current receivable was recorded for DSH of \$59,318, which was included in receivable for Medicaid and other supplemental reimbursements in the consolidated balance sheets.

DSH revenue and its related reserves are as follows:

	<b>September 30, 2019</b>	<b>September 30, 2018</b>
DSH Revenue (earned in current year)	\$ 37,766	\$ 33,680
DSH Reserve	(71,446)	-
DSH Revenue (earned in prior years)	60,899	30,722
Total DSH Revenue	<u>\$ 27,219</u>	<u>\$ 64,402</u>
DSH Reserve Liability	<u>\$ (71,446)</u>	<u>\$ -</u>

The 1115 Healthcare Transformation Waiver (1115 Waiver) program is a federally approved program designed to supplement the unreimbursed costs of providing care to Medicaid and uninsured patients as the state implements the expansion of Medicaid managed care services across the state. There are two pools of funds established under the 1115 Waiver program: uncompensated care (UC) and delivery system reform incentive payment (DSRIP). The state uses intergovernmental transfers from state-owned and local governmental entities to draw down federal funds to finance both pools. TCH recognizes revenue related to its share of the UC pool on an accrual basis utilizing the submitted application and estimated payment. The UC performance obligation is the rendering of patient care. TCH allocates the transaction price based on the rendering of patient care over time. TCH considers historical UC adjustments and changes in program calculations and funding methodologies when estimating the expected final transaction price. The DSRIP pool provides payments to hospitals upon achieving certain goals and metrics that are intended to increase access to health care, improve the quality of care, and enhance the health of patients and families they serve. TCH recognizes DSRIP revenue on an accrual basis based on the expected achievement of performance metrics and reporting requirements. The DSRIP performance obligation is the achievement of certain performance metrics and the completion of reporting requirements. TCH allocates the transaction price as these performance obligations are completed over time. TCH considers historical performance when estimating DSRIP revenue.

The 1115 Waiver program was established during fiscal year 2012 and was extended through December 31, 2017. On December 21, 2017, CMS approved an extension of the 1115 Waiver effective from January 1, 2018 through September 30, 2022. The 1115 Waiver extension provides for level funding to supplement the unreimbursed costs of providing care to Medicaid and uninsured patients through September 30, 2019. Per the special terms and conditions of the 1115 Waiver extension, statewide UC expenditures were reassessed, resulting in an increase in the UC funding pool amount (to \$3,870,000 per program year) for services provided between October 1, 2019 and September 30, 2022. Further, for the same period, UC funds may only be used to defray uncompensated costs incurred by the hospitals for providing medical services to uninsured charity patients. The DSRIP funding pool will be reduced for October 1, 2019 through September 30, 2021 with funding expiring thereafter.

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1115 Waiver revenue and its related receivable are as follows:

	<b>September 30,</b>	<b>September 30,</b>
	<b>2019</b>	<b>2018</b>
UC	\$ 47,118	\$ 41,911
DSRIP	42,285	6,497
Total 1115 Waiver Revenue	<u>\$ 89,403</u>	<u>\$ 48,408</u>
 1115 Waiver Receivable	 <u>\$ 14,302</u>	 <u>\$ -</u>

Additionally, for UC funding earned in prior years but not yet received due to litigation regarding the Final Rule (CHAT Case), HHSC has determined the methodology to allocate funds based on the Court's ruling. However, the calculation has not yet been approved by CMS and is subject to change. As such, no revenues have been recognized for potential UC funding earned in prior years but not yet received.

The Texas Legislature approved legislation effective in May 2019, amending the Texas Health & Safety Code to enable the Harris County Hospital District (HCHD) to create and operate a Local Provider Participation Fund program (LPPF) that would require mandatory payments by all hospitals in the county based upon net patient revenue. These mandatory payments are used as the non-federal share of supplemental Medicaid payments. The HCHD's board of managers subsequently authorized creation of an LPPF in Harris County and chose to utilize mandatory payment revenue as the non-federal share of supplemental Medicaid payments for certain programs such as uncompensated care, uniform rate enhancements, etc. The assessed LPPF expense is recorded as a component of enhanced mission support within the consolidated statement of operations and changes in net assets.

## 17. ASSOCIATED ORGANIZATIONS

TCH has an affiliation agreement with Baylor. Under the terms of the agreement, Baylor conducts research and educational activities, and its physicians provide patient care services while utilizing TCH's facilities in the practical application of the teaching process. Mutual commitments include sharing of operational and research costs, including residents' and physicians' salaries. In addition, TCPG has an agreement with Baylor relating to overhead operating costs of the adult surgical subspecialty departments that manage pediatric components. For the twelve months ended September 30, 2019 and 2018, Texas Children's recorded expense of \$552,124 and \$515,493, respectively, related to these agreements, which is included in professional fees in the accompanying consolidated statements of operations and changes in net assets. Amounts due to Baylor of \$54,803 and \$47,330 are included in accounts payable and accrued expenses in the consolidated balance sheets as of September 30, 2019 and 2018, respectively.

Texas Children's entered into an agreement with Baylor to provide enhanced mission support for graduate and undergraduate medical education. For the twelve months ended September 30, 2019 and 2018, Texas Children's made payments to Baylor of \$11,645 and \$19,801, respectively. Additionally, as of September 30, 2019 and 2018, amounts due to Baylor of \$4,587 and \$1,365, respectively were recorded in accounts payable and accrued expenses. For the twelve months ended September 30, 2019 and 2018, Texas Children's recognized \$34,705 and \$13,201, respectively, in expenses which are included in enhanced mission support in the consolidated statements of operations and changes in net assets. As of September 30, 2019 and 2018, the amount recorded as prepaid expense was \$6,283 and \$20,365, respectively, which is included in other current assets in the consolidated balance sheets. These amounts are not included in the professional fees disclosed above.

In fiscal year 2016, Texas Children's purchased the Baylor Clinic building and the O'Quinn Medical Tower within the Texas Medical Center from CHI St. Luke's Health Baylor College of Medicine Medical Center and St. Luke's Medical Tower Corporation (the sellers). As part of the sale and purchase agreement, certain space is leased back to the sellers, which is a joint venture between CHI St. Luke's Health and Baylor. For the twelve months ended September 30, 2019 and 2018, Texas Children's recognized \$10,174 and \$10,151, respectively, of rent revenue from the sellers.

## 18. SUBSEQUENT EVENTS

Texas Children's evaluated events and transactions occurring subsequent to September 30, 2019 through December 12, 2019, the date of issuance of the consolidated financial statements. During this period, there were no subsequent events requiring recognition in the consolidated financial statements. Additionally, there were no non-recognized subsequent events requiring disclosure.

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# Texas Children's



Supplemental Information

**Texas Children's  
Consolidating Balance Sheet  
As of September 30, 2019**  
*(Dollars in thousands)*

	Texas Children's Hospital	Texas Children's Hospital Foundation	Obligated Group Eliminations	Combined Obligated Group	Texas Children's Pediatrics	Texas Children's Health Plan	TCH Insurance Company Ltd.	Texas Children's Women's Specialists	Texas Children's Physician Group	Cain Foundation	Eliminations	Total
<b>Assets:</b>												
<b>Current assets</b>												
Cash and cash equivalents	\$ 54,889	\$ 27,620	\$ -	\$ 82,509	\$ 21,661	\$ 108,888	\$ 119	\$ -	\$ 7,907	\$ 29	\$ -	\$ 221,133
Patient accounts receivable	410,761	-	-	410,761	9,612	-	-	-	33,822	-	(45,131)	409,064
Receivable for Medicaid and other supplemental reimbursements	73,620	-	-	73,620	-	-	-	-	-	-	-	73,620
Assets limited as to use, current portion	46,418	-	-	46,418	-	-	-	-	-	-	-	46,418
Other current assets	187,889	-	-	187,889	4,843	40,581	10,030	63,780	96,600	-	(199,989)	203,734
Investment-related receivables	-	173,392	-	173,392	-	483	-	-	-	-	-	173,875
<b>Total current assets</b>	<b>773,577</b>	<b>201,012</b>	<b>-</b>	<b>974,589</b>	<b>36,116</b>	<b>149,952</b>	<b>10,149</b>	<b>63,780</b>	<b>138,329</b>	<b>29</b>	<b>(245,120)</b>	<b>1,127,824</b>
Assets limited as to use	2,023,288	-	(2,019,624)	3,664	-	4,862	92,968	-	-	-	(60)	101,434
Investments	322,862	2,333,318	(322,826)	2,333,354	-	177,030	-	-	-	23,267	(11,037)	2,522,614
Property and equipment, net	2,200,135	-	-	2,200,135	26,142	15,324	-	5,837	276	-	-	2,247,714
Other assets	122,834	-	-	122,834	5,116	701	-	-	-	-	-	128,651
Amounts due from affiliate	55,462	-	-	55,462	-	-	-	-	-	-	(55,462)	-
Investment in subsidiary	172,614	-	-	172,614	-	-	-	-	-	-	(172,614)	-
<b>Total assets</b>	<b>\$ 5,670,772</b>	<b>\$ 2,534,330</b>	<b>\$ (2,342,450)</b>	<b>\$ 5,862,652</b>	<b>\$ 67,374</b>	<b>\$ 347,869</b>	<b>\$ 103,117</b>	<b>\$ 69,617</b>	<b>\$ 138,605</b>	<b>\$ 23,296</b>	<b>\$ (484,293)</b>	<b>\$ 6,128,237</b>
<b>Liabilities and net assets (deficit):</b>												
<b>Current liabilities</b>												
Accounts payable and accrued expenses	\$ 343,750	\$ 333,862	\$ (322,826)	\$ 354,786	\$ 48,141	\$ 175,701	\$ 8,597	\$ 83,148	\$ 116,295	\$ 866	\$ (256,403)	\$ 531,131
Investment-related accrued expenses	-	180,844	-	180,844	-	78	-	-	-	-	-	180,922
Current portion of long-term debt	19,640	-	-	19,640	-	-	-	-	-	-	-	19,640
Line of credit	-	-	-	-	-	-	-	-	-	-	-	-
Long-term debt subject to remarketing agreements	160,000	-	-	160,000	-	-	-	-	-	-	-	160,000
<b>Total current liabilities</b>	<b>523,390</b>	<b>514,706</b>	<b>(322,826)</b>	<b>715,270</b>	<b>48,141</b>	<b>175,779</b>	<b>8,597</b>	<b>83,148</b>	<b>116,295</b>	<b>866</b>	<b>(256,403)</b>	<b>891,693</b>
Long-term debt	724,270	-	-	724,270	-	-	-	-	-	-	-	724,270
Loss reserves for self-insurance program	-	-	-	-	-	-	36,101	-	-	-	-	36,101
Retirement plan liability	85,117	-	-	85,117	-	-	-	-	-	-	-	85,117
Other long-term liabilities	67,353	-	-	67,353	11	8,786	55,204	-	4	-	(55,216)	76,142
<b>Total liabilities</b>	<b>1,400,130</b>	<b>514,706</b>	<b>(322,826)</b>	<b>1,592,010</b>	<b>48,152</b>	<b>184,565</b>	<b>99,902</b>	<b>83,148</b>	<b>116,299</b>	<b>866</b>	<b>(311,619)</b>	<b>1,813,323</b>
<b>Net assets (deficit):</b>												
Without donor restrictions	3,874,432	2,019,624	(2,019,624)	3,874,432	19,222	163,304	3,215	(13,531)	22,306	22,430	(172,674)	3,918,704
With donor restrictions	396,210	-	-	396,210	-	-	-	-	-	-	-	396,210
<b>Total net assets (deficit)</b>	<b>4,270,642</b>	<b>2,019,624</b>	<b>(2,019,624)</b>	<b>4,270,642</b>	<b>19,222</b>	<b>163,304</b>	<b>3,215</b>	<b>(13,531)</b>	<b>22,306</b>	<b>22,430</b>	<b>(172,674)</b>	<b>4,314,914</b>
<b>Total liabilities and net assets (deficit)</b>	<b>\$ 5,670,772</b>	<b>\$ 2,534,330</b>	<b>\$ (2,342,450)</b>	<b>\$ 5,862,652</b>	<b>\$ 67,374</b>	<b>\$ 347,869</b>	<b>\$ 103,117</b>	<b>\$ 69,617</b>	<b>\$ 138,605</b>	<b>\$ 23,296</b>	<b>\$ (484,293)</b>	<b>\$ 6,128,237</b>

**Texas Children's  
Consolidating Statement of Operations and Changes in Net Assets**  
Year ended September 30, 2019  
(Dollars in thousands)

	Texas Children's Hospital	Texas Children's Hospital Foundation	Obligated Group Eliminations	Combined Obligated Group	Texas Children's Pediatrics	Texas Children's Health Plan	TCH Insurance Company Ltd.	Texas Children's Women's Specialists	Texas Children's Physician Group	Cain Foundation	Eliminations	Total
Changes in net assets without donor restrictions:												
Operating revenues:												
Net patient service revenue	2,151,478	-	-	2,151,478	231,603	-	-	-	293,179	-	(524,468)	2,151,792
Premium revenue	-	-	-	-	-	1,724,717	11,079	-	-	-	(11,168)	1,724,628
Medicaid and other supplemental reimbursements	120,543	-	-	120,543	7,040	-	-	-	-	-	(7,891)	119,692
Grants	13,879	-	-	13,879	7	721	-	-	-	-	-	14,607
Other	249,353	-	-	249,353	1,804	122	4,076	8,519	245,192	-	(363,638)	145,428
Net assets released from restrictions for operations	46,776	-	-	46,776	121	-	-	-	-	-	(49)	46,848
<b>Total operating revenues</b>	<b>2,582,029</b>	<b>-</b>	<b>-</b>	<b>2,582,029</b>	<b>240,575</b>	<b>1,725,560</b>	<b>15,155</b>	<b>8,519</b>	<b>538,371</b>	<b>-</b>	<b>(907,214)</b>	<b>4,202,995</b>
Operating expenses:												
Salaries and benefits	1,131,979	-	-	1,131,979	167,489	61,970	-	4,868	32,966	-	-	1,399,272
Medical claims	-	-	-	-	-	1,608,752	14,827	-	-	-	(584,292)	1,039,287
Professional fees	311,275	-	-	311,275	-	2	-	2	471,411	-	(230,566)	552,124
Supplies and pharmaceuticals	316,921	-	-	316,921	48,025	3	-	1,238	2,017	-	-	368,204
Outside purchased services	170,409	-	-	170,409	20,055	49,476	92	2,290	9,370	-	(62,696)	188,996
Depreciation and amortization	184,003	-	-	184,003	6,802	6,331	-	679	83	-	-	197,898
Operation of plant	134,305	-	-	134,305	3,287	31	8	6	26	-	(1,098)	136,565
General and administrative	78,662	-	-	78,662	6,225	45,886	228	970	22,499	-	(21,562)	132,908
Enhanced mission support	52,407	-	-	52,407	-	-	-	-	-	-	-	52,407
Interest	29,118	-	-	29,118	-	-	-	-	-	-	-	29,118
<b>Total operating expenses</b>	<b>2,409,079</b>	<b>-</b>	<b>-</b>	<b>2,409,079</b>	<b>251,883</b>	<b>1,772,451</b>	<b>15,155</b>	<b>10,053</b>	<b>538,372</b>	<b>-</b>	<b>(900,214)</b>	<b>4,096,779</b>
Operating income (loss)	172,950	-	-	172,950	(11,308)	(46,891)	-	(1,534)	(1)	-	(7,000)	106,216
Nonoperating gains (losses):												
Investment return, net	759	53,403	-	54,162	-	10,521	-	-	-	770	-	65,453
Change in interest rate swap valuation	(29,377)	-	-	(29,377)	-	-	-	-	-	-	-	(29,377)
Other	(14,440)	-	-	(14,440)	-	-	-	-	-	-	7,000	(7,440)
Net nonoperating (losses) gains	(43,058)	53,403	-	10,345	-	10,521	-	-	-	770	7,000	28,636
Revenues and gains in excess (deficiency) of expenses and losses	\$ 129,892	\$ 53,403	\$ -	\$ 183,295	\$ (11,308)	\$ (36,370)	\$ -	\$ (1,534)	\$ (1)	\$ 770	\$ -	\$ 134,852

**Texas Children's**  
**Consolidating Statement of Operations and Changes in Net Assets, *continued***  
**Year ended September 30, 2019**  
*(Dollars in thousands)*

	Texas Children's Hospital	Texas Children's Hospital Foundation	Obligated Group Eliminations	Combined Obligated Group	Texas Children's Pediatrics	Texas Children's Health Plan	TCH Insurance Company Ltd.	Texas Children's Women's Specialists	Texas Children's Physician Group	Cain Foundation	Eliminations	Total
Changes in net assets without donor restrictions:												
Revenues and gains in excess (deficiency) of expenses and losses brought forward	\$ 129,892	\$ 53,403	\$ -	\$ 183,295	\$ (11,308)	\$ (36,370)	\$ -	\$ (1,534)	\$ (1)	\$ 770	\$ -	\$ 134,852
Net assets released from restrictions for purchases of property, equipment and other	36,933	-	-	36,933	(1,888)	-	-	-	-	(1,381)	-	33,664
Change in pension liabilities	(75,933)	-	-	(75,933)	-	-	-	-	-	-	-	(75,933)
Equity transfer	11,798	(11,798)	-	-	-	-	-	-	-	-	-	-
Contributed capital	-	-	-	-	792	60,000	-	-	-	-	(60,792)	-
Beneficial interest in Texas Children's Hospital Foundation	41,605	-	(41,605)	-	-	-	-	-	-	-	-	-
Change in net assets without donor restrictions	144,295	41,605	(41,605)	144,295	(12,404)	23,630	-	(1,534)	(1)	(611)	(60,792)	92,583
Changes in net assets with donor restrictions:												
Donor-restricted contributions	47,419	-	-	47,419	-	-	-	-	-	-	-	47,419
Net assets released from restrictions	(83,453)	-	-	(83,453)	-	-	-	-	-	-	-	(83,453)
Investment return and other, net	20,426	-	-	20,426	-	-	-	-	-	-	-	20,426
Change in net assets with donor restrictions	(15,608)	-	-	(15,608)	-	-	-	-	-	-	-	(15,608)
Change in net assets	128,687	41,605	(41,605)	128,687	(12,404)	23,630	-	(1,534)	(1)	(611)	(60,792)	76,975
Net assets (deficit) at beginning of year	4,141,955	1,978,019	(1,978,019)	4,141,955	31,626	139,674	3,215	(11,997)	22,307	23,041	(111,882)	4,237,939
Net assets (deficit) at end of year	\$ 4,270,642	\$ 2,019,624	\$ (2,019,624)	\$ 4,270,642	\$ 19,222	\$ 163,304	\$ 3,215	\$ (13,531)	\$ 22,306	\$ 22,430	\$ (172,674)	\$ 4,314,914

**Texas Children's**  
**Condensed Consolidating Statement of Cash Flows**  
**Year ended September 30, 2019**  
*(Dollars in thousands)*

	Texas Children's Hospital	Texas Children's Hospital Foundation	Obligated Group Eliminations	Combined Obligated Group	Texas Children's Pediatrics	Texas Children's Health Plan	TCH Insurance Company Ltd.	Texas Children's Women's Specialists	Texas Children's Physician Group	Cain Foundation	Eliminations	Total
<b>Operating activities:</b>												
Net cash provided by (used in) operating activities	\$ 154,370	\$ 39,151	\$ (26,422)	\$ 167,099	\$ 3,652	\$ 28,478	\$ (3,920)	\$ 567	\$ (1,846)	\$ (442)	\$ (11,037)	\$ 182,551
<b>Investing activities:</b>												
(Purchases) sales of investments, net	(21,481)	(46,478)	26,422	(41,537)	-	(42,504)	3,860	-	-	262	11,037	(68,882)
(Purchases) sales of property and equipment	(138,716)	-	-	(138,716)	(2,390)	2,008	-	(567)	2	-	-	(139,663)
Net cash (used in) provided by investing activities	(160,197)	(46,478)	26,422	(180,253)	(2,390)	(40,496)	3,860	(567)	2	262	11,037	(208,545)
<b>Financing activities:</b>												
Repayments on line-of-credit, net	(5,000)	-	-	(5,000)	-	-	-	-	-	-	-	(5,000)
Principal payment on long-term debt	(18,600)	-	-	(18,600)	-	-	-	-	-	-	-	(18,600)
Proceeds from issuance of long-term debt	271,812	-	-	271,812	-	-	-	-	-	-	-	271,812
Deferred financing costs	(2,164)	-	-	(2,164)	-	-	-	-	-	-	-	(2,164)
Extinguishment through purchase of LT debt	-	-	-	-	-	-	-	-	-	-	-	-
Payments on line of credit, net	-	-	-	-	-	-	-	-	-	-	-	-
Redemption of long-term debt	(267,397)	-	-	(267,397)	-	-	-	-	-	-	-	(267,397)
Principal payment on capital lease obligation	(2,922)	-	-	(2,922)	-	-	-	-	-	-	-	(2,922)
Restricted contributions received	57,859	-	-	57,859	-	-	-	-	-	-	-	57,859
Proceeds from sale of donated securities with restrictions	-	6,190	-	6,190	-	-	-	-	-	-	-	6,190
Restricted investment return	8,970	-	-	8,970	-	-	-	-	-	-	-	8,970
Net cash provided by financing activities	42,558	6,190	-	48,748	-	-	-	-	-	-	-	48,748
Net increase (decrease) in cash and cash equivalents	36,731	(1,137)	-	35,594	1,262	(12,018)	(60)	-	(1,844)	(180)	-	22,754
Cash and cash equivalents at beginning of year	18,158	28,757	-	46,915	20,399	120,906	179	-	9,751	209	-	198,359
Cash and cash equivalents at end of year	\$ 54,889	\$ 27,620	\$ -	\$ 82,509	\$ 21,661	\$ 108,888	\$ 119	\$ -	\$ 7,907	\$ 29	\$ -	\$ 221,113
<b>Supplemental Disclosures</b>												
Cash paid for interest	\$ 35,919	\$ -	\$ -	\$ 35,919	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 35,919
Capital in accounts payable and accrued expenses	\$ 21,364	\$ -	\$ -	\$ 21,364	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 21,364